

4 May 2017

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

Dear Mr Anderson,

RE: REVIEW OF RATE OF RETURN GUIDELINE – EVIDENCE SESSIONS

Thank you for the opportunity to contribute to the development of the Australian Energy Regulator's (AER) next rate of return guideline (the Guideline).

Overview

The AER's evidence sessions, undertaken in March and April 2018, covered a range of topics that are being closely monitored by customers, network businesses, investors and economic regulators in other jurisdictions. ATCO Gas Australia (ATCO) commends the AER for how well the evidence sessions were planned and facilitated, and for the high level of engagement demonstrated by senior leadership of the AER in each of the sessions.

ATCO would like the AER to consider the following when applying the findings of the concurrent expert evidence sessions to its Guideline:

- Regulatory certainty and stability are key drivers of investor confidence and therefore, also drive the ability of gas distribution businesses to provide valuable services to energy consumers over the long term. This can be achieved by building incrementally on past decisions and analysis in the new Guideline.
- The AER will need to carefully balance the experts' views where there is disagreement and provide transparency in how it deals with these differences in the development of the new Guideline.
- ATCO supports adopting ATO tax statistics as the best, and most direct, estimate of an upper-bound for a 'utilisation' gamma. Several experts highlighted concerns about estimating gamma from ATO data. The AER must quickly address these concerns to increase confidence in using ATO data to estimate an upper-bound for a 'utilisation' gamma.



ATCO is a member of Energy Networks Australia (ENA) and supports the submissions being separately lodged by the ENA as part of this consultation process.

Submission

The regulation of gas networks in Western Australia operates under the National Gas Law (as adopted in Western Australia) and the National Gas Rules. The Economic Regulation Authority (ERA) regulates gas networks in Western Australia. Similar to the AER, the ERA is required to conduct a review of the Guidelines that apply to regulated gas networks and transmission pipelines in Western Australia.

The ERA announced on the 27 November 2017 that they will publish a draft Guideline in the first-half of 2018 to allow time to consider any relevant information provided by stakeholders in response to the AER's issues paper. ATCO understands that the ERA intends to publish the final updated Guideline in the second half of 2018.

ATCO maintains its view that the next Guideline should build constructively and incrementally on past decisions and analysis, and, where justified, use updated relevant empirical evidence. ATCO also believes that the AER should provide stakeholders with a clear understanding of how it has reached its conclusions.

The AER's concurrent expert evidence sessions occurred over March and April 2018, covering the following topics: Gearing; Financial performance measures; Risk and judgement; Gamma; Equity Beta and MRP; Risk Free Rate Averaging Period; and Automatic Application.

ATCO acknowledges that the experts reached consensus on a range of issues.¹ However, there are several areas of disagreement on rate of return estimation that will need to be resolved in some way by the AER.

In the areas where the experts have disagreed, it is important that the AER is transparent in how it deals with these differences. This includes the AER:

- detailing whether it plans to address these differences in the current process or hold over resolving the differences until the next process; and
- explaining why it has adopted one view in its Guideline and rejected the other. Simply noting that there is some expert support for the view that has been adopted is not sufficient to provide clarity for stakeholders.

¹ Cambridge Economic Policy Associates, Expert Joint Report, 21 April 2018, Available here: <https://www.aer.gov.au/system/files/AER%20-%20Evidence%20Session%201%20%26%20%20-%20Joint%20Expert%20Report%20-%2021%20April%202018.pdf>



ATCO supports the experts' view that the AER should consider including the allowed rate of return objective in the new guideline.

ATCO's main area of interest from the concurrent expert evidence sessions is the experts' findings on gamma. In the context that the experts accept that a 'utilisation' approach to gamma will be used, ATCO supports adopting ATO tax statistics as the best, and most direct, estimate of an upper-bound for a 'utilisation' gamma.

