



12 December 2017

Mr Warwick Anderson  
General Manager, Network Expenditure  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Dear Mr Anderson

## **REVIEW OF RATE OF RETURN GUIDELINE**

Origin Energy (Origin) appreciates the opportunity to comment on the AER's Issues Paper relating to the review of the rate of return guideline (the Guideline).

The AER has sought views on the extent to which its current approach to setting the allowed rate of return remains appropriate. Origin notes that the AER is required by the National Electricity Rules (NER) to review the Guideline within five years of its first publication. In doing so, we also note that the COAG Energy Council Senior Committee of Officials (SCO) has expressed an expectation that the Guideline will serve as binding rate of return instrument.

We support the AER using its current approach to setting the allowed rate of return as a starting point for the review, rather than adopting a 'blank slate' approach. We also note that a number of matters relating to the interpretation of how certain parameters are calculated are still before the courts.

With that in mind we believe that the AER should, to every extent practicable, incorporate the interpretations of both the Tribunal and Full Court into the review of the Guideline to deliver greater certainty and predictability in how the regulatory rate of return is applied across the different network service providers (DNSPs).

Origin's comments to specific questions raised by the AER are set out below.

*To what extent has the current approach to setting the allowed rate of return achieved the NEO Objective and NGO, the ARORO, and the related revenue and pricing principles?*

The NER require the AER to determine an allowed rate of return that achieves the allowed rate of return objective at the time it makes its revenue determination; notably that it provide a DNSP with a rate of return commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as the service provider in respect of the provision of standard control services.

We believe that the economic theory underpinning the methods and models set out in the Guideline is broadly accepted by all stakeholders, but disagreement arises about how the theory should apply in practice. In this regard, the application of several elements of the Guideline have been subject to legal challenge.

In a number of instances, the interpretations of the Courts have not aligned with those of the AER. Notwithstanding, to reduce uncertainty and risk we support a position where the outcomes of the various legal proceedings are incorporated in a more binding set Guideline. We believe this will deliver a more stable and predictable processes in the future application of the Guideline.

*Should information on profitability, asset sales, financeability and any other financial information be used when assessing outcomes against the NEO and NGO, ARORO, and the related RPPs?*

We believe the examination of a firm's profitability and financeability provides a useful cross-reference regarding the relationship between regulatory returns and the broader performance of the business. Notwithstanding, while examination of these parameters acts as a useful tool to understand the impact of the rate of return on a businesses' operations, the debt and equity principles of the Guideline must retain primacy in terms of how the actual return is derived.

*To what extent are changes required to our current approach of transitioning from an on-the-day rate to a trailing average?*

Origin considers that there is no disagreement that the trailing average approach is an acceptable methodology and permissible under the NER. However, there is disagreement about how, if any, transition should be applied.

This matter has been considered by both the Tribunal and the Full Court. We understand that both appeal bodies agreed that the regulatory revenue allowance for debt is required to be estimated to provide a service provider with a rate of return commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk as the service provider in respect of the provision of standard control services.

Furthermore, the similar degree of risk may change from service provider to service provider meaning there is no single benchmark efficient entity. We also believe this is reflected in the fact that while the Full Court accepted the claims by the NSW networks for an immediate implementation of an historic trailing average, the Tribunal did not accept the claims for review put forward by ActewAGL and Jemena.

While we have supported the AER's position on transitioning to a trailing average, and continue to do so, we also recognise the interpretation of the respective appeals bodies. With these matters in mind, we do not believe the AER should change its approach per se, but rather ensure that the application of its approach better reflects the interpretation of the appeal bodies. Doing so in a clear and understandable way will provide necessary confidence in the predictability of the regulatory regime.

**Concluding comments**

Origin has and continues to support a number of positions adopted by the AER in its previous decisions, notably around the transition to a trailing average cost of debt. Notwithstanding, we also believe that to every extent practicable the AER should incorporate the interpretations of both the Tribunal and Full Court to deliver greater certainty and predictability in how the regulatory rate of return is applied across the different network service providers.

If you have any questions regarding this submission, please contact Sean Greenup in the first instance on (07) 3867 0620.

Yours sincerely



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