23 February 2018

Paula Conboy
Chair
Australian Energy Regulatory
GPO Box 520
Melbourne VIC 3001

Dear Ms Conboy Paula,

December 2017 Position Paper – Remitted debt decisions for NSW/ACT 2014-19 electricity distribution determinations and Jemena Gas Networks 2015-20 (NSW) Access Arrangement

Evoenergy welcomes the opportunity to respond to the AER's Position Paper on the remitted debt decisions for the NSW/ACT 2014-19 electricity distribution determinations.

As discussed in our response to the AER's Opex Issues Paper, Evoenergy remains committed to identifying an expeditious resolution of this matter that minimises price shocks for consumers related to network price increases, is consumer focused, and provides certainty and clarity for all stakeholders. Evoenergy looks forward to continuing its constructive discussions with the AER and consumer representatives on such a resolution.

In the interim, Evoenergy attaches its response to the AER's proposed approach to remaking the debt decisions for the NSW/ACT 2014-19 electricity distribution determinations.

For the reasons explained in that response, Evoenergy maintains its view that the only correct and lawful remitted debt decision for Evoenergy's 2014-19 distribution determination is a trailing average approach without transition.

Evoenergy observes that the AER, in its Position Paper, largely disregards the Tribunal's direction and reasons for setting aside the AER's original debt decision, and the Full Federal Court decision affirming that direction, with the result that it gives no meaningful consideration to their legal effect in the remittal, on the apparent basis that they provide limited clear direction. This is an error.

For the reasons discussed in the attached response, the Tribunal's direction and the Full Court's decision, operate to require the application of a trailing average approach without transition in the remitted debt decision for Evoenergy, as only this approach conforms to the requirements of clause 6.5.2 of the Rules as construed in the Tribunal's and Full Court's reasons for decision. Evoenergy further observes that the Tribunal's direction does not permit the AER to adopt an on-the-day approach if (as Evoenergy contends) the orders and reasons of the Tribunal and Full Court preclude its 'revenue neutral transition'.

In its Position Paper, the AER relies on other Tribunal and Federal Court decisions in support of the application of its 'revenue neutral transition' in the remitted debt decision for Evoenergy. Evoenergy

considers these other decisions are incapable of authorising a departure from the AER's obligation to comply with the Tribunal's direction in accordance with its terms, particularly in circumstances where that obligation has been confirmed by the Full Court. The AER has already sought to review the Tribunal's decision to set aside the AER's original debt decision and its application was refused. It is not open to the AER to now contend, on the basis of other decisions in other matters, that it is permitted to apply a 'revenue neutral transition' if that approach cannot be reconciled with the Tribunal's direction. And, in Evoenergy's view, it cannot.

In any event, these other decisions fall far short of establishing that it is open to the AER to apply its 'revenue neutral transition', even in future regulatory decisions in which the AER's decision-making is not constrained by the Tribunal's direction.

If you wish to discuss any aspect of our response, please do not hesitate to contact David Graham, Director Regulatory Affairs and Pricing on 02 6248 3605 or david.graham@actewagl.com.au.

In the alternative, I look forward to continuing to engage with you on a way forward that expeditiously resolves this matter for the benefit of all stakeholders including in particular Evoenergy's customers.

Yours sincerely

Michael Costello

Chief Executive Officer

Evoenergy's Response to the AER's Position Paper

The AER's proposed approach to remitted debt decisions

In its Position Paper, the AER proposes to rely on its reasoning in its APA VTS determination in making the remitted debt decisions for the NSW/ACT 2014-19 electricity distribution determinations.[1] That is, as in its debt decisions set aside by the Tribunal as a result of their successful review by the NSW/ACT electricity distributors, the AER again proposes to gradually transition the NSW/ACT electricity distributors from an on-the-day approach to a trailing average approach over a 10 year period. The AER now refers to this method as its 'revenue neutral transition'.

The AER further observes that, in the event its 'revenue neutral transition' is precluded by the law or orders of the Tribunal or Federal Court, it may apply an on-the-day approach to setting the allowed return on debt in the remitted debt decisions.[2]

In proposing this approach, the AER largely disregards the Tribunal's determination for the NSW/ACT electricity distributors that set aside the AER's original debt decisions (**NSW/ACT Tribunal Decision**)[3] and the Full Federal Court decision on the AER's appeal that affirms it (**NSW/ACT Federal Court Decision**).[4]

The AER relevantly observes that:

- the NSW/ACT Tribunal and Federal Court Decisions provide 'limited clear direction on how we should remake the debt transition decision or on the interpretation of 'efficient financing costs' within the ARORO';[5] and
- the Tribunal's direction does not give a 'clear clarification of the directions for the remittal'.[6]

As a consequence, the AER gives no meaningful consideration to the legal effect of the NSW/ACT Tribunal Decision or the Tribunal's direction. It proceeds to consider whether the application of its 'revenue neutral transition' (and failing that, application of an on-the-day approach) is lawful on the (false) premise that the NSW/ACT Tribunal Decision and direction do not limit its discretion.

