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12 September 2016

Mr Julian La Brooy
Advisor
Australian Energy Market Commission
PO Box A2449

SYDNEY SOUTH NSW 1235

Dear Mr La Brooy

RATE OF RETURN GUIDELINES REVIEW

I refer to the above review and present DBP's views on the proposal to shift the first review of the Rate of Return Guidelines from December 2016 to December 2018. DBP does not oppose the proposed change in date, and can see the logic of not reviewing Guidelines, particularly for the first time, in the midst of several Tribunal and Federal Court challenges concerning aspects of the decisions made under the Guidelines. However, noting that this is only proposed to be a one-off change with subsequent reviews to occur on the originally-proposed three yearly timeframe, DBP would urge the Commission to ensure this actually happens, and that future reviews are not delayed in the manner that this one has been. This is for the following reasons:

- As regulatory determinations are essentially an ongoing task, with one company or another facing a review almost every year, and since rate of return issues are invariably contentious, it seems unlikely that there will ever be a time where some form of challenge does not intersect with the proposed review timeframe. Additionally, in the event that some decision processes, currently in their early stages, subsequently result in challenges before the Tribunal or Federal Court in 2018, this should not result in further delay in respect of updating the Guidelines.

- Regulatory determinations occur once every five years in energy, meaning that if subsequent reviews are pushed back by two years (as this one is proposed to do) or we move to a five rather than a three-yearly cycle of reviews of the Guidelines, the same firms will be affected by having a decision at the same time as the review, and this is not fair on the companies concerned, or their customers.

In respect of your particular questions:

***The AEMC seeks stakeholder views on any potential benefits, costs and risks that the proposed solution carries*.**

The sole benefit of the change is to avoid the issue noted above of a Guideline review being undertaken at a time when several legal challenges are afoot. In respect of costs and risks, the major issue is that the 2013 Guidelines were written in a manner which delineated not only approaches, but also values for certain key parameters, such as the MRP and beta in the cost of equity. These have not been updated subsequently, even though market information has changed and, although it is open to the AER to depart from its Guidelines, it appears to favour giving each service provider the same number for key parameters. This introduces a degree of stasis into the rate of return which is arguably unhelpful if this stasis will now remain prevalent for another two years. It is worth noting that, in making the rule change that introduced the present version of Rule 87 (including the concept of the Guidelines and their regular review), one of the key objectives of the AEMC was to avoid such a stasis in circumstances where there were changes in the prevailing conditions for the markets for funds.

As the timeframe has been extended between reviews, it will be incumbent upon the AER to give more fulsome consideration to potential changes in parameters which it might have believed would remain relatively constant for three years at the time it made its Guidelines in 2013.

Additionally, the progress of determinations subsequent to the Guidelines has highlighted some gaps in the overall system. Most notably, the AER (unlike the ERA) did not include consideration of inflation as part of its Guidelines and this has become an issue in subsequent determinations, as well as the subject of challenge before the Tribunal. The AER has started to address the issue in its proposed amendments to its roll-forward model, but it arguably would have been more efficient to integrate this with a review of the rate of return guidelines, and the AER will now need to give consideration to how the two issues interact on different timeframes.

Neither of these issues necessarily change conclusions in respect of the merit of shifting the first review date, but they will need careful management by the AER, and point to the shift not being an entirely trivial issue.

The AEMC seeks stakeholder comment on these timing issues, including:
1. whether the timing issue is a significant issue for affected stakeholders and why; and
2. whether the proposed transitional provisions would be likely to address the issue.

DBP is not affected by the change in timing for the purposes of its next proposed 5 yearly review (due in 2020), and thus this is not an issue we wish to comment upon. If you have any further queries in relation to the points made above, please do not hesitate in contacting me.

Yours sincerely

Nick Wills-Johnson
Manager – Economic Regulation