



Pathway to the 2022 rate of return instrument

Consultation Paper on 2022 Instrument Process

June 2021

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1 About this consultation

While much of our process for developing the instrument is settled, there are two aspects we highlighted in our Pathway to 2022 where we would like to hear views to inform our decisions regarding key steps in the process.

These are:

- Funding experts for the Concurrent Evidence Sessions and Expert Conclave and the structure of the expert sessions. We want these sessions to be as useful as possible for informing our consideration. We also want them to be balanced and to canvass a full set of perspectives.
- The appointment of the Independent Panel and the operation of the Panel. The Panel is a critical step in our process and we want to obtain the greatest value from their input.

This short consultation paper has been prepared to inform our decisions so we can start work on setting up the expert sessions and independent panel.

1.1 How to make a submission

Interested parties are invited to make submissions on this consultation paper by **9 July 2021**.

In section 5, we have set out some preliminary views on potential process steps for consideration. This may guide your submission, however we encourage you to address any other matters of relevance.

We prefer that all submissions are in Microsoft Word or another text readable document format. Submissions on our issues paper should be sent to: rateofreturn@aer.gov.au.

Alternatively, submissions can be sent to:

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We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (October 2008), which is available on our website.

2 Introduction

Two key elements of the 2018 Rate of Return review were the Concurrent Evidence Sessions and the Independent Panel, both of which will be continued in the 2022 review. Given our experience with the set-up, running and outcomes of these processes we have identified a number of alternative options to improve and refine the outcome and work towards producing the best possible Rate of Return Instrument.

2.1 Aims and Objectives

We are undertaking this targeted consultation to assist us finalise the framework for each of these important components. We highlight the key questions where stakeholders can contribute.

As always with a consultation paper, we request any stakeholder feedback on the areas discussed in this paper. We will reflect on this feedback and confirm our position in a position paper later in the year.

2.2 Legislative Requirements

The CoAG Energy Council reforms introduced in 2018 had the effect of elevating the framework for setting the rate of return that applies in determining the revenue of regulated electricity network and gas pipeline businesses into law.

A key element of the legislative amendments was the establishment of a binding instrument, setting out a single approach to the calculation of rate of return parameters for all network businesses. This instrument is to be developed by the AER, through a single, industry-wide process every four years.

The reforms were intended to enhance regulatory certainty for regulated businesses, investors, consumers and the AER regarding the rate of return component of the networks' determinations and reduce the regulatory burden for all stakeholders in terms of the time and costs involved in debating rate of return issues.

They also sought to make the process more robust to enable early resolution of contested issues. In developing the instrument, and in addition to existing consultation requirements, we are required to seek input from:

- experts with appropriate qualifications or experience, with nominations to be sought at the commencement of the process; and
- an independent expert panel, comprising at least three members, who will assess and publicly report on the draft guideline.¹

In particular, section 18M of the National Electricity Law states that:²

- Before publishing a draft rate of return instrument...the AER must seek concurrent expert opinions or evidence about the proposed instrument

¹ CoAG, Bulletin: Consultation on binding rate of return amendments, March 2018

² Section 18M, National Electricity (South Australia) Act 1996

- The AER must call for nominations of eligible experts but may seek the expert opinions or evidence from any eligible expert.
- If practicable, the AER must seek the expert opinions or evidence from at least 3 eligible experts.

In addition, section 18P of the National Electricity Law requires the following:³

- The AER must, as soon as practicable after publishing the draft instrument, establish an independent panel to give the AER a written report about the instrument.
- The panel
 - may carry out its activities, including giving the report, in the way it considers appropriate; but
 - must seek to give the report by consensus.
- The panel must
 - consist of at least 3 members, appointed by the AER, who have qualifications or experience in a field the AER considers relevant to making a rate of return instrument
 - give the report to the AER before the AER makes the instrument.
- The report must
 - include the panel's assessment of the evidence and reasons supporting the rate of return on capital or the value of imputation credits under the instrument; and
 - state whether the report is given by consensus.
- The AER must publish the report on its website.

³ Section 18P National Electricity (South Australia) Act 1996

3 The 2018 rate of return instrument

The 2018 rate of return review was the first time that we held Expert Sessions and convened an Independent Panel. This experience, and subsequent comments from stakeholders, have proven useful in improving the processes for the 2022 review.