Further, in concluding that the NSW/ACT Federal Court Decision provides 'limited clear direction' and does not preclude the AER's 'revenue neutral transition', the AER adopts a narrow and selective characterisation of that Decision. More specifically, the AER takes the view that the relevant findings in that Decision are limited to:[7]

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[1] AER Position Paper, p.19.
[2] AER Position Paper, p.19.
[3] *Application by Public Interest Advocacy Centre Ltd and Ausgrid* [2016] ACompT 1, which sets out the 'lead reasons' which are incorporated by reference in the Tribunal decisions for Endeavour Energy, Essential Energy and Evoenergy (then ActewAGL Distribution): see, e.g., *Application by ActewAGL Distribution* [2016] ACompT 4, [4] and [79].
[4] *Australian Energy Regulator v Australian Competition Tribunal (No 2)* [2017] FCAFC 79; *Australian Energy Regulator v Australian Competition Tribunal (No 3)* [2017] FCAFC 80.
[5] AER Position Paper, p.3.
[6] AER Position Paper, p.10.
[7] AER Position Paper, p.10.

- clarification that a benchmark efficient entity 'is not necessarily either regulated or unregulated';
- a finding that '[t]he important characteristic' of a benchmark efficient entity is that it has a similar degree of risk to the service provider with respect to the provision of its regulated services; and
- a finding that a change in debt methodology 'does not necessarily' result in any impacts for a benchmark efficient entity.

The AER instead maintains that its proposed approach is legally permissible in reliance on (in chronological order):

- the 2016 Tribunal decision in respect of the debt appeal by SA Power Networks (**SAPN Tribunal Decision**);[8]
- the 2017 Tribunal decision in respect of the debt appeal by Evoenergy's (then ActewAGL Distribution's) gas distribution business and Jemena's electricity distribution business (**Vic/ACT Tribunal Decision**);[9] and
- the 2018 Federal Court decision in respect of SA Power Networks' appeal from the Tribunal's determination affirming the AER's debt decision for it (**SAPN Federal Court Decision**).[10]

Evoenergy's view on the correct and lawful approach to the remitted debt decisions

Evoenergy disagrees with the AER's position that the NSW/ACT Tribunal and NSW/ACT Federal Court Decisions provide limited clear direction on how the AER should make the remitted debt decisions.

The Tribunal's direction and, by reason of it, the Tribunal's reasons impose the primary legal constraint on the AER in making the remitted debt decisions. The direction and reasons cannot be disregarded simply because the AER considers that the outcome of other decisions of the Tribunal and the Federal Court are to be preferred to giving effect to the Tribunal's direction.

In Evoenergy's view, the Tribunal's direction operates to require a trailing average approach without transition for Evoenergy, as only this approach conforms to the requirements of clause 6.5.2 of the National Electricity Rules (**Rules**) as construed in the Tribunal's reasons. Further, contrary to the AER's suggestion in its Position Paper, the direction does not permit it to adopt an on-the-day approach for the NSW/ACT 2014-19 distribution determinations if (as Evoenergy contends) the orders and reasons of the Tribunal and Federal Court preclude its 'revenue neutral transition'.

The NSW/ACT Federal Court Decision affirms the Tribunal's direction and reasons and, in doing so, makes findings of law on the construction of the allowed rate of return objective and clause 6.5.2 of the Rules that are consistent with the reasons of the Tribunal and, like those reasons, operate to require a trailing average approach without transition for Evoenergy.

[8] *Application by SA Power Networks* [2016] ACompT 11.
[9] *Application by ActewAGL Distribution* [2017] ACompT 2.
[10] *SA Power Networks v Australian Competition Tribunal (No 2)* [2018] FCAFC 3. In an update to its Position Paper posted on the AER's website, the AER contends that this decision also supports its proposed approach of applying a 'revenue neutral transition'.

Contrary to the AER's assertions:[11]

- The NSW/ACT Federal Court Decision makes plain that the construction of 'efficient financing costs' in the allowed rate of return objective was central to the determination by the Tribunal and the Court of the issues in dispute before them. The Court concludes, in dismissing the AER's challenge to the Tribunal's finding that the benchmark efficient entity is not regulated, that this finding is properly characterised as a finding that the 'efficiency yardstick' provided by the allowed rate of return objective is the financing and risk management practices that are to be expected according to the disciplines of a workably competitive market. It is uncontroversial that this is best represented by a staggered portfolio of fixed rate debt.
- While the relevant legislative objectives continue to govern the making of the AER's remitted debt decisions, the construction of the allowed rate of return objective and clause 6.5.2 of the Rules in the NSW/ACT Tribunal and Federal Court Decisions is binding on the AER, and operates to circumscribe the discretion exercisable by the AER in accordance with what it considers will best achieve the relevant legislative objectives.
- The Tribunal's direction requires the AER to make remitted debt decisions for the NSW/ACT 2014-19 distribution determinations that are premised on the introduction of a trailing average approach. The AER's discretion in respect of the remitted debt decisions is confined to whether a transition to the trailing average approach ought be applied. In the case of Evoenergy's 2014-19 distribution determination, the Tribunal's reasons for decision (which the AER is required by the Tribunal's direction to give effect to) and the Full Court's findings of law operate to require an immediate transition to that approach.
- This is confirmed by the NSW/ACT Federal Court Decision, in which the Full Court contemplated that the AER would be required by the Tribunal's direction (which the Full Court determined not to set aside) to impose, on remittal, the trailing average approach to Evoenergy without transition. The Full Court relevantly observed:

  > 'The same conclusion applies with respect to ActewAGL [now Evoenergy]. Even though it held no debt, it was nonetheless necessary for the AER to arrive at an estimate for its return on debt in accordance with the allowed rate of return objective in r 6.5.2(c) so as to achieve the purposes of the return on capital building block. Even so, there is no meaningful, relevant impact on the benchmark efficient entity apposite for ActewAGL [now Evoenergy] that could be said to have arisen from the change in methodology for estimating its allowed rate of return. The occasion for need for a transition simply did not exist.'

