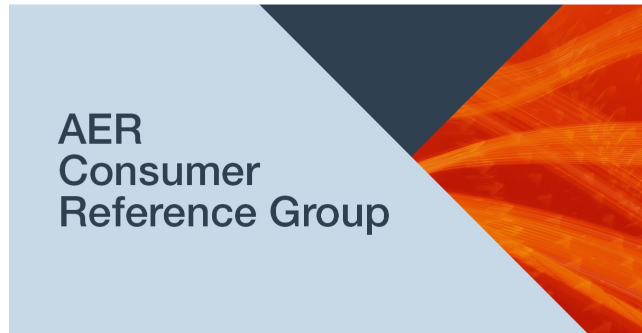

Advice to the Australian Energy Regulator

CRG Response to the AER's call for submissions on RAB multiples

CRG contributors: Bev Hughson (CRG Chair), Kieran Donoghue (Deputy Chair), Allan Asher, Helen Bartley, Dr Ron Ben-David, Jo De Silva

November 2022

Abbreviations and short forms

The CRG has adopted the following abbreviations throughout this submission.

Abbreviation/short form	Long form/full name
AER	Australian Energy Regulator
AST	AusNet services, a previously listed owner of network assets
ASX	Australian Stock Exchange
CAPM	Capital Asset Pricing Model
CEPA	Cambridge Economic Policy Associates Pty Ltd
CESS	Capital expenditure sharing scheme
CGS	Commonwealth Government Securities
CMA	Competition and Markets Authority
CRG	Consumer Reference Group
DFN	Development & Future Networks
EBITDA	Earnings before interest, tax and depreciation
EBSS	Efficiency benefit sharing scheme
ENA	Energy Networks Association
EV	Enterprise Value
IER	Independent Expert Report
MRP	Market risk premium
NSP	Network Service Provider
RAB	Regulated Asset Base
RoRI	Rate of return instrument
SKI	Spark Infrastructure, a previously listed owner of network assets
WACC	Weighted average cost of capital

Table of Contents

Abbreviations and short forms **2**

1 Introduction **4**

1.1 Context 4

1.2 Summary of advice 5

2 RAB multiples **7**

2.1 Background 7

2.2 Adjusting for unregulated business 7

2.3 Assumptions on terminal multiple 9

2.4 Tax step-up 10

2.5 Other items 11

2.6 Revised results 11

2.7 Conclusion 11

3 Independent Expert Reports **12**

3.1 Status of expert reports in the AER's RoRI process 12

References **15**

1 Introduction

1.1 Context

In its Draft Decision, the AER included RAB multiples as one of three cross-checks for assessing the reasonableness of its overall rate of return. The AER clearly stated that these cross-checks were not determinative, but they could provide a 'sense-check' on its decision.

Energy Networks Australia (ENA) has strongly opposed the use of RAB multiples even prior to the Draft Decision[1] while supporting the use of other cross-checks, including a narrow financeability test. The ENA's main objection to RAB multiples was that it was "impossible"[2] to disaggregate the multiple factors that contribute to a RAB multiple, other than the rate of return allowance.

However, other stakeholders, including the CRG[3], have noted the consistently high RAB multiples for sales of regulated network assets over many years, and therefore encouraged the AER to consider ways to use this direct market information on the value investors place on regulated network assets. The Independent Panel's report to the AER also supported further investigation of observed RAB multiples[4].

In May 2022, the AER published a report by CEPA[5] that sought to disaggregate the RAB multiples observed during the most recent sales of two network businesses, Spark Infrastructure and AusNet Services. The current revenues and profits from these two businesses are largely dependent on revenue from services regulated by the AER.

The ENA, network businesses and their consultant Frontier Economics[6] (ENA/Frontier) , strongly criticised the CEPA report. The AER has now published a subsequent report by CEPA[7] in which CEPA revises its earlier analysis of RAB multiples to address these criticisms.

The AER has not published any accompanying documents or set out specific questions on which it is seeking a response but has allowed stakeholders with an interest in the Rate of Return Instrument (RoRI) a short period to provide feedback for the AER to consider in its final RoRI decision.

