

4 February 2016

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

Dear Mr Anderson

**ActewAGL Distribution submission on the AER's Draft Decision ActewAGL (ACT, Queanbeyan and Palerang) - access arrangement 2016-21 and contemporaneous reset processes**

Pursuant to clause 59(5)(c)(iii) of the National Gas Rules (**the Rules**) ActewAGL Distribution is pleased to make this submission in relation to the AER's Draft Decision on ActewAGL's access arrangement (ACT, Queanbeyan and Palerang) - 2016-21 (**Draft Decision**) and in each of the contemporaneous reset processes under the Rules and the National Electricity Rules identified in this submission below.

**TYPOGRAPHICAL ERROR IN THE ACCESS ARRANGEMENT**

ActewAGL Distribution's proposed Access Arrangement contains a typographical error in the part addressing "(d)...Provision of Basic Metering Equipment Charges" - see page 66 of the clean version.

The change required to correct this manifest error, being to replace the word "Point" in the heading of the second table in that section with the word "Station" is marked-up on the attached copy of the relevant page (a clean copy is also attached) - see **Attachment 1**. The error is manifest because it is evident from reading the heading of the second table in the context of the first table.

**IMPLICATIONS OF THE RECENT TRANSGRID SALE**

ActewAGL Distribution is aware of two recent submissions relating to the implications of the recent sale of a 99-year lease interest in TransGrid, the NSW electricity transmission network owner and operator, for the AER's determination of the return on equity:

1. a submission made to the Australian Competition Tribunal by the Public Interest Advocacy Centre (**PIAC**) dated 26 August 2015; and
2. a submission made to the Australian Energy Regulator (**AER**) by the Victorian Energy Consumer and User Alliance (**VECUA**) dated 6 January 2016.

While, as far as ActewAGL Distribution is aware, neither of the above submissions were made in relation to the Draft Decision, ActewAGL Distribution makes the following submissions for the AER's consideration should it decide to consider or rely upon the above submissions in making either its Final Decision on ActewAGL's access arrangement 2016-21 and/or in its decisions on the distribution determinations that will apply to the Victorian electricity distribution network service providers (AusNet, CitiPower, Powercor, United Energy and Jemena) during the regulatory control period 2016-2020 (**Victorian Businesses**).

VECUA submits that the outcome of the recent TransGrid sale process "makes a mockery" of claims made by network service providers regarding the required return on equity. VECUA appears to consider that the fact that the agreed sale price for TransGrid exceeds its regulated asset base (**RAB**) value indicates that the return on equity allowed by the AER for TransGrid (7.1%) is at least sufficient for it to meet efficient financing costs and attract equity investment.

This issue is addressed in the accompanying expert report of Frontier Economics entitled "Response to submissions on the relevance of the TransGrid sale" dated February 2016 - see **Attachment 2**.

Frontier Economics concludes that the fact that the TransGrid sale price exceeded the RAB value does not constitute any evidence of the adequacy of the AER's allowed return on equity of 7.1% for the remaining four years of the current regulatory period. The reasons for this conclusion include:<sup>1</sup>

- the sale price reflects not only the allowed return on equity of 7.1% for the next four years, but also a range of other factors, including:
  - expected cash flows over the full 99-year lease period;
  - the extent to which the acquirer considers that it may be able to outperform regulatory benchmarks under incentive-based regulation or be eligible to receive incentive payments (e.g. its expected ability to achieve operating efficiencies);
  - the acquirer's assessment of the value attributed to non-regulated assets owned by TransGrid;
  - the potential for future growth in the earnings of the firm over the 99-year lease period, arising from: the expansion of existing non-regulated activities; the development of new non-regulated activities; and/or increasing the scale and/or efficiency of regulated activities;
  - any synergies with the acquirer's existing business;
  - any diversification benefits available to the acquirer;
  - any strategic value to the acquirer (e.g. value in seeking to establish an operation in a new market or reach an efficient scale in a market where it already has some interests); and
- since controlling interests are purchased at a material premium to ordinary equity, the prices paid for controlling interests cannot be used to infer anything about the required return on ordinary equity – even aside from the other reasons set out above.

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<sup>1</sup> Frontier Economics, *Response to submissions on the relevance of the TransGrid sale*, January 2016, pp 4-5.



Frontier also notes that the return on equity allowance of 7.1% recently determined by the AER for TransGrid only applies for four years of the 99-year lease period, and that beyond this four-year period it may reasonably be assumed that allowed returns would return to more acceptable levels. This could occur either as a result of a change in the AER's methodology (e.g. following a rule change or Tribunal ruling against the current AER method) or continuation of the AER's current methodology in different market conditions (i.e. with a higher risk-free rate, leading to a higher return on equity under the AER's method).