  There is no suggestion in the NSW/ACT Federal Court Decision that the Full Court contemplated the AER would, despite the Tribunal's direction, be permitted to apply a trailing average approach with a transition or some other debt methodology such as the on-the-day approach.

Evoenergy further observes that the AER places inappropriate reliance on the SAPN and Vic/ACT Tribunal Decisions, and the SAPN Federal Court Decision. These Decisions are incapable of

[11] AER Position Paper, p. 10.

authorising a departure from the AER's obligation to comply with the Tribunal's direction in accordance with its terms, particularly in circumstances where that obligation was confirmed by the Full Court in the NSW/ACT Federal Court Decision. Further and in any event, these Decisions fall far short of establishing that it is open to the AER to apply its 'revenue neutral transition', even in future regulatory decisions in which the AER's exercise of discretion is not fettered by the Tribunal's direction.

The NSW/ACT Tribunal Decision and the effect of the Tribunal's direction

The Tribunal's direction requires the AER 'to make the constituent decision on return on debt **in relation to the introduction of the trailing average approach** in accordance with [its] reasons for decision' [bold emphasis added].

This requires the AER to make a remitted debt decision for Evoenergy's 2014-19 distribution determination that is premised on the introduction of a trailing average approach. That is to say, it is not open to the AER to implement some other methodology (such as the on-the-day approach). The only matter that it is open to the AER to decide on remittal, at least in respect of the debt methodology to be used, is whether a transition ought to be applied to the trailing average approach under clause 6.5.2(k)(4) of the Rules.

Further and in any event, in the case of Evoenergy's 2014-19 distribution determination, the Tribunal's reasons for decision (which the AER is required by the Tribunal's direction to give effect to) operate to require an immediate transition to that approach.

The AER must make the remitted debt decision in accordance with the 'reasons for decision'. The expression 'reasons for decision' is not to be narrowly construed. They are not simply the *ratio decidendi* of that Decision nor are they simply the Tribunal's reasons for setting aside the AER's determinations. Rather, the expression 'reasons for decision' encompasses all of the Tribunal's reasons for determining that the grounds of review asserted by Evoenergy (then ActewAGL Distribution) are established.

Accordingly, it would be incorrect for the AER to contend that the Tribunal's reasons for setting aside the debt decisions were simply that the AER erred in concluding that the benchmark efficient entity is a 'regulated' entity and in construing clause 6.5.2(k)(4) of the Rules,[12] and the AER is free to decide upon any debt methodology that does not assume that the benchmark efficient entity is 'regulated' or rely on the AER's then construction of clause 6.5.2(k)(4).

The Tribunal found two reviewable errors in respect of the AER's debt decision, being that:[13]

- the AER's selection or identification of the BEE as a regulated entity involved a wrong exercise of discretion in all the circumstances and its decision on debt was thus unreasonable in all the circumstances; and
- the AER's exercise of discretion to apply the characteristics of its selected regulated BEE to the transition process in the case of Networks NSW and Evoenergy is erroneous and its decision on the transition process was unreasonable in all the circumstances.

[12] Cf AER Position Paper, p.10.

[13] NSW/ACT Tribunal Decision, [938].

The Full Court observed in the NSW/ACT Federal Court Decision that the first of these findings could be stated more directly: the AER erred by misconstruing the allowed rate of return objective in clause 6.5.2(c) of the Rules.[14]

The Tribunal's reasons for concluding that the AER erred in its debt decisions went further than simply concluding that the benchmark efficient entity was not regulated and the AER misconstrued clause 6.5.2(k)(4) of the Rules. The Tribunal's reasons were to the effect that the allowed rate of return objective and clause 6.5.2(k)(4) of the Rules require consideration of the financing costs (including debt structure) of the benchmark efficient entity.

The Tribunal's reasons for making its two findings of reviewable error by the AER require the following:

- Start with the efficient financing costs of a benchmark efficient entity as described in the NSW/ACT Tribunal Decision[15] - that is:
    - the benchmark efficient entity is to have a similar degree of risk to that of the particular service provider for which the return on debt is to be estimated;[16]
    - the 'efficient financing costs' of the benchmark efficient entity are to be determined by reference to the financing cost structure (i.e. debt management practices) that would be adopted by that benchmark efficient entity where it supplies the standard control services in a competitive market.[17] It was common ground before the Tribunal that the benchmark efficient entity would have a staggered debt financing cost structure that mirrored the trailing average approach.[18]
- In the case of a changed methodology, determine whether that benchmark efficient entity would suffer any impacts as a result of the changed methodology.[19]
- This determination is to be made and the 'starting point' for any transition under clause 6.5.2(k)(4) of the Rules ascertained by reference to the debt portfolio and financing costs that the particular service provider should hold at the commencement of the relevant regulatory control period as a consequence of efficiently structuring its debt portfolio under the former regulatory approach to estimating the return on debt applying in the preceding period.[20]
- This assessment should be realistic and have particular regard to the actual debt portfolio and financing costs adopted by that particular service provider in response to that former approach; fictions should not be imposed when the service provider has already implemented a debt structure that satisfies a required aspect of the benchmark efficient entity's 'efficient financing costs'.[21]

[14] NSW/ACT Federal Court Decision, [539].
[15] NSW/ACT Tribunal Decision, [933(1)].
[16] NSW/ACT Tribunal Decision, [916] and [922].
[17] NSW/ACT Tribunal Decision, [914] to [916], [921] and [925] to [927]. The reference to 'those services' in the first sentence of [914] is properly understood to be a reference to the 'standard control services' referred to in the preceding sentence (i.e. the last sentence of [913]).
[18] NSW/ACT Tribunal Decision, [915].
[19] NSW/ACT Tribunal Decision, [922] and [933].
[20] NSW/ACT Tribunal Decision, [934].
[21] NSW/ACT Tribunal Decision, [935].

