

22 August, 2014

AER Board
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3000

Via email: Anthony.bell@aer.gov.au

CCP Advice to the AER Board re CCP Rate of Return Paper

Dear Andrew, Cristina, and Jim

The Consumer Challenge Panel (CCP) thanks the AER Board for the opportunity to discuss the attached paper on the regulated rate of return (the RoR Paper)¹ at a meeting with the Board and AER staff on 12 August 2014.

We also appreciate the feedback provided to us by the Board and the senior executives of the AER.

This letter is for publication with the RoR Paper. It clarifies the intended purpose of the RoR Paper, and sets out how we believe the important issues raised in the RoR Paper should be further progressed.

The Purpose of the RoR Paper

The RoR Paper is a whole of CCP advice to the AER. It is not a submission to the AER on any particular network determination.

As a “critical friend” to the AER, the CCP’s role includes identification of aspects of the AER’s regulatory decisions that, in the opinion of the CCP, may not be in the long-term interests of consumers. Where this occurs, the CCP’s responsibility is to ‘challenge’ the AER to undertake further investigations of these matters.

The RoR Paper puts a range of evidence to the AER to demonstrate the CCP’s concerns that there is a significant risk that the objectives of the recent regulatory reforms will not be realised in practice.

The evidence provided in the paper includes comparisons between the AER’s RoR determinations and those of other regulators operating under broadly similar jurisdictional arrangements.

¹ Consumer Challenge Panel, *Smelling the roses and escaping the rabbit holes: the value of looking at actual outcomes in deciding WACC*, July 2014.

The RoR Paper also identifies a range of financial outcomes for the network businesses, all of which point to these businesses achieving significantly higher returns than anticipated by the Guideline both in the past, and in the future.

The RoR Paper therefore suggest that the AER has not given sufficient credence to these types of outcome measures, including benchmarking its own decisions against other regulators.

The evidence provided in the RoR Paper is not exhaustive; it is a starting point for further investigations.

Using outcome data in regulatory decision-making requires the development of a suite of robust outcome measures. Such a task is clearly beyond the scope and the budget of the CCP. However, the CCP considers that it must be within the capability of the AER to develop a suite of outcome measures that will enable the AER to achieve a better balance between the interests of consumers and networks, consistent with the recent regulatory reforms.

The use of outcome measures in the future will, for instance, enhance the AER's exercise of its discretion in determining the RoR, and enable the AER to assess more critically the claims by networks. The use of such measures is also consistent with the AER's RoR Guideline, and with the conceptual framework set out in the National Electricity Rules (NER) to determine the efficient rate of return for a benchmark efficient network service provider.

CCP's Request to the AER Board

The CCP holds deep concerns that future RoR decisions may not be in the long term interests of consumers. To address these concerns, the CCP encourages the AER to investigate approaches such as, but not only, those set out in the attached RoR Paper.

The CCP therefore requests the AER Board to consider the following:

- How can the measures identified in the RoR Paper be developed further to provide robust outcome measures?
- What other outcome measures may usefully contribute to more robust regulatory decisions?
- How can the AER better benchmark its own RoR determinations and outcomes against those of other comparable regulators?

The CCP recognises the complexity of the task that it is proposing to the AER. Nevertheless, we consider that extending the quality and application of actual data provides a useful counterpoint to increasingly detailed econometric modelling. Moreover, the development of these outcome measures is

conceptually little different from the task the AER has already undertaken to benchmark efficient operating and capital expenditures.

Finally, the CCP wishes to acknowledge the commitment of the AER Board to promoting consumer engagement and to meeting the long-term interests of consumers. The CCP's intention in this letter of advice and the attached RoR Paper is to encourage the Board to assist the AER to deliver on these commitments.

The CCP welcomes a response from the AER Board to these requests, and is happy to undertake further discussions on all these matters.

Yours faithfully

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on behalf of the
Consumer Challenge Panel

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