A key element of the criticism of the CEPA report was their claim that more direct evidence on the adequacy of the RoRI was available from independent expert reports[8] that accompanied the scheme booklets to shareholders of AusNet Services (ASX: AST) and Spark Infrastructure (ASX: SKI) on their

[1] ENA, *2022 Rate of Return Instrument Review – CEPA report EV/RAB multiples*, 27 May 2022

[2] Op. cit., p.3

[3] See for example, Consumer Reference Group, Advice to the Australian Energy Regulator, CRG Response to the AER's December 2021 Information Paper, March 2022, p. 117

[4] Independent Panel, *Independent Panel Report: AER Draft Rate of Return Instrument*, July 2022

[5] CEPA, *EV/RAB Multiples – AER*, May 2022

[6] Frontier Economics, *Analysis of RAB Multiples, Summary of the Issue and Objective of the CEPA report*, May 2022

[7] CEPA, *EV: RAB multiples – final report*, October 2022

[8] Grant Samuel, *Financial services guide and Independent expert's report in relation to the proposal by Australian Energy Holdings no 4 Pty Ltd*, December 2021, and KPMG, *Independent Expert Report and financial services guide*, October 2021

proposed takeovers and delistings. Although the independent expert reports identified the elements of value for the businesses to support acceptance of the offer price, ENA/Frontier persisted in their claim that RAB multiples could not be disaggregated to assess the cost of capital, despite similarities between the two exercises.

1.2 Summary of advice

The CRG's previous advice to the AER on RAB multiples remains, i.e., that the AER should provide "additional and relevant information[9]" as part of a suite of cross-checks and that given that transaction multiples are widely publicised, "the analysis of RAB multiples will help meet the CRG criterion of engendering consumer confidence in the regulatory framework, and this is important[10]".

In terms of the specific issues canvassed in the latest CEPA report, the CRG observes that:

- There is no single definitive valuation of AusNet Services or Spark Infrastructure's unregulated assets. CEPA has taken account of the criticisms levelled at its earlier assumptions and has widened the range of plausible valuations. Even if the values are at the high end, CEPA arrive at RAB multiples (in their terminology, EV:RABs) of 1.52x and 1.43x respectively.
- CEPA's approach to terminal EV:RAB values assumes that opportunities for outperformance will decline over time and thus terminal values are lower than current values (but are still greater than 1, i.e., some outperformance is assumed). This is an appropriate assumption. The alternative assumption proposed by the ENA/Frontier is that the level of outperformance will continue in perpetuity at their current levels. If this is the case, then it is evidence of a failure of the incentive regulation and represents poor value for NSP customers from the regulatory outcomes.
- CEPA has incorporated the potential value of a tax "step-up" arising from the opportunity to revalue the tax asset base of regulated networks on change of ownership. The ENA/Frontier assumption is that if this value arises it will accrue fully to shareholders. The AER should consider if this is appropriate or if regulatory tax allowances should take some account of such benefits so that customers can share in them.
- Other criticisms have been addressed by CEPA, and mostly have limited impact on the overall conclusions. CEPA finds , that even after adjustments, there remains significant assumed outperformance of regulatory assumptions entailed in the valuations of AST and SKI at the time of takeover. The CRG considers this finding to be robust. While CEPA notes that there are several combinations of assumptions that could explain these valuations, it is implausible that they do not include some element of outperformance of the rate or return.

In the context of the 2022 RoRI, we consider that the evidence supports the view that the current (2018) RoRI is at least equal to and may well exceed NSPs' actual cost of capital. It follows that, providing the 2022 RoRI takes a similar approach, it will be at least sufficient to allow an efficient NSP to finance its activity, and the AER should be confident that if its analysis indicates that one or

---

[9] CRG, *Advice to the AER re information paper and call for submissions*, March 2022, p.117

[10] Partington G., and Satchell S., *Report to the CRG: AER Cross Checks*, March 2022, p.9

more of the parameters of the 2022 RoRI can be set lower than in the 2018 decision, that this can still reflect an unbiased decision[11]. We do not consider that the CEPA analysis is suitable for direct estimation of RoRI parameters, only that it can serve as a useful cross check. The AER should continue to use a suite of cross checks, including RAB multiples, and consider their results holistically in making its decision.