It follows from the above that:

- the return on debt for Evoenergy must be commensurate with 'efficient financing costs' determined by reference to the debt management practices that would be adopted by the benchmark efficient entity where it supplies the standard control services in a competitive market—that is, the trailing average methodology;
- the benchmark efficient entity apposite to Evoenergy could not be said to suffer any impacts as a result of a change of methodology from the on-the-day approach to the trailing average approach, with the result that no transition to the trailing average methodology is needed.

The Tribunal did not, in respect of the construction of the allowed rate of return objective, determine the narrow question of the characteristics of the benchmark efficient entity - that is, whether the benchmark efficient entity is a regulated or an unregulated entity - in isolation. Nor did the Tribunal, as the AER has previously suggested,[22] find only that once the step is taken of starting with a benchmark efficient entity which has the characteristics of a participant in a competitive market, the AER's approach to transitioning the return on debt estimate and the application of clause 6.5.2(k)(4) must be reconsidered.

It follows that the Tribunal's direction operates to require the AER to proceed on remittal on the basis that only a trailing average approach without transition conforms with the requirements of clause 6.5.2 of the Rules.

The NSW/ACT Federal Court Decision

The focus of the AER's case on appeal was whether the Tribunal had erred in its construction and application of the allowed rate of return objective referred to in clause 6.5.2(c) of the Rules, and clause 6.5.2(k)(4) which pertains to the need for the AER to have regard to impacts arising from any change in the methodology used to estimate the return on debt from one regulatory period to another.[23]

In dismissing the AER's appeal in respect of the Tribunal's decision, the Full Court made a number of findings of law on the proper construction and application of the allowed rate of return objective and clause 6.5.2(k)(4) of the Rules that form part of the ratio of its decision.

The key findings of the Full Court in the NSW/ACT Federal Court Decision are as follows:

- The issue in dispute before the Tribunal was 'the question of the proper construction and application of r 6.5.2 of the NER, in particular the proper construction and application of the allowed rate of return objective specified in r 6.5.2(c)'.[24]
- The issue raised by the network respondents and determined by the Tribunal did not relate to the characteristics of the benchmark efficient entity - that is, whether the benchmark efficient entity is a regulated or an unregulated entity - in isolation.[25] Rather, the issue raised and determined was whether, in estimating the return on debt in accordance with the allowed rate of return objective, it was not appropriate to adopt the AER's gradual transition (now referred to as its 'revenue neutral transition') and that an immediate transition to the trailing average approach

[22] AER, *Supplementary Submissions of the Australian Energy Regulator in ACT 3 to 8 of 2016*, [14].
[23] NSW/ACT Federal Court Decision, [387].
[24] NSW/ACT Federal Court Decision, [415].
[25] NSW/ACT Federal Court Decision, [483], [484] and [486].

should instead be adopted because the efficient financing costs of a benchmark efficient entity appropriate to their circumstances did not require any transition to the trailing average approach. In the words of the Full Court:[26]

> '[The NSW/ACT electricity distributors'] basic proposition, both before the AER and the Tribunal, was that the AER has applied the wrong benchmark which, in the result, was antithetical to the allowed rate of return objective because, in a workably competitive market, efficient financing costs would be represented by a staggered portfolio of fixed rate debt, which they already held without the need to transition, and that their debt costs should be benchmarked accordingly.'

- Reference to whether the benchmark efficient entity is a regulated or unregulated entity is a shorthand way of referring to this broader issue.[27]
- One and the same benchmark efficient entity is engaged by both the allowed rate of return objective and clause 6.5.2(k)(4).[28]
- The efficient financing costs of the benchmark efficient entity are to be ascertained by reference to the debt management practices of a benchmark efficient entity operating in a workably competitive market.[29] The Full Court relevantly observed that:[30]

  > '…in promulgating the 2012 Rule amendments which introduced the allowed rate of return objective, the AEMC noted that the long-term interests of consumers would be best served by ensuring that the methodology used to estimate the return on debt reflected, to the extent possible, the efficient financing and risk management practices that might be expected in the absence of regulation.'

  It went on to conclude in respect of the allowed rate of return objective that:[31]

  > '...the required benchmarking is with respect to the efficiency of financing and risk management practices that are to be expected according to the disciplines of a workably competitive market'.