3.1 How did these processes operate in 2018?

Concurrent evidence sessions

In 2018, the AER held two day-long concurrent evidence sessions. These sessions were designed to assist the AER Board in making a decision on the RORI by allowing them to hear the views of relevant experts.

Participating experts were nominated and engaged by stakeholders, including the Energy Networks' Association, the Australian Gas Infrastructure Group, the Consumer Reference Group, and the Network Shareholders Group. Experts also attended on behalf of the AER.

To provide context for the sessions the AER produced a number of Issues Papers which summarised the AER's current thinking on key issues and potential areas of discussion. This was done with the intention of guiding discussion and aiding the preparation of the experts.

Each session was closed to the public to allow detailed and natural discussion between the AER Board and the participating experts. However, we were able to invite a small number of representatives from the key stakeholder groups to observe. The sessions were managed by an external facilitator with an agenda of topics for discussion set by us and supplemented by issues identified by experts themselves. A number of senior AER staff were on hand to clarify any issues that arose. The AER Board were primarily in attendance to observe and listen, but took the opportunity to ask questions and seek clarification.

At the conclusion of each session, a joint expert report was compiled by the external facilitator, with the assistance of the experts, to summarise positions on key topics. These reports were published on the AER's website along with transcripts of each session.

Independent Panel

The Independent Panel was established to review the AER's 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:

- provide us with the benefit of an independent review
- promote confidence amongst stakeholders that our findings on rate of return issues were robust and had been tested.

In the 2018 RORI review, we made a public request and received nominations for the members of the Independent Panel from a range of stakeholders, including Energy Consumers Australia, Energy Networks Australia and the Consumer Challenge Panel 16. AER staff also proposed potential candidates.

Following a rigorous selection process, five panel members, comprising domestic and international experts, were selected:

- Natalia Southern (Chair)
- Pat Duignan, New Zealand
- Geoff Frankish
- Scott Hempling, United States
- Prof Stewart Myers, United States.

As part of its terms of reference, the Independent Panel was asked to address the following question in its review:

In your view, is the draft guideline supported by sound reasoning based on the available information such that it is capable of promoting achievement of the national gas and electricity objectives?

In its deliberations, the Panel sought clarification from the AER on a number of matters. Those questions asked by the panel were minuted and published on the AER's website to enable all stakeholders to have access to it.

On 7 September 2018, the Independent Panel provided us its final report.

While this report was not binding, it was a useful source of evidence that we had regard to in making our final decision on the 2018 RORI.

3.2 Assessment of the 2018 review process

In May 2019, we engaged the Brattle Group (Brattle) to conduct interviews with stakeholders who were involved in our 2018 review process. It found that stakeholders generally supported the structure of the review, but believed there to be a number of opportunities where we could improve the structure and communication in order to increase the involvement of stakeholders and avoid any misunderstandings.⁴

In November 2019, we released our Pathway to the 2022 Rate of Return - Consultation Paper (the 2019 Consultation Paper) which addressed some of the issues raised in the Brattle Group's report and sought comment on:

- a number of proposed decision-making process points in the 2022 review
- high-level roles proposed for various entities involved in the forthcoming consultation and review.

⁴ Brattle Group, *Stakeholder Feedback on the AERs Process for the 2018 Rate of Return Instrument*, June 2019

4 What have we decided so far?

In May 2020, we released our Pathway to 2022 Rate of Return Instrument – Position Paper⁵ (the 2020 Position Paper) setting out the process for the 2022 review. In deciding on this process, we were guided by:

- our legislative obligations
- stakeholder submissions to our 2019 Consultation Paper, and comments made to the Brattle Group, in relation to ways of improving the 2018 review process
- our own experience of the 2018 review.

The 2020 Position Paper resolved a number of matters in relation to the establishment and operation of the Concurrent Evidence Sessions and the convening of the Independent Panel.

Concurrent Evidence Sessions

The Objective of the Sessions

In 2018, we took the view that the key objective of the Concurrent Evidence Sessions should be to aid the Board in exercising its judgement when deciding on the RORI. The sessions provided an opportunity for the Board to hear from the experts as they laid out key evidence and debated disputed topics.

An alternative approach would be for the sessions to have a more determinative role in decision-making. In this context, for example, where experts are able to agree on a position (or a majority view emerges), this would be highly persuasive when the Board makes its decision.

