

22/08/2019

Mr Warwick Anderson
General Manager, Network Finance & Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Lodged by email: networkperformancereporting@ aer.gov.au

Dear Mr Anderson

Discussion paper – Allocations of interest and tax expenses for the calculation of return on equity (regulatory) profitability measure

TransGrid welcomes the opportunity to provide comments on the discussion paper released by the Australian Energy Regulator (**AER**) in July 2019 as part of its review into the types of profitability measures that could be applied to the Network Service Providers (**NSPs**) that they regulate.

TransGrid recognises the interest shown by consumer groups and the AER in the profitability of regulated network businesses. However, it is important to ensure that the measures used and the data underlying those measures are fit for purpose and provide the basis for meaningful comparisons. We continue to have significant concerns that this will not be achieved through this review. These concerns were provided to the AER in a public submission dated 30 May 2018.

In addition to those concerns, we understand that the AER is seeking views on the advice it sought from PricewaterhouseCoopers (**PwC**) on approaches to allocate interest and tax expenses from corporate groups to NSPs for determining the return on equity (regulatory) profitability measure.

We do not agree with the recommended approach for allocating tax expenses because, as observed by the AER, regulated networks are held under a variety of more complicated holding structures – including tax-consolidated groups, partnerships, stapled partnerships, trusts and stapled trusts.¹ Under a stapled structure, tax information is not available to TransGrid's regulated business.

TransGrid has no visibility of tax information for upstream investors

TransGrid's corporate structure is a stapled structure. As profits are passed through to investors, tax is paid at the investor level rather than the TransGrid level. TransGrid has no visibility of tax information for its upstream equity investors.

We do not agree with PwC's recommendation that network businesses that are held within a flow through structure should self-assess a blended rate based on investors' tax profiles. TransGrid is not in a position to request or compel this information to be provided by its investors for the purpose of a benchmark exercise and we do not consider it appropriate for TransGrid to provide its own estimate of the tax rate applicable to investors.

A 30% tax rate should be applied to pass through structures for benchmark purposes

We recommend a tax rate of 30% be applied as an industry standard for benchmark purposes. This would be consistent with the AER's current approach to estimating the efficient tax allowance. We do not agree with PwC's recommendation that NSPs in a flow through entity apply a self-assessed

¹ AER, *Review of regulatory tax approach*, Final Report, December 2018, p. 35

blended tax rate having regard to the investor profiles and the tax status of the project vehicle for the reasons outlined above.

Network businesses should be able to choose the method that provides the best estimate of regulated interest for their entity

In regards to the three options for allocating interest expenses, NSPs are best placed to determine the methodology which they consider best reflects the allocation of the interest to the regulated business. Using measures which require interest payments to be allocated to different parts of the business are problematic because TransGrid's financing arrangements are undertaken for the business as a whole, not separately for the regulated and non-regulated parts of the business. As NSPs have different ways of reporting, allocation of interest should be left up to the NSP so long as the methodology used is justifiable.

The AER's approach may increase complexity, duplication and confusion in relation to financial information

TransGrid's regulatory accounts, that are submitted annually to the AER, are prepared on the basis of the statutory audited accounts for the regulated business. The financials for TransGrid's non-regulated business do not form part of TransGrid's annual regulatory reporting process. We recommend this remains unchanged and that only information relating to the regulated business be included in the AER's proposed profitability measures.

We are concerned that producing additional financial information has the potential to increase confusion and misinterpretation by financial markets and other stakeholders. We are also concerned that if profitability measures are applied to influence regulatory decisions, they could undermine the inherent incentives in the regulatory framework.

If you would like to discuss this submission, please contact me on

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Yours faithfully

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Stephanie McDougall
Head of Regulation