In terms of the use of Independent Expert Report data in informing the AER's decision, we observe that:

- The use of financial market expert estimates of elements of the RoRI, in particular the Market Risk Premium (MRP), have been thoroughly canvassed by the AER. While the AER reports a range of expert estimates in its annual data clearly sets out the reasons it does not use these estimates as direct inputs into its parameter estimation. These reasons remain pertinent.
- There is no special authority attached to the Grant Samuel or KPMG reports, simply because they relate to a takeover transaction. Arguments from authority, as set out in the Grant Thornton report[12] should carry no weight in the AER's consideration.
- Notwithstanding the above, the *individual* parameter estimates used by Grant Samuel and KPMG are largely consistent with the 2018 RoRI. It is only at an overall rate of return level that there are differences, and these differences can be explained by the different purposes of these exercises compared to the AER's RoRI. We do not consider the AER should put any great weight on the similarities or the differences.

Accordingly, we do not consider either independent expert report should cause the AER to have second thoughts about its RoRI decision.

[11] We note that the overall RoRI may turn out to be higher, simply because of increases in the risk free rate in recent times.

[12] Grant Thornton, *Energy Networks Australia - RAB Multiple Project*, March 2022

2 RAB multiples

2.1 Background

Regulatory Asset Base (RAB) multiples are an analytical tool used by the AER to value regulated utilities such as the NSPs by applying a multiplier to their RAB. A RAB multiple of 1 means that the enterprise value of an NSP is equal to its RAB. The building block approach that the AER uses to set revenues is predicated on the assumption that the revenues will be just enough to cover the expenses of an efficient NSP plus a return on capital and a return of capital (depreciation). If this assumption holds into perpetuity, then the enterprise value should be equal to the RAB. In practice, the AER is operating under uncertainty and this assumption does not hold. Costs differ (and the NSPs are specifically incentivised to beat the AER's cost estimates), revenue differs and the actual cost of capital of an NSP is also likely to differ from the allowed rate of return. If these variations were simply stochastic variations around the central estimate used by the AER, then one would expect the RAB multiple to be 1.

However, RAB multiples are typically higher than 1 and this implies a belief by investors that the NSP will systematically outperform the AER's assumptions. The key question in the context of the RoRI is whether that provides any information about how to set an efficient rate of return for regulated network assets, given that outperformance may arise from other building blocks (operating expenditure, capital expenditure, tax, etc.). This is largely assumed knowledge, but it is useful to recall the underlying principles.

The CRG and other stakeholders have supported use of RAB multiples as a cross-check and encouraged the AER to perform or commission analysis of relevant data points, such as the transaction valuations of AusNet services (AST) and Spark Infrastructure (SKI). The Independent Panel also recommended such analysis be performed to inform the 2022 RoRI[13]. The AER commissioned CEPA to carry out analysis and CEPA's original report[14] was published in May 2022, shortly before the Draft Instrument and Explanatory Statement were published. Consequently, the AER did not have time to include its views on the CEPA work in the Explanatory Statement. However, several stakeholders provided feedback on the analysis. In particular, the ENA commissioned Frontier Economics[15] to critique the CEPA report, and the ENA and several NSPs made submissions critical of the CEPA report. In response, AER commissioned CEPA to review stakeholder criticisms and provide updated analysis as required. The revised CEPA report was published in October 2022.

2.2 Adjusting for unregulated business

NSPs, or their listed holding companies, typically have some income sources separate from their regulated revenues. The expected present value of the future streams of these types of income are part of the overall corporate value. In order to arrive at a RAB multiple from an overall enterprise value, it is necessary to deduct the value of these unregulated revenue streams.

---

[13] Independent Panel, *Independent Panel Report: AER Draft Rate of Return Instrument*, July 2022, p.56

[14] CEPA, *EV/RAB Multiples – AER*, May 2022

[15] Frontier Economics, *Analysis of RAB Multiples, Summary of the Issue and Objective of the CEPA report*, May 2022

This adjustment was one of the most contentious elements of CEPA's original analysis, especially in the case of AST.

AST's unregulated business is its Development & Future Networks (DFN) business. Grant Samuel's Independent Expert Report (IER) valued this at $3-$3.3bn[16]. CEPA's original analysis took a more conservative valuation of $300-900m[17]. We agree with CEPA when they state:[18]

> *"If there is scope for incumbent network businesses to create such large NPVs from investment in related assets, we would anticipate a regulatory response to protect consumers, or for competition to lead to a reduction in returns".*

NSPs/Frontier argued that the appropriate valuation of DFN for the purposes of disaggregation of RAB multiples was the midpoint of the IER: $3,150m. Adjusting for this and retaining other assumptions made by CEPA brought the RAB multiple of the regulated businesses down to 1.06, implying minimal expected outperformance.