The expert sessions will be an important component of the RORI process and we want to maximise their value. We also recognise that there will be other aspects of the process that will be important in guiding our decision-making. In particular, we point to the working paper series we are currently progressing, the submissions we expect to receive from stakeholders prior to the draft instrument and the report from the Independent Panel on the draft instrument.

As such, we have decided that the expert sessions should be focussed on assisting the Board's decision-making rather than taking a more determinative role. The sessions are not intended to develop consensus or majority views which would then bind the Board's decision making. In addition, it is important for the Board to be able engage with a balanced overview of the key topics where the breadth of expert views are available.

Nominating the experts

The legislation requires us to call for nominations for experts and to include a minimum of three experts (if practicable).

⁵ <https://www.aer.gov.au/system/files/Pathway%20to%202022%20rate%20of%20return%20instrument%20-%20Position%20paper%20-%20May%202020%20-%20Final.pdf>

We recognise that stakeholders may wish to engage their own experts. However, the purpose of these sessions is not to provide a representation of each stakeholder's perspectives, but rather for the Board to have access to the evidence that will best support its decision-making. This evidence should be presented objectively and be unbiased. It should support the Board's decision-making and that should be the obligation for each of the experts rather than representing the perspectives of particular stakeholders.

In this context, it is important that we include those experts that will best advance our decision-making. This means we may not include all nominated experts in the sessions. Where we think there is likely to be overlap in the evidence presented by multiple experts, we may include only one expert who is able to sufficiently present the evidence. This approach will enable us to structure the sessions so that the key material is covered and we are able to consider the span of evidence in a balanced manner. The current working paper process will enable us to identify the key topics where expert advice will assist.

Following the experts sessions, there will be a period for submissions before we make our draft instrument. If stakeholders consider that important aspects have not been covered in the sessions, the submission period is an opportunity to draw issues to our attention.

As we review the topics to be covered in the sessions and the experts that have been nominated, we will consider whether we should include additional experts in the sessions. It may be that we identify evidence that is not able to be sufficiently presented by the nominated experts and if that is the case we may decide to include additional experts.

Expert Conclave

We recognise that simply extending the time spent on the Concurrent Evidence Sessions will not necessarily improve outcomes, and potentially only serve to add costs.

Accordingly, we have resolved to implement an 'expert conclave'. This will comprise a private meeting between the selected experts, held prior to the main evidence sessions, to narrow the topics for consideration, consider how best to follow the agenda and focus discussions.

The Information Paper, published in December 2020, will identify subject matter where there is a reasonably settled view among stakeholders and those areas where there are still a number of open options and more work is required. In this context, the Information Paper, and the stakeholder submissions on that Paper, will guide the Conclave in identifying appropriate areas for discussion in the expert sessions.

Stakeholders will be given an opportunity to submit potential questions for the expert panel to debate. In the first instance, these will be provided to the AER which, in turn, will consider which ones to put forward to the conclave.

Attendance at the sessions

In our review of the 2018 process, we recognised there is strong support for greater attendance at the expert sessions. This would enable additional stakeholders to view the deliberations first hand and better understand the context of the discussion.

Accordingly, we propose to make the sessions more accessible to stakeholders.

For convenience, we will limit in-person attendance to session participants. However, to promote equity in access for all parties, the evidence sessions will be streamed for interested stakeholders.

Facilitator

During the 2018 review, we held two concurrent evidence sessions which focused on different topics of discussion. Both sessions were assisted by a facilitator, who directed the discussion.

The role of the facilitator is also important in ensuring that all relevant information is put before Board Members, enabling them to make the best decision possible.

Stakeholders generally supported the presence and role of the facilitator.⁶

For 2022, we have decided that the sessions will be run by a Commissioner from the Australian Competition and Consumer Commission with a knowledge of rate of return issues. Their role will be to guide deliberations, allowing experts to discuss the subject matter in a manner that clearly explains alternative views and evidence at hand.

Expert Report

During the 2018 process, the concurrent evidence session facilitator co-ordinated the development of a report to record the opinions of the participating experts in a single document—the expert joint report.

We have decided that an expert report will not be produced for the 2022 review. This decision reflected our experience from the 2018 process and our desired approach for a more comprehensive preparation in advance.

