

17 January 2020

Mr Warwick Anderson
General Manager Network Finance and Reporting
Australian Energy Regulator
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Melbourne VIC 3001

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Dear Mr Anderson

Pathway to the 2022 Rate of Return Instrument

SA Power Networks thanks the Australian Energy Regulator (AER) for the opportunity to provide this submission in response to the consultation paper on the pathway to the 2022 rate of return instrument (Consultation Paper) and the accompanying Brattle Report.

Consultation on the process for formulating the 2022 rate of return instrument (RORI) is a very welcome step. As the AER notes, the rate of return is a very significant driver of revenue for network businesses and can have material impacts on price outcomes for our customers. Providing an appropriate rate of return is also critical for supporting much-needed investment in infrastructure required to support reliable and efficient supply over the long term.

SA Power Networks supports a number of the proposals in the Consultation Paper that are directed at allowing more time for effective consultation. In particular, we agree that the 2022 process would benefit from being conducted over an extended timeframe. We also support the AER's proposal to commence consideration of a number of discrete issues prior to the formal Guideline process, beginning in 2020.

However, we would encourage the AER to do more to address the concerns raised by several stakeholders (as reflected in the Brattle Report) regarding its processes for identifying issues and engaging with the evidence presented to it. It is important that the AER firstly acknowledge these concerns and how changes to the process may assist in ensuring greater confidence in the development of the 2022 rate of return instrument.

SA Power Networks considers that it is important that all stakeholders have confidence that, throughout the RORI development process, the AER will undertake a balanced assessment of the evidence and that the outcomes will properly reflect the weight of evidence that is presented and considered. We recommend consideration of process steps to provide greater confidence to stakeholders around the AER's assessment of evidence.

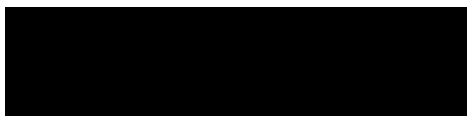
We also provide some specific suggestions for:

- improving the effectiveness of the Expert Roundtable and Independent Panel Review processes; and
- clarifying and strengthening the role of consumer representative groups.

Our specific suggestions and recommendations are summarised in Attachment B.

These recommendations if implemented would materially increase stakeholder confidence in the development of the 2022 rate of return instrument. SA Power Networks would welcome the opportunity to discuss our suggestions with the AER.

Yours sincerely



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Attachment A: SA Power Networks comments in response to the Consultation Paper

1. Ensuring a Balanced Assessment of the Evidence

SA Power Networks considers that it is important that all stakeholders have confidence that, throughout the RORI development process, the AER will undertake a balanced assessment of the evidence and that the outcomes will properly reflect the weight of evidence that is presented and considered. It is also particularly important for the RORI development process to be seen as one that is led by evidence and not designed to support a predetermined outcome.

The Brattle report includes several examples of stakeholders on both sides of the debate expressing concerns about the way the AER went about assessing the evidence during the 2018 Guideline process.

For example, Brattle reported that a broad range of stakeholders considered that the AER did not properly engage with the evidence or provide appropriate reasoning for how it reached its decisions:

Stakeholders from both network and consumer groups thought that the AER did not substantively engage with the evidence that the stakeholders presented during the process. Stakeholders thought that the AER did not provide adequate reasoning for its positions in its decisions.¹

Brattle also noted that the AER's analysis and reasoning did not properly reflect the relative importance of the various issues:

Relatedly, stakeholders perceived that the AER's decisions did not necessarily treat issues in a way that corresponded to the importance that stakeholders assigned to the issues.²

The Brattle Report also highlighted a view among stakeholders that the AER applied different standards to evidence depending on whether the evidence conformed with an apparently predetermined desire to reduce allowed returns:

Stakeholders claimed that evidence that pointed towards a lower rate of return seemed to be accepted or given greater weight, whereas evidence pointing towards a higher rate of return seemed to face a much more critical review, or that the AER appeared unwilling to ignore countervailing evidence even if it had major flaws.³

And Brattle also reported that:

There was a perception among some stakeholders that the AER applied higher standards of evidence to submissions from groups seen to be aligned with networks than to those seen to be aligned with consumers.⁴

¹ Brattle Report, p. 10.