The CRG considers that there are a range of plausible assumptions that can be taken in valuing the DFN business, and that the Grant Samuel range is not definitive, just because it was used in the IER. By comparison, Grant Samuel values the DFN business at around two thirds of the transmission network ($4.4-$4.6bn). This is despite the latter representing a certain, ongoing stream of income based on the existing RAB while the former (the DFN value) largely represents potential future income streams, many of which may not manifest for several years, if at all.

To the extent the income streams arise from construction of new assets, there is cost risk to factor in, as well as the possibility of new competitors, which is likely to reduce the profitability of such projects. The 2021 EBITDA of DFN was $122.6m or only one third of the transmission EBITDA of $366m. Moreover, the transaction took place at the end of a long period of low interest rates. Grant Samuel made some allowance for this in adjusting the cost of capital used (see discussion in Section 3 below), but nonetheless there is a possibility that future discount rates will be higher than those used in the valuation. This would reduce the net present value of the future cashflows.

Grant Thornton recognised that this risk is lower for regulated businesses because their allowed rate of return will tend to move up or down with interest rates, resulting in an offsetting impact:

> *"Changes in the risk-free rate (and in turn the regulated rate of return) at future reset dates have a material impact on allowable revenues and cash flows. However, they do not have a significant impact on the NPV as any change in the risk free rate should also be reflected in the discount rate".*[19]

This is not to suggest that Grant Thornton are definitively wrong, but nor are they definitively right about the value of DFN at the point of the transaction. There is clearly great uncertainty. Moreover,

[16] Grant Samuel, *Financial services guide and Independent expert's report in relation to the proposal by Australian Energy Holdings no 4 Pty Ltd*, December 2021, p. 51

[17] CEPA, *EV/RAB Multiples – AER*, May 2022, p. 26

[18] CEPA, *EV: RAB multiples – final report*, October 2022, p. 9.

[19] Op. cit., p70

Grant Samuel's valuation, while making use of their own "simplified, high level financial model[20]" is ultimately based on "key inputs sourced from the Corporate Model[21]", which is AST's internal projection. Indeed, Grant Samuel emphasise that their models **"do not constitute a forecast or projection by Grant Samuel of the future performance of AusNet's business operations[22]"** [emphasis added]. While Grant Samuel's valuation may be adequate for its report to current shareholders and prospective buyers of AST, this does not make it definitive and Grant Samuel's caution on the forecast is well founded.

Regardless, CEPA's revised analysis includes a valuation of $3,150m for DFN as its high end. Despite this large adjustment to the overall EV, deducting it still results in a regulated business RAB multiple of 1.47[23]. This still exceeds the indicative threshold of 1.3 for further investigation posited by Biggar (2018).

Similar issues, albeit with smaller quantum, arise when adjusting SKI for unregulated business.

2.3 Assumptions on terminal multiple

To decompose the RAB multiple once the value of the unregulated businesses has been deducted, it is necessary to assume the long-term enterprise value of the regulated business. The higher the RAB multiple at that time, the less of the total RAB multiple is attributable to near-term outperformance.

CEPA took the view that the terminal value would be a lower multiple than the current multiple. That is, they assumed that outperformance would decline over time. This is reasonable. AusNet's regulated businesses are subject to an incentive-based regulatory framework, which is iterative, allowing the regulator to learn information about efficient costs as businesses respond to the incentives of the regime.

By contrast, Frontier argued the base assumption should be to retain the same RAB multiple for the terminal value. We do not believe this is either realistic or acceptable given outperformance arises largely from the regulatory incentive schemes which, if operating as intended, can be expected to narrow the opportunities for outperformance over time. For example, in their assessment of the current incentive schemes, the ENA expects outperformance as measured in the CESS to decline as the AER improves the accuracy of its expenditure allowance forecasts and the incentive schemes reduce the information asymmetry between the AER and network. [24]

The CRG considers it somewhat telling that the NSPS' consultant should consider it so easy for NSPs to continue to systematically outperform their allowances that the current high levels of outperformance would not decline over time. If true, this would be a source of great concern to consumers. This is a key point with respect to high observed RAB multiples. They can be disaggregated in different ways, each with a different assumption about the main source of extra

