

30 July 2020

Mr W Anderson
General Manager, Networks Finance and Reporting
Australian Energy Regulator
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Dear Mr Anderson

Submission on AER Discussion Paper – Review of Expected Inflation 2020

SA Power Networks welcomes the opportunity to provide a submission to the Australian Energy Regulator (AER) as part of its review of regulatory inflation. We look forward to engaging constructively with the AER and other stakeholders throughout the remainder of this very important review process.

We have also contributed to the development of the Energy Networks Australia (ENA) submission on this matter and endorse the analysis and the proposed solutions that are set out in the ENA submission to this process.

The AER's current forecasting approach materially overstates expected inflation in the prevailing market conditions which generates outcomes that have serious financial implications for regulated businesses. We consider that reform is required as the current approach to estimating expected inflation will result in reduced future investment in the energy sector and returns well below the cost of capital for finance providers. This places unacceptable risk on the provision of an essential service, as energy networks must raise large amounts of new finance every year for essential capital expenditure that we fund up front, but which customers pay for over many years.

The interaction between (a) the AER's current record low allowed return on equity, and (b) the AER's over-estimate of expected inflation now have a number of serious consequences, including:

- that investors who adopt the same inflation expectations when investing in network equity as they do when investing in other financial securities will currently expect a return on equity of 2% nominal under the AER's current allowances (because equity holders bear the cost of the inflation under-performance on both equity and debt, ie on 100% of the RAB). This is explained in more detail in the ENA's submission;
- the AER's recent revenue determinations consign networks to incur losses in every regulatory year;
- the AER's own consultants have identified significant issues with the AER's current approach to regulatory inflation. For example:

- Sapere has identified an “underlying inconsistency” that “would not be consistent with the efficient investment and efficient operation of an NSP”; and
- Deloitte Access Economics has published inflation forecasts that are materially lower than the AER’s estimates.

The ENA submission raises substantial concerns with the process for the current review. With respect to the expert reports commissioned by the AER, the ENA notes that they do not cover the full range of stakeholder concerns. Consequently, the extent to which the AER can rely upon them in its decision-making is limited. Moreover, it is important that all stakeholders have confidence that the AER approaches this sort of review on the basis that it is open to being persuaded by the weight of evidence that is presented. Reports that are finalised prior to the receipt of any submissions or evidence from stakeholders do not assist in building that confidence.

The ENA submission also poses a series of questions to the AER experts and their responses to these questions will aid transparency of the AER’s decision making which will assist all stakeholders and ensure the integrity of the review process.

We look forward to working constructively with the AER in an open and transparent process to arrive at an outcome for regulatory inflation that promotes investment in the long-term interests of consumers. Please contact Patrick Makinson on [REDACTED] to discuss this submission further.

Yours sincerely

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