² Brattle Report, p. 10.

³ Brattle Report, p. 10.

⁴ Brattle Report, p. 10.

Brattle also reported that stakeholders cited examples where evidence that was contrary to the apparently predetermined position was summarily dismissed:

Stakeholders cited several instances where the AER did not provide satisfactory reasons for taking or not taking information into account. These stakeholders felt that there was a sense of inevitability in the outcome of the review (i.e., the outcome was somewhat pre-determined) and that the evidence they provided against this outcome was ignored.⁵

Stakeholders identified, as a specific example, the fact that the AER's own estimates of beta and MRP had uniformly increased since the 2013 Guideline review, and yet both parameters were materially cut in the 2018 review:

In another example, the networks presented evidence that inputs into estimations for beta and the MRP considered by the AER had increased since 2013, yet in the AER's 2018 decision, values for beta and the MRP decreased. These stakeholders claimed to have lost confidence in the process as a result of the AER's inconsistent assessment of evidence. Stakeholders highlighted that while the AER allegedly said throughout the process that the networks submitted good evidence, none of this evidence seemed to have weight in the final outcome.⁶

Another example raised by stakeholders related to the cross checks that the AER applied to its allowed return on equity. Stakeholders questioned why the fact that the allowed return failed the AER's own cross checks did not lead to any reconsideration of that allowed return – if the cross checks were irrelevant to the final decision, it is not clear why they were performed:

Stakeholders said the AER had created crosschecks to test whether its proposal for the return on equity was reasonable. However, the return on equity that the AER determined did not pass the crosschecks that the AER had set up. When the AER proceeded with this return on equity, it provided no reasoning for discounting the result of the crosschecks.⁷

Brattle also reports that stakeholders considered that there were insufficient opportunities to challenge, or provide more information in relation to, the AER's dismissal of some pieces of evidence:

More generally, stakeholders thought that there were insufficient opportunities at times to provide further evidence when the AER dismissed a submission's evidence.⁸

The Brattle Report indicates that stakeholders considered there to be some deficiencies in the AER's 2018 Guideline process. In particular:

- stakeholders from both network and consumer groups thought that the AER did not substantively engage with the evidence that the stakeholders presented during the process. Stakeholders thought that the AER did not provide adequate reasoning for its positions in its decisions;

⁵ Brattle Report, p. 11.

⁶ Brattle Report, p. 11.

⁷ Brattle Report, p. 11.

⁸ Brattle Report, p. 12.

- some stakeholders perceived that the process was designed to support a predetermined outcome; and
- some stakeholders considered that the outcomes of the process did not reflect the evidence. Rather, evidence contrary to the predetermined outcome was seen to be unfairly dismissed (often without proper explanation), while evidence consistent with the predetermined outcome was accepted, even if that evidence was of questionable quality.

The AER now has an opportunity to rebuild stakeholder confidence through its 2022 RORI development process. SA Power Networks recommends that the AER consider improvements to its consultation processes to give all stakeholders greater confidence that evidence will be considered thoroughly and in a balanced manner.

2. The Expert Roundtable Sessions

SA Power Networks agrees that the Expert Roundtable process is an important component of the RORI development process and that it should be retained. However, SA Power Networks recommends a number of refinements to the Expert Roundtable process to address some important deficiencies that were identified in 2018.

Some of the key problems that have been identified with the 2018 Expert Roundtable process are:

- the time allocated to each topic was not proportional to its importance. For example, considerable time was spent discussing the possible components of legislation that might be introduced, when such political considerations were not within the expertise of participants or within the control of the AER;
- the key points of dispute were not adequately identified before the sessions. Some experts did not attend the pre-session discussions. The result was that, during the sessions, much time was spent just establishing the key points of contention;
- the AER did not have confidence in the Joint Experts' Report, stating that it considered that its own expert may have dissented from the agreed position if the AER had allowed more time for the process; and
- no part of the process involved experts supporting their positions with evidence. No distinction was made between expert statements that were based on a careful review of evidence and conjectures that were offered 'on the fly.' The sessions were more a forum for high level discussion of opinions (without much regard to the basis for those opinions) rather than a discussion about the evidence on each issue.