[20] Op. cit, p57

[21] Ibid

[22] Ibid

[23] CEPA, *EV: RAB multiples – final report*, October 2022, p29

[24] See for instance, ENA, *"ENA initial perspectives: AER Incentive Scheme Review – CESS position paper", August 2022, p. 1*

cashflows, whether incentive schemes, expenditure efficiencies, lower tax payments than assumed by the regulator, or a lower cost of capital than the allowed return – or a combination. Whichever it is points to an area with scope for the regulator to tighten its assumptions in the long-term interest of consumers.

Indeed, as part of the AER's 2021/22 review of the regulatory incentive schemes, the ENA proposed in its presentation to the AER's August Public Forum that the CESS had contributed to reductions in opportunities for networks to benefit to the same degree as in the past from discrepancies between forecast and actual capital expenditure.[25]

The ENA explained this outcome as a function of the "continuous improvement" in the "AER's Assessment Toolkit" that is driving more accurate regulatory cost allowances, as illustrated in the quotation below:[26]

> *"[The toolkit] important in overall accuracy of [the AER's] allowance setting over time and the reduction of the information asymmetry between the AER and the networks resulting from the AER's significant investment in regulatory assessment tools that are now well developed".*

2.4 Tax step-up

The AST IER note that transactions of large capital assets create an opportunity for the acquirer to revalue some of the assets for book purposes and in turn for tax purposes (though the *regulatory* asset base is not affected). This upward revaluation allows for higher future tax deductions, which create value for the acquirer and is thus reflected in the valuation at takeover. Since the vendor cannot access this benefit, the acquiror may not have to pay full value. This uncertainty is reflected in Grant Samuel excluding the value of this so-called "tax step-up" in at least one of its scenarios for each component of AST. Other scenarios have different values. KPMG have not included a tax step-up in its valuation of SKI, reflecting the different ownership structure (SKI does not own 100% of the underlying assets).

The original CEPA report included some value for a tax "step-up" in its sensitivity analysis but not in its base case. This was disputed by Frontier, who argued that it should be included in the base case, despite the uncertainties evident in the IER.

In its revised analysis, CEPA incorporated the potential value of a tax "step-up" arising from the opportunity to revalue the tax asset base of regulated networks on change of ownership in its base case. Both CEPA and Frontier assume that if this value arises it will accrue fully to shareholders.

The AER should consider if this is appropriate or if regulatory tax allowances should take some account of such benefits so that customers can share in them.

---

[25] See for instance, ENA, *"ENA initial perspectives: AER Incentive Scheme Review – CESS position paper", 26 August 2022, p. 1.*

[26] Ibid, p. 2. While the focus is on the CESS scheme, the same general point on reduced information asymmetry applies equally to the other major incentive scheme, the EBSS.

2.5 Other items

We note that in its revised analysis CEPA has addressed the other issues raised by NSPs and Frontier, and we are satisfied that these issues do not materially undermine the conclusions.

2.6 Revised results

Even after accounting for the feedback from Frontier and the NSPs, CEPA's revised results indicate a high RAB multiple for both AST and SKI. Their central estimates are 1.61 and 1.44 respectively. These are both well in excess of the indicative 1.3 and warrant further investigation. CEPA note that these multiples could be accounted for by a range of combinations of excess returns and RAB growth. The faster the RAB growth, the lower the implied excess return, as the excess return is recovered over a larger future RAB.

Importantly, for RAB growth to be accretive of value, the expected allowed return must exceed the actual WACC. If the two were identical, then RAB growth would not return any excess value to existing shareholders. The assumption is that RAB additions would need to be partly financed by new equity and the equity portion of the return would be required in full for that new equity, while the debt portion would be needed to pay the incremental debt finance of the RAB additions. The indexation of the RAB is to compensate for the inflation portion of the rate of return, so that should not logically be a source of excess value either.

2.7 Conclusion

CEPA finds , that even after adjustments, there remains significant assumed outperformance of regulatory assumptions entailed in the valuations of AST and SKI at the time of takeover. The CRG considers this finding to be robust. While CEPA notes that there are several combinations of assumptions that could explain these valuations, it is implausible that they do not include some element of outperformance of the allowed rate of return.