- The benchmark efficient entity has a similar degree of risk to that of the particular service provider attributed to it.[32]
- Whereas the AER expressly eschewed the notion that transitional arrangements should be specific to individual service providers' debt financing practices,[33] plainly enough, the benchmark efficient entity must be one that is apposite for the service provider in question.[34]
- Regard should be had to the actual circumstances, including debt management practices, of the particular service provider in ascertaining the efficient financing costs of the benchmark efficient

[26] NSW/ACT Federal Court Decision, [486].
[27] NSW/ACT Federal Court Decision, [486].
[28] NSW/ACT Federal Court Decision, [570].
[29] NSW/ACT Federal Court Decision, [531], [533] and [537].
[30] NSW/ACT Federal Court Decision, [531].
[31] NSW/ACT Federal Court Decision, [533].
[32] NSW/ACT Federal Court Decision, [536].
[33] NSW/ACT Federal Court Decision, [568].
[34] NSW/ACT Federal Court Decision, [570].

entity in accordance with clause 6.5.2(c) of the Rules.[35] The Full Court concluded in respect of the proper construction of clause 6.5.2(c):[36]

> 'The requirement of r 6.5.2(h) is to estimate the return on debt for a particular service provider in a way that achieves the allowed rate of return objective. In this connection, the undoubted function of r 6.5.2(c) is to provide, as the electricity network respondents said, an "efficiency yardstick" for the particular costs under consideration. This was plainly the AEMC's intention in the 2012 Rule Determination. While, for this purpose, the benchmark efficient entity is a construct, there is nothing in r 6.5.2(c) which requires one to be oblivious to the actual circumstances, including the debt management practices, of the particular service provider whose debt costs are being benchmarked. It is the efficiency of that service provider's costs that is to be benchmarked according to what would be required by the disciplines of a workably competitive market. Considered against the yardstick of the efficient financing costs of the benchmark, the service provider's debt management practices will either be efficient or inefficient. Where inefficiency exists, that inefficiency should not be reflected in the allowed rate of return for that service provider. Only efficient financing costs are to be allowed.'

- In applying clause 6.5.2(c) to estimate the return on debt, and in considering whether impacts of the kind referred to in clause 6.5.2(k)(4) exist, fictions should not be imposed when the provider has already implemented a debt structure that satisfies the requirements of the intended benchmark efficiency.[37] The passage from the NSW/ACT Federal Court Decision set out immediately above continues:[38]

> 'But none of this means that, in applying r 6.5.2(c) to estimate the return on debt under r 6.5.2(h), and in considering whether impacts of the kind referred to in r 6.5.2(k)(4) exist that should be taken into account for that purpose, fictions should be imposed when the service provider has, for example, already implemented a debt structure that satisfies a required aspect of the intended benchmark efficiency.'

As a consequence, the Federal Court concluded that:[39]

- Even though Evoenergy (then ActewAGL Distribution) held no debt, it was nonetheless necessary for the AER to arrive at an estimate for its return on debt in accordance with the allowed rate of return objective in clause 6.5.2(c) so as to achieve the purposes of the return on capital building block.
- Even so, there was no meaningful relevant impact on the benchmark efficient entity apposite for Evoenergy that could be said to have arisen from the change in methodology for estimating its allowed rate of return. The occasion or need or a transition simply did not exist.

[35] NSW/ACT Federal Court Decision, [571].
[36] NSW/ACT Federal Court Decision, [571].
[37] NSW/ACT Federal Court Decision, [571].
[38] NSW/ACT Federal Court Decision, [571].
[39] NSW/ACT Federal Court Decision, [573].

As is plain from the above, the AER's characterisation of the NSW/ACT Federal Court Decision in the Position Paper is not sustainable.[40] The construction of 'efficient financing costs' was central to the Full Court's dismissal of the AER's challenge to the Tribunal's finding that the benchmark efficient entity was not regulated. Further, the Court's finding that the allowed rate of return objective provided an 'efficiency yardstick' - being, the financing and risk management practices that are to be expected according to the disciplines of a workably competitive market - was of equal importance to the dismissal of that challenge as the Court's finding that the risk of the particular service provider is to be attributed to the benchmark efficient entity.[41]

Further, the issue in dispute before the Tribunal, and thus before the Full Court on appeal, was not, as the AER has previously suggested,[42] confined to whether the AER erred in adopting a regulated benchmark efficient entity and a 'one size fits all' benchmark efficient entity for the purpose of its original debt decisions. The Full Court expressly rejected the AER's narrow characterisation of the issue in dispute and articulated that issue in terms that made plain it raised broader issues of construction of the allowed rate of return objective for the Tribunal's and the Court's determination. Nor did the Court, as the AER has also suggested,[43] find only that the allowed rate of return objective does not posit the benchmark efficient entity as either a regulated entity or an unregulated entity and that clause 6.5.2(k)(4) contemplates the possibility that there may not be a single benchmark efficient entity.

The Full Court's conclusion that no transition to the trailing average approach was warranted for Evoenergy was premised on its own findings on the proper construction of the allowed rate of return objective and clause 6.5.2(k)(4), which findings were required for the determination of the issue in dispute before it. That conclusion does not leave open the possibility that there may nonetheless be some impact on a benchmark efficient entity as a consequence of a change in debt estimation methodology.[44]

The Tribunal's direction and the Full Court's findings of law operate to require a trailing average approach for Evoenergy without transition, as only this approach conforms with the requirements of clause 6.5.2 of the Rules as construed by the Tribunal and the Full Court.