The AER's Preliminary Position Paper indicates that more time will be allocated to the Expert Roundtable sessions in the 2022 review. SA Power Networks strongly supports this proposal.



SA Power Networks considers that the Expert Roundtable process could be further improved by the following changes:

- the panel of experts and an Independent Convener should be appointed well in advance of the Roundtable process;
- the Independent Convener should meet with the experts to identify the key issues to be addressed in the Roundtable sessions. The AER board would also have input into this process in terms of identifying issues that it would like to be informed about via the Roundtable process;
- on each issue, all panel members with expertise on that issue would prepare a Joint Report prior to the Roundtable session. This joint report would take the same summary form as that prepared in 2018, whereby a series of propositions would be set out and each expert would set out their preliminary view as to agreement or disagreement, with a brief explanation if required. This would greatly assist in focusing the discussion during the Roundtable session itself;
- each expert would be required to briefly summarise the evidentiary basis for their opinions. This would identify the relevant evidence and would assist the AER in distinguishing between evidence-based conclusions and conjecture;
- senior AER staff would participate in the Roundtable session. They would be able to greatly assist the discussion by explaining the AER's approach to particular issues in the 2018 Guideline;
- a full transcript of the session would be published, as in 2018; and
- a final Joint Experts' Report would be prepared after the sessions; updating the previous report to reflect any developments from discussion during the Roundtable sessions.

SA Power Networks considers that these process improvements would benefit all stakeholders. In particular, the AER will be able to have greater confidence in the output of the Expert Roundtable process.

3. The Independent Panel Process

SA Power Networks agrees that the Independent Panel process is an important component of the RORI development process and that it should be retained. However, SA Power Networks recommends a number of refinements to the Independent Panel process to address some important deficiencies that were identified in 2018.

The 2018 Independent Panel did not focus on key issues

The primary deficiency in the 2018 process was that the Independent Panel expended much effort on issues that were tangentially relevant and gave only limited consideration to the main issues of contention. The best example of this is that the Independent Panel Report contained five lines of analysis on the role of DGM estimates of the MRP, while setting out pages of material relating to the number of decimal points to which gamma should be estimated.



During the 2018 process, stakeholders proposed to the AER that there should be an opportunity to briefly identify what each stakeholder considered to be the key issues – to help focus the work of the Independent Panel on those issues that were both material and in contention. Stakeholders proposed that such a communication to the Independent Panel might be by way of a written note limited to a small number of pages. However, the AER rejected the proposal that the Independent Panel might have its attention directed to the key issues.

SA Power Networks considers that this proposal should be reconsidered for the 2022 RORI development process. We consider that the value of the Independent Panel would be greatly increased if it was focused on issues that stakeholders considered to be important.

The 2018 Independent Panel did not consider the substance of the AER's reasoning

SA Power Networks considers that the scope of the Independent Panel's review should be carefully considered.

There are two potential questions that the Independent Panel might be asked to consider:

- has the AER provided an explanation of its reasons for reaching a particular conclusion; and
- is the AER's conclusion supported by the weight of evidence considered?

In the 2018 Guideline review, the Independent Panel made many recommendations in relation to the sufficiency of the AER's explanations for various conclusions it had reached – the first question above. However, the Independent Panel did not address the second question, relating to whether or not the AER's conclusion was supported by the evidence.

SA Power Networks considers that this was real shortcoming in the Independent Panel review process, and a missed opportunity to improve the rigour of the final analysis. A process in which an Independent Panel agrees that the AER's conclusions are supported by the evidence is one in which all stakeholders can have greater confidence.

