12 December 2017

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

Dear Warwick,

Re: Issues Paper – Rate of Return Guideline

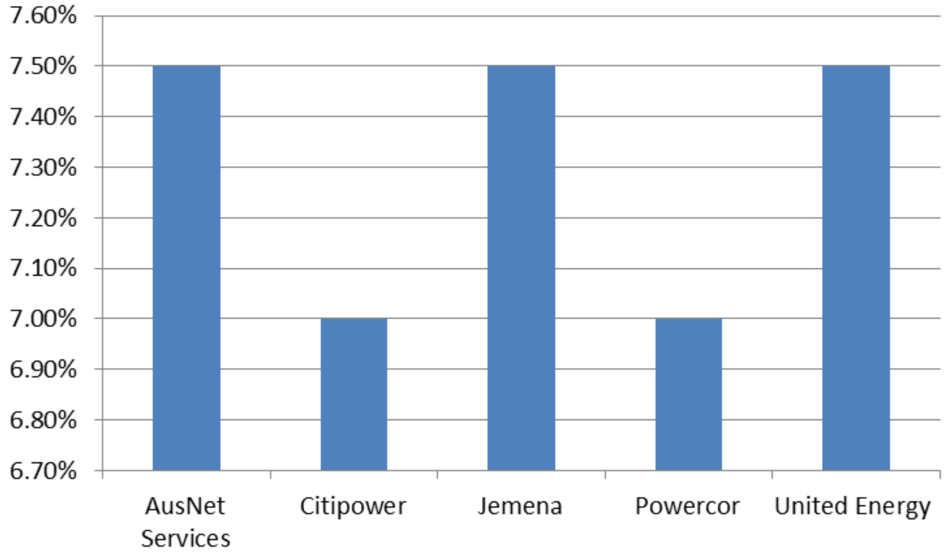
The Victorian electricity distribution businesses (**Victorian DBs**) welcome the opportunity to provide this submission on the AER's Rate of Return Issues Paper.

The Victorian DBs consider that achieving a consistent and stable outcome is a key consideration when reviewing the Rate of Return Guideline. While it is necessary that the estimate of the rate of return reflects market rates at the time of the determination, there are ways in which the volatility of the rate of return can be managed, without jeopardising the achievement of either the National Electricity Objective or the Revenue and Pricing Principles.

To this end, the Victorian DBs also consider that an increase in the length of the sampling period for the risk free rate used in setting the cost of equity could provide greater stability in the allowed rate of return outcomes across regulatory periods. Under the current Guideline, the averaging period for the cost of equity is only 20 days in length. Depending on the exact timing of the equity averaging period, very different costs of equity can be set for businesses for their five year regulatory periods, even if the timing of their regulatory periods are aligned.

For example, in the 2016-20 Victorian revenue review, the cost of equity set for the 5 year period varied from 7.00% to 7.50%, as shown in the figure below. This was despite the regulatory determinations covering the same period.

Figure 1 – Victorian DBs Allowed Cost of Equity for 2016-20 Regulatory Period



The issue with a 20 day averaging period is that such a short window can be heavily impacted by market events, for example, Brexit. The Victorian DBs do not see a need for the equity averaging period to be limited to 20 days in length[1].

The Victorian DBs consider that increasing the length of the equity averaging period to 3 to 12 months would help mitigate the short term fluctuations experienced under a 20 day equity averaging period.

In addition, aligning the timing of the equity averaging periods across the Victorian DBs, which are subject to simultaneous regulatory determinations, will provide stability in the outcomes across the jurisdiction. The averaging period could be pre-determined in consultation with the Victorian DBs either during the Guideline review, or at the time of consulting on the Framework and Approach. Under this approach, all Victorian electricity distribution customers will face the same cost of equity in the 2021-25 regulatory period. This avoids the case where customers on different sides of the same street can experience very different price impacts driven by different costs of equity, if they are customers of different networks.

AusNet Services proposed an equity averaging period of 8 months in its gas access arrangement review for its 2018-22 access arrangement period. At the time, the Consumer Challenge Panel did not consider that enough evidence had been presented to justify this change, but stated that it should be considered as part of the current Guideline review.

[1] Unlike for debt, where a short (15-20 day) averaging period is often desirable to enable businesses to hedge the allowed return on debt.

The Victorian DBs would welcome further discussion with the AER on the matters presented above. Please contact Charlotte Eddy, Manager Economic Regulation at AusNet Services on 03 9695 6309 with any questions.

Sincerely,

Renate Vogt
General Manager Regulation
Citipower Powercor United Energy

Tom Hallam
General Manager Regulation and Network Strategy
AusNet Services

Usman Saadat
General Manager – Regulation
Jemena