This is confirmed by the NSW/ACT Federal Court Decision, which contemplates that the AER would be required by the Tribunal's direction (which the Full Court determined not to set aside) to impose, on remittal, the trailing average approach to Evoenergy without transition. The Full Court relevantly observed:

> 'The same conclusion applies with respect to ActewAGL [now Evoenergy]. Even though it held no debt, it was nonetheless necessary for the AER to arrive at an estimate for its return on debt in accordance with the allowed rate of return objective in r 6.5.2(c) so as to achieve the purposes of the return on capital building block. **Even so, there is no meaningful, relevant impact on the benchmark efficient entity apposite for ActewAGL [now Evoenergy] that could be said to have arisen from the change in**

[40] AER Position Paper, p. 10.
[41] Cf. AER Position Paper, p.10.
[42] AER, *Supplementary Submissions of the Australian Energy Regulator in ACT 3 to 8 of 2016*, [14].
[43] AER, *Supplementary Submissions of the Australian Energy Regulator in ACT 3 to 8 of 2016*, [15] and see also [25].
[44] Cf. AER Position Paper, p.10; AER, *Supplementary Submissions of the Australian Energy Regulator in ACT 3 to 8 of 2016*, [15].

methodology for estimating its allowed rate of return. The occasion or need for a transition simply did not exist.' [Bold emphasis added]

There is no suggestion in the NSW/ACT Federal Court Decision that the Full Court contemplated the AER would, despite the Tribunal's direction, be permitted to apply a trailing average approach with a transition or some other debt methodology such as the on-the-day approach.

The relevance of other Tribunal and Federal Court Decisions to the remitted debt decisions

Evoenergy considers that the AER places inappropriate reliance on the SAPN and Vic/ACT Tribunal Decisions, and the SAPN Federal Court Decision.

None of these Decisions alter the AER's obligation to comply with the Tribunal's direction in accordance with its terms.

The SAPN and Vic/ACT Tribunal Decisions relied on by the AER in support of its proposed approach are administrative decisions only. Unlike the NSW/ACT Tribunal Decision, they have no legal force and effect in the remittal.

The SAPN Federal Court Decision is a judicial decision. However, it expresses no view on the correct and reasonable approach to the introduction of the trailing average approach in Evoenergy's circumstances, or the correctness or otherwise of the NSW/ACT Tribunal Decision. In any event, it is incapable of authorising a departure from the AER's obligation to comply with the Tribunal's direction in accordance with its terms, particularly in circumstances where that obligation was confirmed by the Full Court in the NSW/ACT Federal Court Decision.

Evoenergy notes, in particular, the Full Court's observation in the SAPN Federal Court Decision that it does not regard the NSW/ACT Federal Court Decision as confining the 'impacts' to which the AER may have regard in applying clause 6.5.2(k)(4) of the Rules to impacts in the form of hedging contracts that need to be unwound.[45] Even if this is correct (which Evoenergy disputes for the reasons discussed below), it does not follow that it is open to the AER to consider its NPV=0 principle, and gains or losses arising as a 'side-effect' of changing the debt estimation methodology, in making the remitted debt decisions.

The SAPN Federal Court Decision does not consider the NSW/ACT Tribunal Decision or the making of the remitted debt decisions in making its observation concerning the 'impacts' to which the AER may have regard when applying clause 6.5.2(k)(4) of the Rules. It had no cause to.

Whether or not the NSW/ACT Federal Court Decision confines the 'impacts' to which the AER may have regard in making the remitted debt decisions, the Tribunal's reasons (with which the AER must comply in making those decisions by reason of the Tribunal's direction) do. Whether a consideration of the NPV=0 principle, and gains or losses arising as a 'side-effect' of changing the debt estimation methodology, is consistent with the allowed rate of return objective and clause 6.5.2 of the Rules was an issue raised by the AER before and considered by the Tribunal in the NSW/ACT Tribunal Decision.

[45] SAPN Federal Court Decision, [295].

The Tribunal:

- nonetheless adopted a Rule construction (discussed above) that precludes a consideration of these matters in ascertaining the 'impacts' of a change in methodology and the 'starting point' for any transition under the allowed rate of return objective and clause 6.5.2 of the Rules; and
- concluded that any consideration of the gains or losses arising as a 'side-effect' of the change of methodology and resultant alteration to the 'starting point' for transition would need to occur, if it were to occur, under section 16(1)(d) of the National Electricity Law but did not decide whether section 16(1)(d) permitted this.[46]

The AER has already sought to review the NSW/ACT Tribunal Decision in respect of debt and its application was refused. It is not open to the AER to now contend, on the basis of decisions in other matters, that it is permitted to apply a 'revenue neutral transition', if that approach cannot be reconciled with the Tribunal's direction. And, in Evoenergy's view, it cannot, for the reasons already discussed.

The relevance of other Tribunal and Federal Court Decisions to future debt decisions

Further, even in future regulatory decisions in which the AER's exercise of discretion is not fettered by the Tribunal's direction, the SAPN and Vic/ACT Tribunal Decisions, and the SAPN Federal Court Decision fall far short of establishing that it is open to the AER to apply its 'revenue neutral transition', particularly in the circumstances apposite to Evoenergy.

As decisions of an administrative character, the findings in the SAPN and Vic/ACT Tribunal Decisions relied on by the AER in support of its proposed approach do not constitute law.

In any event, Evoenergy considers these Decisions provide little guidance on the correct and reasonable approach to transitioning to the trailing average approach particularly where the imposition of any transition is in issue and in the circumstances apposite to Evoenergy.

The SAPN Tribunal Decision was premised on the parties' agreement on the merits of the imposition of some form of gradual transition to the trailing average approach and, more specifically, the merits and form of a gradual transition arrangement for the risk-free component of the cost of debt.[47] The issue before the Tribunal was therefore confined to the appropriateness of the AER's gradual transition of the debt risk premium component in the factual circumstances apposite to SA Power Networks.

