

18 December 2017

Warwick Anderson
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001



Dear Mr Anderson,

Submission on rate of return guideline review issues paper

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC welcomes the opportunity to respond to the AER's issues paper. This brief submission is intended to reiterate and supplement comments PIAC has made as a member of the Consumer Reference Group.

Support for an incremental review

PIAC supports an incremental review of specific aspects of the existing rate of return guideline and generally agrees with the priority areas identified in the AER's Issues Paper.

Support for a binding guideline

The COAG Energy Council has stated it will introduce legislation to make the Rate of Return Guideline binding. PIAC supports a binding guideline to increase certainty for consumers and remove opportunities for cherry-picking matters for review.

However, this proposed legislation is still to be published and there are multiple potential mechanistic approaches to determining the rate of return. For instance, the guideline may specify a particular numerical value for a parameter, or it may specify the method and data to be used to calculate it.

As a result, it is unclear what changes may be necessary to the current method for determining the rate of return. Of particular concern is whether there are mechanisms available to the AER to deviate from the guideline in response to extreme and unexpected events such as the global financial crisis.

Principles for considering new data sources

PIAC supports the AER having regard to additional information such as profitability, asset sales and financeability in making its decisions. Similarly, PIAC supports the AER having regard to new prospective data sets, such as those used for cost of debt. In both cases, the AER should retain discretion as to whether and how to incorporate this data in its decisions.

PIAC stresses that more data should never be used as a proxy for better data, and recommends the AER include principles for considering new data sources:

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- Include new data whenever it decreases the potential error margin of the final result – such as by providing a more accurate representation of the behaviour, costs and risks faced by an efficient regulated business.
- Where it does not decrease the potential error margin, only include new data when the error margin is symmetric – i.e.: the likelihood of over-estimation is equal to that of under-estimation.

Estimating risk for regulated network businesses

PIAC supports the AER using, and continually improving, its foundation model for cost of capital. However, PIAC would welcome examination of the risks that efficient regulated network businesses face. This should be supplemented by a bottom-up analysis of the risk allocation between networks and consumers to provide transparency of the market risk premium used in setting the cost of capital.

The estimation of gamma should be settled

PIAC supports the AER's approach to estimating gamma and considers that, following the recent decisions of the Australian Competition Tribunal and Full Federal Court, re-prosecuting arguments around the estimation method is unnecessary.

Consistency with the treatment of inflation

PIAC agrees with the AER that, while inflation is closely related to the rate of return, it is being considered in a separate review process. However, it is essential that the AER maintain consistency between inflation and rate of return, particularly with respect to any assumptions and data sets used.

Continued engagement

PIAC would welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth.

Yours sincerely,

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