Proposals for the 2022 Independent Panel

SA Power Networks makes the following recommendations for changes to the 2022 Independent Panel process:

- Key stakeholders (eg ENA and CRG) should each be allowed to provide the Independent Panel with a note, limited to five pages, that sets out what the stakeholder considers to be the key issues for consideration.
- The Independent Panel should consider whether the AER's conclusions are supported by the weight of evidence, not just whether the AER had explained its reasons for reaching a particular conclusion.
- The Independent Panel should produce a second report after the AER releases its final RORI. The second report would consider the AER's responses to any recommendations set out in the first report.



- The Independent Panel should document the role of each member in preparing the report and identify the information and material to which each member had regard.

It is important to note that the proposed changes would *not* result in the Independent Panel process becoming a merits review process by proxy. The AER is *not* bound to follow the findings or recommendations of the Independent Panel. The AER is free to disagree with the views of the Independent Panel and to reject any recommendation made by it. This is quite unlike the merits review process where the Tribunal was able to effectively remake a decision where it found the AER to be in error.

4. The Role of Consumer Representation

SA Power Networks strongly supports the involvement of consumer representatives in the RORI development process.

SA Power Networks proposes three changes to the role of consumer representation, in order to maximise its benefits:

- first, a formal role should be created to ensure the representation of future consumers as part of the CRG. SA Power Networks is acutely aware, from its extensive consumer engagement process, of the potential tension between the interests of current and future consumers – in terms of the trade-off between short-term prices and longer-term service quality levels. It is important that these potentially competing interests be appropriately balanced in consumer representation during the RORI development process;
- secondly, and consistent with the first point above, the CCP's activities should be focused on the *long-term* interests of consumers; and
- finally, SA Power Networks would like to see greater transparency around the input provided by the CCP. All meetings between CCP members and AER staff should be logged and made public.

Greater clarity around the role of consumer groups and transparency around their input will deliver benefits for all stakeholders. It will give businesses comfort that the interests of *all* consumers are being appropriately represented and will allow all stakeholders to have greater confidence around the process for taking these interests into account.

SA Power Networks also agrees with the AER that the investor reference group (IRG) has a very important role to play alongside the consumer and retailer reference groups. Investors bring a very important perspective to the RORI development process. Not only do they provide the funding required to support critical investment in network infrastructure, they also bring a unique perspective on funding costs and rates of return required to support ongoing investment. SA Power Networks would therefore support an enhanced role for the IRG in the 2022 RORI development process, to ensure that the views of investors are properly heard and considered alongside those of other stakeholders.



Attachment B: Summary of SA Power Networks specific recommendations to improve the RORI development process

Process element	SA Power Networks' recommendations
Expert Roundtable Sessions	<ul style="list-style-type: none"> • The panel of experts and an Independent Convener be appointed well in advance of the Roundtable process. • The Independent Convener meet with the experts to identify the key issues to be addressed in the Roundtable sessions. • All panel members with expertise on a particular issue prepare a Joint Report on that issue prior to the Roundtable session. • Each expert would be required to briefly summarise the evidentiary basis for their opinions. • Senior AER staff would participate in each Roundtable session. • Full transcript of each session would be published. • A final Joint Experts' Report would be prepared after the Roundtable sessions, updating the previous report to reflect any developments from discussion during the Roundtable sessions.
Independent Panel Process	<ul style="list-style-type: none"> • Key stakeholders would be allowed to provide the Independent Panel with a note, limited to five pages, that sets out what the stakeholder considers to be the key issues for consideration. • The Independent Panel consider whether the AER's conclusions are supported by the weight of evidence, not just whether the AER had explained its reasons for reaching a particular conclusion. • The Independent Panel produce a second report after the AER releases its final RORI addressing the AER's responses to any recommendations set out in the first report. • The Independent Panel document the role of each member in preparing the report and identify the information and material to which each member had regard.
Role of Consumer Representation	<ul style="list-style-type: none"> • Formal role to be created to ensure the representation of future consumers as part of the CRG. • CCP activities to be focused on the long-term interests of consumers. • Transparency around input provided by the CCP, including a public record of all meetings between CCP members and AER staff.