As the Full Court recognises in the SAPN Federal Court Decision,[48] the findings in the SAPN Tribunal and Federal Court Decisions and the NSW/ACT Tribunal Decisions are distinguishable on the basis of the differing issues before the Tribunal and Full Court in those matters and on the basis of the differing debt management practices of SA Power Networks and the NSW/ACT distributors.

In the Vic/ACT Tribunal Decision, in Evoenergy's view, the Tribunal falls into error, both in respect of the construction and application of clause 6.5.2 of the Rules and the characterisation of the NSW/ACT Federal Court Decision.

[46] NSW/ACT Tribunal Decision, [939] to [943].
[47] SAPN Tribunal Decision, [204].
[48] SAPN Federal Court Decision, [282] and [290].

In construing clause 6.5.2, including in particular the allowed rate of return objective, the Tribunal falls into error primarily because it substitutes its own views on conventional economic policy for the objectives of the policy maker, the AEMC, that inform the 2012 Rule changes.

The amendments to clause 6.5.2 of the Rules, including the introduction of a new allowed rate of return objective and the express conferral on the AER of discretion to introduce a trailing average approach to estimating the cost of debt, gave effect to the AEMC's policy view that (in the words of the Full Court in the NSW/ACT Federal Court Decision[49]) 'the long-term interests of consumers would be best served by ensuring that the methodology used to estimate the return on debt reflected, to the extent possible, the efficient financing and risk management practices that might be expected in the absence of regulation'.

In contrast, the Tribunal concludes, in construing the allowed rate of return objective introduced by the AEMC to give effect to this policy intent, that 'the conventional view (which the Tribunal accepts) is that [achieving the allowed rate of return objective] involves a forward-looking cost of capital, which in turn implies the use of prevailing, or current, rates in the market; and that that in turn implies an NPV=0 test'[50] and that it would be a mistake to think of efficient costs in the context of the return on debt in terms of efficient debt management practices.[51]

It is unsurprising, therefore, that the Tribunal expresses scepticism about whether the historical trailing average approach could ever be said to achieve the allowed rate of return objective for the reason that it represents 'a clear departure' from the forward-looking opportunity cost of capital it describes.[52] In this acknowledgement is an implicit recognition by the Tribunal that the effect of its Decision is to frustrate the AEMC's 2012 Rule changes.

The Tribunal also falls into error in concluding that its construction of clause 6.5.2 of the Rules, in particular of the phrase 'efficient financing costs' referred to in the allowed rate of return objective, can be reconciled with those of the Full Court in the NSW/ACT Federal Court Decision. On this, the Tribunal concludes:[53]

> '…it is essential to read the Full Court's reasons in the context of the questions it was considering. Those questions were: whether the Tribunal erred in law in concluding that the AER was bound to address the RoR Objective on the basis of the benchmark efficient entity must be an unregulated entity; and whether the Tribunal erred in its construction of r 6.5.2(k)(4) of the *NER*. However, the question immediately facing this Tribunal is the construction of "efficient financing costs" for the purpose of giving effect to r 6.5.2(b) [sic] and r 6.5.2(h). While the passage above deals with the application of r 6.5.2(h), it does so in the context of construing clause 6.5.2(k)(4).'

[49] NSW/ACT Federal Court Decision, [531].
[50] Vic/ACT Tribunal Decision, [158].
[51] Vic/ACT Tribunal Decision, [121]; see also [111], [129] and [135].
[52] Vic/ACT Tribunal Decision, [188].
[53] Vic/ACT Tribunal Decision, [103]; see also [122].

While this was the characterisation of the NSW/ACT Federal Court Decision pressed by the AER before the Tribunal,[54] it goes against the Full Court's own characterisation of the issues before it. As already discussed, the Full Court:

- characterised the question before the Tribunal as one of 'the proper construction and application of r 6.5.2 of the NER, in particular the proper construction and application of the allowed rate of return objective in r 6.5.2(c)';[55]
- expressly rejected the AER's narrow characterisation of the issue before the Court as being whether the benchmark efficient entity must be unregulated, and concluded that reference to whether the benchmark efficient entity is a regulated entity was a shorthand way of referring to the true, broader question before the Court, being the proper construction and application of clause 6.5.2 of the Rules and in particular the allowed rate of return objective in clause 6.5.2(c) and whether a transition to the trailing average approach in the circumstances of the NSW/ACT distributors is antithetical to the allowed rate of return objective because, in a workably competitive market, 'efficient financing costs' would be represented by a staggered portfolio of fixed rate debt and their debt costs should be benchmarked accordingly;[56] and
- concludes, in dismissing the AER's challenge to the Tribunal's finding that the benchmark efficient entity is not regulated, that the Tribunal's finding is properly characterised as a finding that the 'efficiency yardstick' provided by the allowed rate of return objective is the financing and risk management practices that are to be expected according to the disciplines of a workably competitive market.[57]

The SAPN Federal Court Decision, while judicial in character and binding on the AER, also provides little guidance on the correct and reasonable approach to transitioning to the trailing average approach particularly where the imposition of any transition is in issue and in the circumstances apposite to Evoenergy.

In the SAPN Federal Court Decision, the Full Court determines only the particular allegations of judicially reviewable error identified by SA Power Networks' grounds of review.[58] As a consequence, the decision falls short of establishing that it is open to the AER to apply its 'revenue neutral transition', particularly in the factual circumstances apposite to Evoenergy.