The TransGrid equity investment prospectus published by Spark Infrastructure (referred to in the VECUA submission) confirms the above analysis. This prospectus does not indicate that the regulated return on equity allowed for TransGrid for the next four years is a driver of the agreed sale price or of the acquirer's perception of the value of TransGrid – the only comment that is made about this is that “TransGrid's current regulatory determination applies for 4 years only (to 30 June 2018) and was not appealed by its previous owners”.<sup>2</sup> Rather, the prospectus identifies other areas of value in the TransGrid business as including:<sup>3</sup>

- strategic benefits for Spark in increasing diversity of cashflow sources, thereby reducing overall portfolio risk;
- scope to increase efficiency through better asset utilisation and process improvements;
- scope for long term growth in regulated activities (and hence RAB growth), supported by macro-economic driven demand growth expectations, and change in generation mix to renewables;
- Spark's ability to leverage TransGrid's assets and apply its own expertise to develop and grow non-regulated business opportunities. The prospectus notes in particular some scope to grow a telecommunications service offering that leverages TransGrid's market positioning across NSW.

Therefore, consistent with previous conclusions of the AER<sup>4</sup> and its experts,<sup>5</sup> ActewAGL Distribution considers that nothing can be inferred from the outcome of the TransGrid sale process, as to the adequacy or otherwise of the regulated return on equity for TransGrid or any other business.

Additional contentions in response to VECUA's submissions on return on capital are attached, which contentions ActewAGL Distribution advances, again, in its own reset process and that pertaining to the Victorian Businesses - see **Attachment 3**.

### **SUBMISSION IN CONCURRENT RESET PROCESSES BEING UNDERTAKEN BY THE AER**

ActewAGL Distribution also makes its rate of return related contentions as set out in its Revised 2016-21 access arrangement proposal, Response to the AER's draft decision

<sup>2</sup> Spark Infrastructure, *Equity Investment in TransGrid and Equity Raising*, 25 November 2015, p 26.

<sup>3</sup> Spark Infrastructure, *Equity Investment in TransGrid and Equity Raising*, 25 November 2015, pp 9-10.

<sup>4</sup> AER, *Rate of Return Guideline Explanatory Statement*, December 2013, p 48.

<sup>5</sup> McKenzie and Partington, *Equity market risk premium*, December 2011, p 34.

(see in particular, Appendix 5.01) lodged in January 2016 and in this submission in each of the current reset processes in relation to:

- the Victorian Businesses; and
- the access arrangements that will apply to Australian Gas Networks (SA) and APT Pipelines (NT) Pty Ltd's Amadeus Gas Pipeline (NT) from 1 July 2016.

#### **UPDATED TARIFF STRUCTURE STATEMENT**

Another Tariff Structure Statement (**TSS**) has been prepared to update the TSS lodged in June 2016.

The TSS explains the tariffs ActewAGL proposes to charge under the revised Access Arrangement lodged in January 2016. The attached version is updated to refer to the tariffs contained in the revised Access Arrangement for the assistance of our stakeholders - see **Attachment 4**.

#### **FURTHER MATERIAL IN SUPPORT OF PROPOSAL**

As explained in our January 2016 response,<sup>6</sup> ActewAGL Distribution makes this submission against the background of the limited time afforded to ActewAGL Distribution to prepare its revised Access Arrangement Revision Proposal.

Accordingly, further materials and expert reports in support of ActewAGL Distribution's revised access arrangement revision proposal and revised access arrangement information as well as our response to the draft decision submitted to the AER on 6 January 2016 and this submission are attached in the folders and files contained on a USB that was delivered to the AER on 4 February 2016 together with this submission. We note that the relevance of these materials is explained in our January 2016 response and this submission

Please contact ActewAGL's manager of gas regulation, Philip Deamer (philip.deamer@actewagl.com.au or phone 02 6248 3438) to discuss any aspects of this submission.

Yours sincerely



Ayesha Razzaq  
Acting Chief Executive Officer  
ActewAGL

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<sup>6</sup> ActewAGL Distribution Response to the draft decision, Section 1.2 pp 8 and 9.

### **List of Attachments to ActewAGL Distribution's Submission**

Attachment 1 - Corrected page of the Access Arrangement (marked-up, clean)

Attachment 2 - Frontier Economics - Response to submissions on the relevance of the TransGrid sale dated February 2016

Attachment 3 - Response to submission made to the Australian Energy Regulator by the Victorian Energy Consumer and User Alliance dated 6 January 2016

Attachment 4 - Updated Tariff Structure Statement

Further materials and expert reports in support of ActewAGL Distribution's:

- revised access arrangement revision proposal;
- revised access arrangement information;
- response to the draft decision
- February 2016 submission,

lodged with the AER on 6 January 2016 and 4 February 2016.

