May 2018

Proposed amendments to the rate of return calculation process are a positive move.

Grattan Institute response to the COAG Energy Council's *Consultation on binding rate of return amendments,* Bulletin March 2018

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Summary points

- Elevating the framework for setting the rate of return that applies in determining the revenue of regulated electricity network and gas pipeline businesses will lead to a more effective and efficient overall process to the benefit of all stakeholders.
- The proposed amendments will deliver a more appropriate structural relationship between the Australian Energy Regulator (AER) and the key stakeholders, the regulated businesses and energy consumers. It may take experience of the new process to establish confidence with those stakeholders, particularly the businesses, but a less adversarial relationship would be a good outcome.
- There is compelling logic to a binding instrument that sets out a single approach to the calculation of rate of return parameters for all network businesses and is developed through a single process every four years.
- The proposed amendments should not lead to adverse outcomes for the businesses and should not reduce or eliminate appropriate access to judicial review of determinations by the AER.

1 The proposed amendments

This brief submission seeks to support the proposed amendments to the binding rate of return for regulated energy businesses. The amendments offer a clear and streamlined process that should provide greater certainty and efficiency for all stakeholders in the rate of return outcome.

The changes are significant and have understandably triggered concerns from the businesses. These seem to be around the process that led to the proposed amendments, the potential for inadequate review of decisions and, most strongly, an underlying lack of confidence in the AER. While these concerns should be acknowledged, the proposed amendments and the process therein, should address those concerns.

1.1 Elevating the process

A feature of determinations over recent years has been a process that creates an adversarial relationship between the regulated businesses and the AER from the beginning and that led to the Competition Tribunal being effectively the “independent” regulator. In our view this should have been neither the intent nor the result of the process.

The proposed amendments should establish a structure and process that aligns the relationship of the AER with the rightful interests of the key stakeholders, the regulated businesses and the consumers.

The role of the AEMC seems superfluous to the proposed process and therefore the removal of the related heads of power makes sense.

1.2 The instrument

The Bulletin proposes that the regulator will make an instrument that specifies the rate of return on capital and the value of imputation credits or the methodology to calculate the rate/value. An example of latter would assist with an assessment of the best approach. It is likely that key elements that contribute to the rate of return will vary within the four-period period. Therefore, a methodology may best be designed such that such external benchmarks can be automatically incorporated without subjecting the instrument to uncertainty or political intervention. This seems to be the intent as described in the Bulletin.

The Bulletin provides for single or separate instruments for electricity and gas. The nature of the issue suggests that a single instrument is appropriate and simpler.

1.3 Industry concerns

The regulated businesses and their industry association have raised concerns about the proposed amendments. These concerns partly relate to their equally strong concern with the removal of the Limited Merits Review. The key concerns seem to be:

- A lack of consultation with the development of the proposed amendments.
- The potential for ad hoc or ill-considered outcomes from the AER and a perceived weakening of access to judicial review.
- A deep lack of confidence in the capacity of the AER to make robust decisions consistent with the regulatory principles as prescribed by the NEO/NGO and NEL/NGL.

These concerns are partly addresses in the proposed amendments and the opportunity for consultation provided by the Bulletin. We do not share the businesses lack of confidence in the capacity or intent of the AER. The additional resources provided to the AER should assist with the quality of its review and decision-making. And, access to judicial review does not appear to be limited or undermined by the amendments.

1.4 The process

In the first instance, the NEO/NGO and the NEL/NGL should provide the high-level principles to guide the making of the instrument. The process as described seems to provide a clear pathway with appropriate checks and balances. The adoption of a consumer reference group and independent panel is consistent with that principle. However, it would be a good idea to specifically include the role of the regulated businesses in the process.

Recognition that failure to comply with a specific process requirement in every detail should not invalidate the validity of the instrument seems a practical safeguard. For example, there may be minor areas of inconsistency between the NGO/NEO and the NGL/NEL. However, it should equally be made clear that none of the proposed amendments removes access to judicial review. This is even more important with the removal of the Limited Merits Review from the regulatory process, a step that we strongly supported.

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