Meeting summary— 27 August 2018
Key issues and action items

TO: Profitability Measures Review Working Group (PMRWG)

CC: Warwick Anderson

SUBJECT: Summary of outcomes from the PMRWG meeting 27 August 2018

In response to feedback, we established a working group to engage on issues raised in response to the AER's draft position paper for the review into profitability measures that can be applied to electricity and gas network service providers (NSPs).

The Profitability Measures Review Working Group (PMRWG) first met on 27 August 2018. The purpose of the meeting was to seek the PMRWG's views on the issues raised by NSPs on the Return on Assets (RoA) (regulatory) profitability measure prior to the AER publishing the RoA data and ratios. The meeting agenda was as follows:

1. Opening remarks / update on work program
2. Data sources and calculation methods
3. Issues raised on the Return on Assets calculations
4. Next steps

For items 2 and 3, AER staff (we) provided a discussion paper and put forward our views for discussion. The following is a summary of the outcomes of this meeting.

Opening remarks / update on work program

We noted the objective of profitability measures review, provided an update on the forward work plan and the key issues for discussion.

Data sources and calculation methods

We noted that we had initially considered publishing RoA data and ratios with our draft position paper. However, we had delayed publishing this information following issues raised by NSPs around the data sources (e.g. the NSPs were reporting different types of depreciation in their annual reporting — either statutory, regulatory or straight-line) and whether the calculations should be inclusive or exclusive of incentive scheme penalties and rewards.

We noted that we had since worked with the NSPs to address these issues and were working towards publishing the measures soon.

Issues raised with the latest RoA values

We noted that we had provided the NSPs with revised RoA ratios and the inputs we used to calculate them. While the NSPs raised some issues with the revised RoAs, for the most part they did not consider the issues would have a material impact on the RoA results and agreed that the data could be provided to the working group. We noted that, subject to comments from the working group, our intention would be to publish RoA information.

We provided the PMRWG the key issues raised by NSPs and our response to them. We sought the PMRWG's views on these issues and the publication of the data.

PMRWG considerations

The PMRWG supported the AER's proposal to publish the RoA data and ratios. In regards to the treatment of particular aspects of calculating the RoA ratios, the PMRWG put forward the following views:

- Although timing differences arising from transmission use of system and jurisdiction scheme receipts and payments can contribute to volatility in the RoA values, it was generally agreed these should be included in the EBIT calculation. Although, it was noted that the 'balancing out' of these timing differences should be checked over time.
- Reporting of the RoA ratios should be done both inclusive and exclusive of incentive scheme impacts. Stakeholders could then make their own decisions on how to treat incentives and make their own comparisons of the RoA values against the WACC.

The PMRWG acknowledged that not all of the NSPs issues could be addressed by improving the data sources or changes in approach to calculate the RoA ratios. However, it was agreed these 'outstanding' issues could be detailed in a note accompanying the publication of the RoA ratios to provide transparency to stakeholders interpreting the measure. Specifically, the PMRWG proposed the following issues required additional detail to be provided:

- Adjustments made to deal with timing issues in revenue and expenditures would have distorting impacts that may not be obvious. The preferred approach was to publish the measures free of adjustments, but to address these factors in an accompanying note.
- Revenue can fluctuate year-on-year due to electricity NSPs' revenue caps, where revenue received in excess of the cap in one year is compensated by lower revenue in following years (and vice versa). However, the revenue cap should result in the RoA being relatively more stable when considered as a trend across the regulatory period.
- The remittal outcomes for NSW/ACT NSPs (Ausgrid, Endeavour, Essential and Evo Energy) are likely to impact on the result of their RoA ratios. Excess revenues accrued over the past regulatory period are likely to be returned to customers over the next regulatory period. While upward adjustments to future periods can be made to account for the outcomes of the remittals, it will distort the RoA outcomes.

The PMRWG acknowledged the approach to calculating and reporting on the RoA ratios would likely be refined over time as issues are identified and addressed.

Next Steps

We noted the future meetings would develop guidelines for the allocation interest and tax and other issues associated with the other regulatory measures (return on regulatory equity, earnings per customer and RAB multiples).