

29.07.20

Mr Warwick Anderson
General Manager – Finance and Reporting
Australian Energy Regulator

GPO Box 520
Melbourne
VIC 3001

Dear Warwick,

Regulatory Treatment of Inflation Discussion Paper (as per Australian Gas Infrastructure Group submission)

Thank you for the opportunity to provide our views on the above discussion paper. We regard this review as crucial, particularly at this time of ongoing and historically very low inflation.

We endorse the submission of our industry association, the Energy Networks Association. We would like in this short letter to focus on the real return on equity.

Our view is that, for at least the last five years, the debate around allowed returns and inflation is often confused, with different groups talking at cross purposes. As well as different views on levels of allowances, there are often different views on risk allocation, and even on a basic understanding of the risk allocation under the current methodology. We believe that the AER's practice of setting fixed real returns, but always quoting these returns in nominal terms on the basis of an assumed inflation rate, is a major contributor to this confusion.

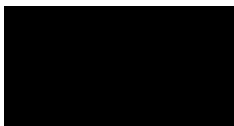
We strongly recommend that the AER quotes returns on the basis that they are used. Currently, the AER sets fixed real cost of equity and cost of debt allowances. The actual revenues and RAB indexation received by the businesses are then indexed to outturn inflation. It should therefore quote these fixed real returns, rather than notional fixed nominal returns which in fact do not apply and so can confuse stakeholders.

For example, if the AER quotes 4.6% nominal allowed cost of equity, assuming inflation of 2.3%, it should instead quote an allowance of 2.3% real cost of equity. This is what the networks receive, which is then indexed to outturn inflation. "2.3% real" makes the level of return and risk allocation clear.

We request that the AER carefully consider this point, including that it is important in helping all stakeholders reach a common understanding, and perhaps in time consensus, on allowed returns.

If you have any queries on this submission, please do not hesitate to contact me on [REDACTED].

Kind regards



Tim Rourke

Chief Executive Officer
CitiPower, Powercor and United Energy