19 May 2014

Mr Warwick Anderson
General Manager – Network Regulation Branch
Australian Energy Regulator

By email: rateofreturn@aer.gov.au

Dear Mr Anderson

Return on debt: Choice of third party data provider

The Public Interest Advocacy Centre (PIAC) thanks the Australian Energy Regulator (AER) for the opportunity to provide comment on its Issues Paper, *Return on debt: Choice of third party data service provider* (the Issues Paper). The Issues Paper discusses 'issues relevant to implementing [the AER's] proposed approach to estimating the return on debt that were not explicitly covered in [the Rate of Return] guideline'.[1]

PIAC made a number of submissions to the development of the AER's Rate of Return (RoR) guideline, [2] motivated by the impact of the RoR on electricity and gas prices paid by residential consumers. PIAC considers that rigorous regulation of energy network service providers (NSPs) is in the long-term interest of consumers. While is widely recognised that disadvantaged and vulnerable consumers are struggling to pay their bills, PIAC's research has shown that a significant proportion of residential consumers who experience utility disconnection are in paid employment. PIAC's 2013 report, *Cut Off III: The Social Impact of Utility Disconnection*, found that 44% of households who had been disconnected from essential utilities derived the majority of their income from paid employment.[3] In these circumstances, effective regulation that sets prices as close as possible to efficient levels has a key role to play in improving the access of all residential consumers to essential services.

PIAC supports the use of third party data providers for determining the return on debt. As noted in the Issues Paper, there are a number of advantages to this approach. These include that the data is developed by market practitioners who are independent of the regulatory process and that it 'reduces the scope for debate on debt instrument selection issues' or selecting data that best suits a particular party's purposes.[4]

Characteristics of third-party data sources

The Issues Paper considers two key third party data providers. Firstly, the Reserve Bank of Australia (RBA), which began publishing monthly credit spreads estimates for maturities of three, five, seven and ten years in December 2013.[5] The RBA series is based on credit spreads for only the last day of a given month.[6]

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1 AER, *Return on debt: Choices of third party data service provider – Issues paper*, 2014, 3.

2 See for example: Hughson, B & Hodge, C, *Better returns for consumers*, 2013, available at: http://www.piac.asn.au/publication/2013/03/better-returns-consumers; Hughson, B & Hodge, C, *Better equity*, 2013, available at: http://www.piac.asn.au/publication/2013/11/better-equity.

3 Wallace, A & Holloway, L, *Cut Off III: The Social Impact of Utility Disconnection,* report prepared by Urbis for PIAC, 2013, 14, available at: http://www.piac.asn.au/publication/2013/04/cut-iii.

4 AER, above n 1, 11.

5 Ibid 13.

6 Ibid 18.

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Secondly, Bloomberg currently publishes two series of data, the Bloomberg Valuation Service (BVAL) curve and the Bloomberg Fair Value (BFV) curve. However, the Issues Paper notes that AER understands 'that Bloomberg intends to cease publishing the [BFV]', which the AER has used in previous determinations.[7] Bloomberg commenced publication of the BVAL curve in November 2013.[8] The Issues Paper further notes that longest term for which the BVAL curve is available is seven years[9] and that Bloomberg publishes BVAL estimates daily.[10]

These limitations mean that neither data source has the necessary features in its published form to fulfil the AER's requirements. This is because the AER's benchmark efficient firm is taken to issue ten year bonds, and the RoR Guideline proposes using a 'simple average of the prevailing rates observed over a period of ten or more consecutive business days.[11] Using either data set will, therefore, require some extrapolation (for BVAL) or calculating daily estimates based on the RBA's monthly data.

Given both data sets are extremely new, PIAC is hesitant to nominate one as preferred to the other. However, PIAC recommends that the AER not rule out the RBA data, based on the fact it does not provide daily estimates (a possibility that is considered in the Issues Paper[12]). As one of Australia's central bank, PIAC takes the view that the RBA is well placed to compile robust data on Australian financial market indicators.

Recommendation 1

PIAC recommends that the AER not rule out the use of RBA return on debt data due to the fact it contains figures for one day per month, rather than consecutive days.

Given both of the data sets discussed in the Issues Paper are relatively new, PIAC accepts that the AER's approach may need to evolve through the process of yearly updates to the return on debt for a given NSP. PIAC has been heartened by the AER's recent efforts to increase the rigour of analysis underpinning the regulation of NSPs and hopes that this will continue as the Better Regulation Guidelines come into effect throughout the National Energy Market.

Once again, PIAC thanks the AER for the opportunity to provide comment on the Issues Paper. If you would like any further information, please do not hesitate to contact me, or Oliver Derum, EWCAP Senior Policy Officer, on 02 8898 6518, or oderum@piac.asn.au.

Yours sincerely

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7 Ibid 13.
8 Ibid.
9 Ibid 15.
10 Ibid 18.
11 Ibid 19.
12 Ibid.