In the 2018 process, we found the aspect that was of most assistance to us was the discussion itself, along with the opportunity to test ideas and perspectives. By contrast, the joint report was of limited assistance.

In the absence of this report, we will make the transcripts of the sessions available for all stakeholders shortly after the sessions have concluded.

Independent Panel

Objective of the Independent Panel

The objective of the Independent Panel will remain the same. That is, the Panel's work is intended to support the AER make the best possible instrument by reviewing the draft instrument and the information available to us in drafting the instrument.

In our view, the role of the Independent Panel should not include duplication of our regulatory judgement or to put forward an alternative or amended Instrument. Our view is that the Independent Panel is best suited to a role of reviewing that we have:

- undertaken an effective review process

⁶ The Brattle Group, Stakeholder feedback on the AER's process for the 2018 Rate of Return Instrument, p. 17.

- engaged with the material before us with an open mind
- reached a decision that is supported by our stated reasons and the information available to us.

The Brattle Group's review of the 2018 instrument highlighted that there was a desire for the Independent Panel to have a stronger role.⁷ We agree with this view. Following consultation with stakeholders,⁸ we have revised the question to be considered by the Independent Panel, splitting the previous question into two distinct parts and sharpening its focus on promoting the achievement of the energy objectives.

The question we are intending to put to the Panel is:

"In the panel's view, is the draft instrument supported by evidence and reasons, taking into account competing factors such as accuracy, consistency, accessibility and transparency?"

In the panel's view, is the draft instrument likely to contribute to the achievement of the National Electricity Objective and National Gas Objective?"

We think our revised question broadens the panel's scope. However, in making this change, we are also clear that we are not looking to replace the Limited Merits Review or create a second decision-maker.

Submissions to the Independent Panel

Once engaged, the Independent Panel will not receive communication from the AER or stakeholders, except we will respond to any questions from the panel seeking clarification. We will publish these communications and will point to existing material rather than providing new material. It is important that the Independent Panel delivers its report based on the Draft Instrument and the evidence that was put in front of us ahead of the draft.

In this context, while stakeholders will be able to make short summary submissions to the Independent Panel, these must be made available to the AER for it to use in its development of the Draft Instrument.

The consultation period on the AER's Information Paper⁹ closes shortly after the conclusion of the Concurrent Evidence Sessions. Should stakeholders wish to make a submission to the Independent Panel, this submission can be included as part of their response to the Information Paper.

Indicative Timeline

Table 1 sets out an indicative high-level timeline for the development of the 2022 Rate of Return Instrument following the release of the Information Paper.

⁷ The Brattle Group, Stakeholder feedback on the AER's process for the 2018 Rate of Return Instrument, pp. 19-20.

⁸ AER, Pathway to 2022 rate of return instrument, Position Paper, May 2020, pp. 16-17.

⁹ The Information Paper, published in December 2021, will summarise and combine content from all of the Working Papers prepared by the AER in 2020 and 2021. We intend for it to provide an overview of the proposed approach to setting the rate of return, set out the topics to be considered in the expert sessions and guide submissions in advance of the draft instrument.

Table 1 Indicative Timeline

Milestone	Date
Release of Consultation Paper	10 June 2021
Submissions close	9 July 2021
Publish Information Paper	December 2021
Expert Conclave	February 2022
Concurrent Evidence Sessions	February 2022
Submissions on Information Paper close	February 2022
Draft 2022 Rate of Return Instrument released	June 2022
Release of Independent Panel's Report	August 2022
Submissions on Draft Instrument close	September 2022
Final 2022 Rate of Return Instrument released	December 2022

5 Matters for consultation

The legislation sets out high-level requirements for conducting the Expert Sessions and establishing the Independent Panel, but leaves a number of details to be determined by us. Within the framework of the legislation, we are considering how to best structure the Expert Sessions and the Independent Panel in line with our objectives.

The following sections set out the options we are considering and we welcome views to help us settle the final positions.

5.1 How should the experts be funded?

The experts who appear in the Concurrent Evidence Sessions could be remunerated by the stakeholders who nominated them, or directly by the AER.

In 2018, the experts were remunerated by the stakeholders that nominated them. This approach raised a question for us about whether the Board was receiving the best possible support from the sessions. Stakeholders who nominated experts had different levels of resourcing available and so it was not clear that the level of expert engagement in the process fully represented the available evidence.

