



public interest
ADVOCACY CENTRE

**Submission to binding rate of return
amendments**

13 April 2018

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon disadvantaged and marginalised people. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales, developing policy and advocating in energy and water markets.

PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- St Vincent de Paul Society NSW;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association;
- Tenants Union; and
- Mission Australia.

Background

Consumer involvement in network revenue determinations in general

PIAC concurs with the AER's consumer engagement guideline that networks should "engage with their consumers so they can provide services that better align with consumers' long-term interests"¹.

In order to achieve this, consumer advocates are required to engage in network revenue determinations. Generally, this role is performed by jurisdictional consumer advocates and the nationally-funded Energy Consumers Australia (ECA).

However, there remains a large resource - and hence, information - asymmetry between consumers and networks. This asymmetry was demonstrated clearly in recent NSW LMR proceedings, where networks NSW paid legal costs in the vicinity of \$90 million,² compared with approximately \$500,000 spent by PIAC and ECA to fund consumer involvement in the process.³

This asymmetry is of particular concern when the AER and networks engage with consumers on highly technical and complex areas of network regulation, such as rate of return. These processes place extra burden on resource constrained consumer advocates, who may have to sacrifice competing important areas of work altogether to engage with these issues.

PIAC's involvement in NSW network revenue determinations in particular

PIAC has a long history of involvement in network revenue determinations and access arrangements in NSW. PIAC's Energy + Water Consumer Advocacy Program (EWCAP) has been funded by NSW Government consistently since 1998 and engages across numerous policy reform and regulatory processes, including NSW electricity network revenue determinations and gas access arrangements.

Currently, PIAC is involved in four pending and current AER determination processes for NSW networks:

- Remitted decisions for NSW DNSP 2014-19 determinations;
- TransGrid 2018-23 determination;
- NSW DNSP 2019-24 determinations; and
- Jemena Gas Network 2020-25 access arrangement.

In addition to EWCAP staff, PIAC's litigation team has been actively involved in the AER's determinations, including in challenges to these decisions through Limited Merits Review (LMR) and Judicial Review. PIAC was the first consumer organisation to be a participant in LMR proceedings in the Australian Competition Tribunal, as an applicant and intervener in the Tribunal's NSW proceedings. In addition, PIAC acted as a consumer observer and legal advisor

¹ AER, [Consumer engagement guideline for network service providers](#), 2013, 4.

² Sophie Li, "Public Interest Advocacy in the Australian Competition Tribunal" (2017) 87, *Australian Institute of Administrative Law Forum* 93, 101.

³ It should be noted that this figure includes the costs of PIAC's intervention in judicial review proceedings before the Federal Court. The figure consists of approximately \$300,000 in direct costs, including fees for legal counsel, and \$200,000 in internal costs. To our knowledge, the costs of Networks NSW involvement in the judicial review proceedings are not included in the estimate of \$90 million.

for other consumer organisations in LMR proceedings in South Australia and Victoria in 2016 and 2017.

Rate of return and consumer outcomes

The application of an accurate rate of return (RoR) is one of the most important elements of the revenue allowance calculation for consumers. It is highly material, as small differences in the allowed RoR make many millions of dollars difference annually to the revenues of networks and therefore the prices consumers pay for network services.

This is particularly relevant today, given the electricity prices paid by consumers have steadily increased, in real terms, since the 1990s,⁴ and affordability is a pressing concern for many households.

Furthermore, high rates of return provide an incentive for networks to over-invest and take advantage of that RoR, inflating the RAB and locking in higher than efficient network costs for decades.

The importance of RoR is demonstrated by number of appeals of the AER's RoR decisions. Before the abolition of LMR in 2017, almost all appeals through that mechanism addressed either weighted average cost of capital or gamma.

ARORO and the long-term interests of consumers

Despite the importance of RoR to consumer outcomes, the focus on RoR through AER determinations and subsequent appeals has largely been interpreting the allowed rate of return objective (ARORO), an inherently business-focussed aspect of the regulatory framework.

