

8 December 2017

Ms Kaye Johnston
Director, Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601



Dear Ms Johnston,

Discussion Paper on profitability measures for regulated businesses

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

PIAC welcomes the opportunity to respond to the AER's discussion paper on profitability measures for regulated gas and electricity network businesses.

Reporting on profitability is welcome and timely

The proposal to develop and publish profitability measures for the regulated network businesses is both welcome and timely. Given the contribution of network costs to the spiralling cost of energy, the ability to compare profitability between businesses and across the broader economy will provide important insight for the AER and other stakeholders. This information could be considered in various settings, including ongoing revenue determination processes for network businesses as well as the AER's review of its Rate of Return Guideline in order to ensure regulated businesses remain financially viable without excessively high profits at the expense of consumers.

It is essential that any measures remain appropriate for the industry and businesses to which they are applied while also being a useful guide for the AER and other stakeholders.

As the AER noted in its discussion paper, PIAC's concerns regarding the deficiency of the current Rules were exemplified in the 2014-19 revenue determinations for NSW distribution businesses where we stated that:

... the AER did not take sufficient note of the extraordinary profits that the regulated businesses were making under the regulatory arrangements; a fact that PIAC believes indicated gaps in the NER that may not be adequately addressed even under the new rules.¹

Developing and publicly sharing robust and transparent data on the profitability of regulated businesses will be a welcome step towards addressing this.

Question 1 – The preferred profitability measures

At this time PIAC is not able to comment on whether the AER's preferred measures for profitability are the most appropriate or whether there are other measures which may be more

¹ PIAC, *A missed opportunity? Submission to AER draft determination for Ausgrid, Endeavour Energy and Essential Energy*, February 2015, p. 36.

appropriate. However, the AER's preferred measures would be a positive step to increasing transparency of regulated businesses, which strongly PIAC supports.

PIAC also supports the use of several measures to capture the different aspects of a business' profitability rather than relying on a single measure.

PIAC recommends that, wherever possible, the AER, makes available the input data used to calculate the profitability measures. For instance, the Return on Assets can be affected by changes in both the return of a business or its Regulated Asset Base. Making this input data available will assist stakeholders to understand the reasons for changes over time and compare different regulated businesses.

PIAC also recommends the AER review the effectiveness of any profitability measures after implementation to ensure the measures remain useful to the AER and other stakeholders.

Question 2 – Assessment criteria

PIAC supports the assessment criteria used by McGrathNicol to assess the appropriateness of the profitability measures. It is essential any measures remain appropriate for the industry and businesses to which they are applied, while also being a useful tool for the AER and other stakeholders. In particular, PIAC strongly supports that the measures be easily understandable by those without a specialised financial background and do not require data manipulation or assumptions.

Question 3 – Required data to develop profitability measures

By providing clear and consistent directions for the businesses, the AER can ensure the profitability measures provide a transparent and effective tool in assessing the regulated businesses.

PIAC does not comment on the data required to develop the preferred profitability measures. However, PIAC stresses the need for the AER to provide and enforce clear accounting and preparation standards for the businesses in collecting and providing the data for these measures. As noted by the ENA regarding economic benchmarking:

... it is very important that the AER ensure that the definitions in the benchmarking RIN are clear and precise in order to ensure that data collected is consistent across NSPs and through time. Inconsistent interpretations of the data requirements across business would distort the results of any benchmarking models.²

The same is true for any data to be used to assess the profitability of regulated businesses. Inconsistency in data collection may, at best, lead to unnecessary confusion in interpreting the measures or, at worst, affect the validity of the measures altogether.

Question 5 – Consistency across sectors and segments

PIAC supports the AER developing measures which can meaningfully compare profitability across different parts of the energy sector along with other utilities and the broader economy. While we acknowledge the potential challenges in achieving this given the characteristics particular to regulated network businesses, this should not preclude the AER and stakeholders working to achieve this outcome. In the first instance, using multiple measures of profitability

² Energy Networks Australia, *Submission to AER economic benchmarking data templates*, August 2013.

rather than a single measure should assist the comparison of results across a broader number of businesses.

Question 6 – Reporting other financial measures

PIAC supports the AER considering other financial measures which may assist it and other stakeholders to assess the efficiency and appropriateness of regulated network revenue allowances and expenditure. However, at this stage, PIAC considers that profitability should be the primary metric.

Continued engagement

PIAC would welcome the opportunity to meet with the AER and other stakeholders to discuss these issues in more depth.

Yours sincerely,

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