Moreover, the iterative process of the CEPA report, critiques by the NSPs and Frontier, and the revised analysis by CEPA demonstrate that RAB multiples are capable of analysis and disaggregation. Different parties may hold different views on the specific assumptions, but the exercise is feasible. As CEPA notes, this is borne out by international use of the technique, such as by Ofgem and CMA in the UK[27].

In this respect, the Frontier report and ENA feedback that echo it are confusing. While they insist that RAB multiple analysis is impossible, in contradiction Frontier produces an estimate, and the ENA cites the estimate, of 0.87x by using some of CEPA's assumptions and substituting in others of its own. This exercise and the resulting RAB multiple estimates would be utterly meaningless if RAB multiple analysis was truly "impossible".

Of course, the analysis should be contextualised. The CRG is not advocating that RAB multiples can serve as a direct input to parameter estimation, i.e., that a RAB multiple after all adjustments of 1.2x means that the existing allowed return is 20% too high. Rather that it is a useful cross-check, when taken with other relevant cross-checks and assessed in the round.

---

[27] CEPA, *EV: RAB multiples – final report*, October 2022, p.6

3 Independent Expert Reports

3.1 Status of expert reports in the AER's RoRI process

Expert reports have frequently been cited by stakeholders as a potential source of evidence for the RoRI, typically in the context of the return on equity or the MRP. The use of such evidence has been thoroughly canvassed by the AER, typically in the context of either valuation reports (i.e., exercises similar to the IERs for AST and SKI) or surveys of practitioners. The AER's view has typically been that such evidence is only contextual. For the 2014 and 2018 RoR reviews, the AER used valuation reports and brokers' estimates to "inform the overall return on equity[28]" and survey evidence to "inform foundational model parameter estimates" of the MRP[29]. In 2018, the AER reviewed independent valuation report estimates of the equity risk premium (ERP) and was not moved by its observation that its point estimate was lower than many of these estimates, pointing out the limitations of such evidence due to:

> *"concentration of available reports across a few valuation firms and the limited number over a long period of time. The estimates included uplifts applied by values that could reflect a range of factors that do not warrant inclusion in the rate of return as required by our legislative objectives (for example non-systematic risks, term structure of the chosen equity proxies, the relevant investment period exceeding the term of the proxies) [and] lack of clarity around adjustments for dividend imputations"*[30]

These limitations remain pertinent. Despite these clear signals from the AER as to the marginal value of such evidence, in aggregate, but especially in the case of individual reports, the ENA and its consultants repeatedly claim the AER should take account of the Grant Samuel and KPMG reports as "directly relevant evidence"[31] of required returns on equity. As the AER noted in 2018, "our concerns about these limitations are well documented through our assessment of various submissions and reports in our determinations since the 2013 Guidelines"[32] and that stakeholders needed to provide new material to alleviate those concerns. Simply pointing to more recent valuation reports is not the kind of new material the AER would need to change its position.

The CRG agrees with the AER. There is no special authority attached to the Grant Samuel or KPMG reports, simply because they relate to a takeover transaction. Arguments from authority, or those that emphasise the supposed reputational and legal risks that independent expert valuers are exposed to (as set out in the Grant Thornton report)[33] should carry no weight in the AER's consideration. Not all observers consider such reports to carry the stamp of genuine objectivity or relevance:

---

[28] AER, *Rate of return instrument – explanatory statement, December 2018*, p83

[29] Ibid.

[30] Op. cit. p117-118

[31] ENA, *2022 Rate of Return Instrument Review – CEPA report EV/RAB multiples*, 27 May 2022

[32] AER, *Rate of return instrument – explanatory statement, December 2018*, p118

[33] Grant Thornton, *Energy Networks Australia - RAB Multiple Project*, March 2022, see for example pp7-8

> *"independent experts are a flagrantly under-challenged feature of capital markets, parading under a moniker that shrouds their true purpose, which is largely to endorse the views of their pay masters"*[34]

Notwithstanding the above, the *individual* parameter estimates/sources used by Grant Thornton and KPMG are to a large degree consistent with the 2018 RORI:

Table 1: Comparison of parameter estimates

Parameter	AER (2018)	Grant Samuel	KPMG
Risk free rate	10 year commonwealth government securities (CGS) spot yields	10 year CGS spot rate	10 year CGS blended average
Equity risk premium	6%	6.1 %	6.1%
Equity beta	0.6	0.6-0.7	0.57-0.76
Gearing	60%	50%	47-57%
Overall return on equity	5.12%	5.4-6%	6.47-7.1%

Sources: AER rate of return instrument 2018, IERs

In both cases the main driver of higher return on equity is the higher risk free rate as measured by the IERs. Notably, however, they use the same source as the AER (10 year treasury bonds), so it is merely an issue of timing (in the case of Grant Samuel) and the choice to use a blended long-term average (in the case of KPMG). The latter has no bearing on the AER's work, given NSPs are not advocating specifically for this change. Notably, though, the AER is proposing in its Draft RoRI to depart from this approach in the 2022 instrument by using a 5 year term for the risk free rate.

The equity risk premia are very similar and the AER's point estimate of beta is consistent with the lower bounds of the IERs' ranges. Grant Thornton argues that the lower gearing used requires relevering of the betas, but it is not at all clear that this is the case. Grant Samuel note that their choice of gearing is "highly judgmental" and that is "broadly consistent with a beta factor of 0.6-0.7"[35]. Broad consistency does not imply a sufficiently strong arithmetic connection that relevering is necessary. They also note that regulated businesses are regarded as "less risky than unregulated assets/businesses".

---

[34] *Australian Financial Review*, "Kroll Australia gets a mixed reception", 3 November 2022. While the CRG does not necessarily endorse this sceptical viewpoint, it provides a useful counterpoint to the Grant Thornton arguments.

[35] Grant Samuel, *Financial services guide and Independent expert's report in relation to the proposal by Australian Energy Holdings no 4 Pty Ltd*, December 2021, Appendix C p14

Accordingly, their single cost of capital could in principle be disaggregated into a slightly lower regulated cost of capital and a slightly higher unregulated cost of capital. This would only be material if the proportion of EV attributed to unregulated businesses was material. But of course, that is precisely the ENA/Frontier argument in the case of RAB multiples.

While Grant Samuel applies an uplift to the cost of capital implied by their individual parameters this is not relevant to the AER which has no scope to apply such a global adjustment in their exercise. Indeed, it' is this kind of broad adjustment that makes such reports of limited use. This and other differences, can largely be explained by the different purposes of these exercises compared to the AER's RORI. We do not consider the AER should put any great weight on the similarities or differences, but it is useful to present a different picture to the NSPs who choose to focus on the differences rather than the similarities. Such cherry-picking extends to overlooking the cases where valuation or broker reports differ from the NSPs' own arguments. For example, the NSPs have attempted to argue that CGS yields of an appropriate term are not good proxies for the risk free rate but the IERs find them entirely suitable for this purpose. NSPs have consistently argued for a low beta bias, but as the AER has pointed out they found "no evidence of Australian market practitioners considering low beta bias or using the Black CAPM"[36].

To summarise, the CRG considers that the AER should give no particular weight to the IER's cost of capital estimates, either individually or in aggregate with other similar exercises. As has long been the AER practice these reports remain a marginally relevant point of reference. On their own they do not constitute "direct relevant evidence" that the AER's rate of return is too low or too high.

[36] AER, *Rate of return instrument – explanatory statement, December 2018*, p209

AER Consumer Reference Group

References

AusNet Services, *ASX Announcement*, 'Court approves distribution of Scheme Booklet and convening of Scheme Meeting and Scheme Booklet registered with ASIC', Schedule 1: Grant Samuel Independent Expert's Report, December 2021, available from https://www.ausnetservices.com.au/-/media/Files/AusNet/Investor-Centre/ASX-Releases/2021/Scheme-Meeting-and-Scheme-Booklet-registered-with-ASIC.ashx

Australian Energy Regulator, *Draft Rate of Return Instrument*, June 2022, available from https://www.aer.gov.au/system/files/Draft%202022%20Rate%20of%20Return%20Instrument%20-%2016%20June%202022_0.pdf

Australian Energy Regulator, *Draft Rate of Return Instrument: Explanatory Statement*, June 2022, available from https://www.aer.gov.au/system/files/Draft%202022%20Rate%20of%20Return%20Instrument%20-%20Explanatory%20Statement%20-%2016%20June%202022.pdf