Because the ARORO is designed to ensure that networks are able to recover efficient financing costs, these processes have tended to focus on the business, potentially at the expense of consumer interests outlined in the National Electricity Objective (NEO), National Gas Objective (NGO) and revenue pricing principles.

While PIAC acknowledges that regulated entities should be able to recover efficient costs, we are concerned that debates over financing issues have taken up too much of the process. Given that higher returns to businesses always come at the expense of consumers, PIAC contends that this focus has been unhelpful in promoting the long-term interests of consumers.

Comments on the proposed amendment package

Allow the AER to focus on being an expert regulator rather than a legal regulator

PIAC supports the AER having flexibility and using its discretion to analyse the relevant market data and methods in setting the rate of return. More broadly, PIAC encourages the AER to approach its tasks and role as an expert regulator rather than a legal regulator. In the context of the rate of return, this would entail the AER using its full discretion in whatever ways would assist

⁴ Carbon + Energy Markets, [Australia's retail electricity markets: who is serving whom?](#), 2016.

it give primacy to the National Electricity Objective, particularly as it relates to price impacts on consumers over the longer term.

To this end, PIAC also supports the removal of the concept of an ARORO from the Rules. The ARORO is an inherently business-focussed concept. Past debates around the interpretation of this objective may have come at the expense of meeting the overarching and inherently consumer-focussed NEO and NGO.

Consumer engagement obligations

PIAC supports the proposed obligations in the NEL and NGL for consumer engagement in developing and reviewing the rate of return instrument. In particular, PIAC supports the obligation to establish a consumer reference group (CRG) and have regard to any advice, recommendations or submissions made by the group.

A well-functioning CRG will be an effective method for consumer advocates to provide meaningful input into the development of the rate of return instrument. However, in order for the CRG to be effective, it must also be appropriately resourced. Given the issues described earlier with consumer advocate resourcing and the asymmetry of information between consumer advocates and network businesses, PIAC considers that support to CRG members will need to include payment for time and funding for commissioned research.

As a member of the AER's CRG for the current review of the rate of return guideline, PIAC welcomes the AER's current funding and support. However, PIAC would welcome this support being formally recognised as part of the amendment package and the AER's budget being adjusted to reflect this.

PIAC is concerned by the possible interpretations of proposed clause s 18R in the NEL and s30M in the NGL, which states that "Failure to comply with this Subdivision does not invalidate or otherwise affect a rate of return instrument". PIAC does not consider the AER would forgo one or more of these obligations without reason to do so, but is of the view it would be better practice to state that the instrument would not be invalidated if the AER can demonstrate that in not complying fully with the Subdivision it is instead taking an approach that is in the long-term interests of consumers.

Support a more mechanistic application in network determinations

PIAC supports the implementation of a more mechanistic application of the rate of return for regulated businesses. As noted previously, the AER, networks, consumer advocates and other stakeholders have expended significant resources in debates around the correct interpretation of the Rules for setting the rate of return and the choice of data. Moving to a more mechanistic application of the rate of return will significantly reduce the burden on stakeholders at each network determination and free up resources for more meaningful engagement on other aspects of a network business' proposal.

Support the earliest application of the proposed instrument

PIAC supports the transitional provisions proposed for the first rate of return instrument. Ensuring the new rate of return instrument applies to determinations in April 2019 will bring forward the benefits to consumers from a more efficient rate of return and more affordable electricity bills.

Further engagement

PIAC thanks the Senior Committee of Officials for the opportunity to respond to the proposed amendment package, and would welcome the opportunity to discuss this important reform in more depth. Please contact:

- Miyuru Ediriweera, Senior Policy Officer, Energy and Water, at mediriweera@piac.asn.au or on (02) 8898 6525, or
- Craig Memery, Policy Team Leader, Energy and Water, at cmemery@piac.asn.au or on (02) 8898 6522.