ATCO understands that in estimating the gamma using ATO tax statistics the only data needed is corporate tax paid and credits redeemed. The reliability of these figures has been confirmed as part of the ENA December 2017 submission to the AER, where Hathaway states that:

The Company Tax item is the total company tax collected by the ATO during the relevant period and the Credits Redeemed item is the total amount of credits redeemed via the filing of personal tax returns. These two data items are 100% reliable as they are figures that relate directly to ATO tax collections. There is no reason to question the ATO's records of the amount of corporate and personal tax it has collected.²

Hathaway goes on to conclude that the ATO tax statistics can "clearly"³ be used to provide a reliable utilisation estimate of gamma.

ATCO understands that the experts raised substantial concerns over the quality of the ATO data during the second session and indicated that increasing confidence in this data would be of material benefit to the AER. The AER also recently published a note summarising some discussions that the AER has had with ATO staff in relation to the reliability of ATO tax statistics.⁴

The only item in the AER's note that could affect the estimation of gamma is Point 4, which states that the estimate of gamma could be affected by non-resident companies paying tax in Australia which do not generate franking credits.

However, ATCO understands that this effect is stated to be "small", most likely because any non-resident company paying a material amount of company tax in Australia could simply establish a domestic subsidiary, pay the same amount of tax, but obtain the benefits of imputation credits. In any event, to put it beyond doubt, the experts' concern around the data should be resolved by the AER as part of this Guideline review.

² Hathaway, N., 2017, Letter to Energy Networks Australia, December, p. 1.

³ Ibid p. 2.

⁴ Available here: <https://www.aer.gov.au/system/files/AER%20-%20Staff%20note%20on%20tax%20data%20-%20March%202018.pdf>.



The expert's report states that the AER's approach to estimating the utilisation of imputation credits reflects the presence of foreign investors in the local market.⁵ ATCO's position is that estimating gamma from ATO data results in a conservative outcome (the upper bound on the value of gamma) due to the presence of foreign investors.

ATCO's view is that gamma can be estimated directly from ATO data as the proportion of tax paid by the average Australian firm that can be used to offset their Australian income tax liabilities. Under this method, gamma is estimated as the ratio of credits redeemed to credits created for the average Australian firm from ATO data, and results in an estimate of gamma of 34%.

About ATCO Australia

ATCO Australia is a customer-focussed company that develops, builds, owns and operates a range of energy infrastructure assets, supporting residential, business and commercial consumers across Australia. The Australian business includes:

- ATCO Gas Australia, which owns and maintains the largest gas distribution network in Western Australia, connecting over 750,000 customers through more than 14,000 km of natural gas pipelines and associated infrastructure. ATCO Gas Australia is subject to economic regulation by the Economic Regulation Authority under the National Gas Law (NGL) and National Gas Rules (NGR) as applied in Western Australia;
- ATCO Power Australia, which owns and operates two power generation facilities in Australia (a joint-owned facility in Adelaide and a wholly-owned facility in Karratha) with a combined capacity of 266 MW. ATCO Australia's Karratha facility supplies electricity to Horizon Power under a long-term power purchase agreement; and
- ATCO Structures & Logistics, which has been operating in the Australian marketplace since 1961. Today, ATCO Structures & Logistics has two manufacturing facilities and eight offices across the country delivering modular solutions to a diverse group of customers.

The ATCO Australia Group is part of the worldwide ATCO Group of companies with approximately 7,000 employees and assets of \$22 billion. ATCO is engaged in pipelines and liquids (natural gas transmission, distribution and infrastructure development, energy storage, and industrial water solutions); electricity (electricity generation, transmission, and distribution); retail energy; and structures and logistics.

⁵ Cambridge Economic Policy Associates, Expert Joint Report, 21 April 2018, p. 6.



If you have any questions or would like to discuss any of these issues further, please contact Matthew Cronin – General Manager Regulation, ATCO Gas Australia.

Sincerely,



Pat Donovan
President