Going forward we could continue this approach with funding provided by a stakeholder or industry group that nominates an expert. We could then pursue a balance across the available evidence through our choice of experts to be included and through our own engagements. However, this approach may not fully address potential imbalances.

An alternative is for the AER to engage the experts directly and to meet the reasonable costs of engaging those experts. This approach would further reinforce the obligation on experts to support the AER's decision-making rather than represent stakeholder perspectives.

At this time, our preference is for an approach where we engage and remunerate all of the experts. However, we welcome stakeholder views on the relative merits of this proposal.

5.2 How should the sessions be scheduled?

In determining the number and length of each Concurrent Evidence Session, there is a balance to be struck between the efficiency of targeted discussion as part of a small number of short sessions, and the need to allow adequate time for all issues to be considered in the depth each issue warrants.

In 2018, sessions were held over two days, three weeks apart, and comprised six hours of discussion each day.

In 2022, we will be well-prepared for the expert sessions through our working paper series. Through the series, many issues will be able to be progressed and in some cases settled. This means the expert sessions can be directed toward the key outstanding issues. Its success will be dependent upon adherence to the agenda.

We also expect the efficiency and effectiveness of the conduct of the 2022 expert sessions to be supported by the deliberations of the expert conclave.

Accordingly, at this time, we propose that for 2022, the Concurrent Evidence Sessions comprise four two-and-one-half-hour sessions, each potentially thematically-based, held over two days, separated by one week. This would provide time for reflection prior to and after individual sessions.

We are interested in your views on this proposal, and any other matters relating to the scheduling of the expert sessions.

5.3 How many members should comprise the Independent Panel?

The legislation requires us to include a minimum of three experts on the Independent Panel.

In 2018, we established a five-person panel, comprising domestic and international experts.

We consider it important that the Independent Panel is comprised of members who collectively possess a range of relevant skillsets. The skills and background we are seeking for the panel include the following:

- A finance and/or economic background will assist the panel in comprehension of the more technical aspects of the guideline development process. However, it is not the role of the panel to substitute for or duplicate the input of the experts already participating in the review. Rather, the panel will consider whether our decisions in the draft guideline are based on sound reasoning, including by reference to that previous expert input. Also, our view is that the decisions making up the guideline and the evidence on which they are based should ultimately be understandable to stakeholders without having this expertise. As a result, we do not think that all panel members will need to have a finance or economic background.
- Regulators typically have experience in considering competing evidence to make decisions which will directly impact on stakeholders. Such regulatory experience should assist the panel in forming views on whether the decisions in the guideline are based on sound reasoning and a chain of logic that can be followed from evidence to decision.
- Experience in consumer perspectives is important to have on the panel because the ultimate objective of the regulatory framework is focussed on promoting the long-term interests of consumers. In our view, it is important that the panel review the draft guideline from a perspective where decisions are clearly linked to how they promote those long term interests. In our view, panel members with consumer-focussed experience are best placed to provide this perspective.
- Institutional investment experience overlaps to some extent with the benefits of finance and/or economic background. However, in our view it is desirable if possible to also have the perspective of panel members with investment experience as distinct from simply having technical familiarity with rate of return issues. This should assist the panel in evaluating whether the replicability and transparency of the methodology is sufficient to promote investor confidence and thus efficient investment.

While a larger panel provides for a diversity in views and a broader mix in skills and experience, it also brings with it the risk that the panel will find it more difficult to reach a consensus view.

We expect panel members to strive to reach consensus, but will not restrict panel members from expressing differences of views within the report if that is the ultimate view of the members.

For 2022, we are minded to establish a five-member panel to accommodate a diversity of views and experience, and to mitigate against circumstances where a panel member might need to drop out of the process due to unforeseen reasons.

However, we are seeking your comments on the number of experts that will sit on the Independent Panel for the 2022 review, and the relevant expertise necessary.

5.4 How should Panel members be selected?

In 2018, we considered submissions from stakeholders on the classes of individual or specific individuals that they recommend to be considered for the panel. However, we made the final decision on the panel's composition.

While for 2022 we are minded to adopt a similar approach, we are interested whether you have any alternative views as to how the Independent Panel should be selected.