The Court's findings on Rules construction are expressly said to be confined to those required to determine the issues raised by SA Power Networks' grounds.[59] There is no clear and comprehensive statement on the proper construction and application of the allowed rate of return objective and clause 6.5.2(h) and (k)(4) of the Rules.

The Full Court makes no finding on the correctness or reasonableness of the AER's approach to estimating the return on debt for SA Power Networks (and therefore not for Evoenergy) as this was not a question raised by the judicially reviewable errors identified by SA Power Networks' grounds of

[54] AER, *Supplementary Submissions of the Australian Energy Regulator in ACT 3 to 8 of 2016*.
[55] NSW/ACT Federal Court Decision, [415].
[56] NSW/ACT Federal Court Decision, [415], [483], [484] and [486].
[57] NSW/ACT Federal Court Decision, [531] to [533] and [537].
[58] See, for example, SAPN Federal Court Decision, [256] and [289].
[59] SAPN Federal Court Decision, [292].

review.[60] In making an observation to this effect, however, the Court acknowledges that the reasoning in the NSW/ACT Federal Court Decision may support the proposition that the AER's transition was not the correct or preferable approach for SA Power Networks.[61]

As already noted, the Full Court distinguishes the findings in the NSW/ACT Federal Court Decision by reference to the differing debt management practices of SA Power Networks and the NSW/ACT distributors, as well as the differing issues before the Court in this Decision.[62] Against this background, the Court observes that there is no 'necessary inconsistency' between the NSW/ACT Federal Court Decision of the particular questions of construction of clause 6.5.2(k)(4) of the Rules then before it and the particular questions of construction determined in the SAPN Federal Court Decision.[63]

In saying this, however, the Full Court provides no guidance on how its findings on the construction of the allowed rate of return objective and clause 6.5.2(h) of the Rules can be reconciled with those of the Full Court in the NSW/ACT Federal Court Decision.

On its findings on the allowed rate of return objective and clause 6.5.2(h) of the Rules in the NSW/ACT Federal Court Decision, the Full Court observes only that '[o]ne question which arose for consideration in that case was the characteristics of the benchmark efficient entity referred to in the allowed rate of return objective in r 6.5.2(c) - in particular, whether the benchmark efficient entity is a regulated or unregulated entity'.[64] As already discussed, in the NSW/ACT Federal Court Decision, the Full Court expressly conveyed that the issue before it was not a narrow question of the characteristics of the benchmark efficient entity - that is, whether the benchmark efficient entity is a regulated or an unregulated entity - in isolation. The Full Court is silent on how its findings on construction should be reconciled with the finding in the NSW/ACT Federal Court Decision that the efficient financing costs of the benchmark efficient entity referred to in the allowed rate of return objective are to be ascertained by reference to the debt management practices and costs of a benchmark efficient entity operating in a workably competitive market.

This may be explicable on the basis that before the Full Court SA Power Networks' relied on certain of the conclusions reached in the NSW/ACT Federal Court Decision as supporting its construction of clause 6.5.2(k)(4) of the Rules.[65] Regardless, the SAPN Federal Court Decision leaves the lawfulness of the AER's 'revenue neutral transition' in future debt decisions unconstrained by the Tribunal's direction unclear.

The Full Court observes that it does not regard the NSW/ACT Federal Court Decision as confining the 'impacts' to which the AER may have regard in applying clause 6.5.2(k)(4) of the Rules (to impacts in the form of hedging contracts that need to be unwound).[66]

However, the Rules construction adopted by the Full Court in the NSW/ACT Federal Court Decision precludes a consideration of these matters in ascertaining the 'impacts' of a change in methodology. This observation would appear to result from the fact that the Full Court has not properly engaged with

[60] SAPN Federal Court Decision, [289]. See also [256].
[61] SAPN Federal Court Decision, [288].
[62] SAPN Federal Court Decision, [282] and [290].
[63] SAPN Federal Court Decision, [292].
[64] SAPN Federal Court Decision, [279].
[65] SAPN Federal Court Decision, [279].
[66] SAPN Federal Court Decision, [295].

the findings in the NSW/ACT Federal Court Decision on the construction of the allowed rate of return objective and clause 6.5.2(c) of the Rules.

Even if the Court is correct in this, however, it is silent on whether and how other, unspecified 'impacts' would operate to authorise the application of the AER's 'revenue neutral transition' in Evoenergy's particular circumstances, having regard to the findings in the NSW/ACT Federal Court Decision on the construction and proper application in those circumstances of the allowed rate of return objective and clause 6.5.2 of the Rules. This was simply not the question before the Court in the SAPN Federal Court Decision.

As a consequence, the SAPN Federal Court Decision provides little guidance on how the findings on Rules construction in this Decision and the NSW/ACT Federal Court Decision should be reconciled and applied to a provider in the circumstances of Evoenergy in making future debt decisions unfettered by the Tribunal's direction.

Even if Evoenergy's views on the SAPN and Vic/ACT Tribunal Decisions, and SAPN Federal Court Decision are wrong, however, nothing turns on this in the present remittal. This is because, as already explained, these Decisions are of no legal force and effect in this remittal, and do not alter the AER's obligation to comply with the Tribunal's direction, and thus make the remitted debt decisions in accordance with the reasons, in the NSW/ACT Tribunal Decision.