Australian Energy Regulator, *Electricity Network Performance Report* July 2022, available from https://www.aer.gov.au/system/files/2022%20Electricity%20network%20performance%20report%20-%20July%202022.pdf

Australian Energy Regulator, *Rate of return instrument, 'Explanatory Statement'*, December 2018, available from https://www.aer.gov.au/system/files/Rate%20of%20Return%20Instrument%20-%20Explanatory%20Statement.pdf

Australian Financial Review, *"Kroll Australia gets a mixed reception",* 3 November 2022, available from https://www.afr.com/rear-window/kroll-australia-gets-a-mixed-reception-20221103-p5bv95

Biggar, Darryl (2018), *Understanding the role of RAB multiples in regulatory processes*, 20 February 2018. Available from https://www.aer.gov.au/system/files/AER%20-%202018%20RoR%20Guideline%20Review%20-%20The%20Role%20of%20RAB%20Multiples%20in%20Regulatory%20Process.pdf

CEPA, *EV/RAB Multiples* – AER, May 2022, available from https://www.aer.gov.au/system/files/CEPA%20-%20EV%20RAB%20Multiples%20Report.pdf

CEPA, Report to the AER – EV/RAB multiples, 24 October 2022, available from https://www.aer.gov.au/system/files/CEPA%20-%20Report%20to%20the%20AER%20-%20EV%3ARAB%20multiples%20-%2024%20October%202022.pdf

Consumer Reference Group, *Advice to the Australian Energy Regulator, CRG Response to the AER's December 2021 Information Paper,* March 2022, available from https://www.aer.gov.au/system/files/CRG%20-%20Advice%20to%20the%20AER%20re%20Information%20paper%20and%20call%20for%20submissions%20%2811%20Mar%2022%20-%20Rev%2022%20Mar%2022%29.pdf

Energy Networks Australia, *2022 Rate of Return Instrument Review – CEPA Report EV/RAB Multiples*, letter to Clare Savage, Chair Australian Energy Regulator, May 2022, available from https://www.aer.gov.au/system/files/ENA%20-%202022%20Rate%20of%20Return%20Instrument%20Review%20-%20CEPA%20Report%20EV_RAB%20Multiples%20-%2027%20May%202022.pdf

Energy Networks Australia, *"ENA initial perspectives: AER Incentive Scheme Review – CESS position paper",* 26 August 2022, available at https://www.aer.gov.au/system/files/Energy%20Networks%20Australia%20presentation%20-%20Stakeholder%20forum%20on%20review%20of%20incentive%20schemes%20-%2026%20August%202022.pdf

Frontier Economics, *Analysis of RAB Multiples, Summary of the Issue and Objective of the CEPA report*, May 2022, available from https://www.aer.gov.au/system/files/Frontier%20Economics%20-%20Analysis%20of%20RAB%20multiples%20-%2027%20May%202022.pdf

Grant Samuel, *Financial services guide and Independent expert's report in relation to the proposal by Australian Energy Holdings no 4 Pty Ltd*, December 2021, available from https://www.ausnetservices.com.au/-/media/Files/AusNet/Investor-Centre/ASX-Releases/2021/Scheme-Meeting-and-Scheme-Booklet-registered-with-ASIC.ashx

Grant Thornton, *Energy Networks Australia - RAB Multiple Project*, March 2022, available at https://www.aer.gov.au/system/files/ENA%20-%20Submission%20-%20Attachment%20A%20-%20Expert%20Report%20-%20Grant%20Thornton.pdf

KPMG, *Independent Expert Report and financial services guide*, October 2021, available at https://www.sparkinfrastructure.com/system/files_force/spark_infrastructure_scheme_booklet_19_oct_2021_0.pdf?download=1

Independent Panel, *Independent Panel Report: AER Draft Rate of Return Instrument*, July 2022, available from https://www.aer.gov.au/system/files/Independent%20Panel%20Report%20-%20AER%20Draft%20Rate%20of%20Return%20Instrument%202022%20-%20July%202022.pdf

Partington G., and Satchell S., *Report to the CRG: AER Cross Checks*, March 2022, available at https://www.aer.gov.au/system/files/CRG%20-%20Submission%20-%20Attachment%20-%20Expert%20Report%20-%20Partington%20and%20Satchell.pdf