SUBMISSION

CAPM & ALTERNATIVE RETURN ON EQUITY MODELS | 09 OCT 20

EUAA
Energy Users Association of Australia

Mr Warwick Anderson
General Manager
Network Finance and Reporting
Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

RateofReturn@aer.gov.au

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, food and materials processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and expect to see all parts of the energy supply chain making their contribution to the National Electricity Objective.

Our members are highly exposed to movements in both gas and electricity prices and have been under increasing stress due to escalating energy costs. These increased costs are either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items.

We have had the opportunity to extensively discuss our views on this matter with the Consumer Reference Group. This short submission summarises these views.

In summary we see no reason to change from the current approach of using the CAPM model as set out in the current rate of return guideline. As the Draft Working Paper says (p.2):

> "The CAPM is the preeminent model; it has a strong theoretical basis, is widely used by market practitioners, and is more reliable than any of the alternatives identified. This is reflected in its use by all international regulators reviewed—and for most, it is the only model used."

The model's robustness was confirmed in the Partington and Satchell report prepared for the AER. We were not convinced by the suggested changes discussed in the Brattle report.

While some flexibility is important for exceptional circumstances, good regulatory practice is built on consistency and predictability. Both investors and consumers place a high value on these system attributes. This starting point is that there must be a very good reason for change – the "bar" for change should be set relatively high to ensure that any change is enduring and unambiguously in the long-term interests of consumers. So that the transactions costs of the change do not swamp the proposed benefits and so that if unexpected adverse impact occurs in the future, there are still net benefits. We do not think this bar has been reached by those seeking change to the return on equity methodology.

As for the detailed issues:

Forward looking CAPM inputs - we are persuaded by Partington and Satchell on the limitations of the DGM in general and in particular to estimate the market risk premium so do not support its use; we also agree with the AER on the limitations of the Wright approach; on beta estimates we are persuaded by the Partington and Satchell view on the benefits of longer return periods and not using international firms as comparators.

Use of single or multiple models – we agree with the AER conclusion that the use of multiple models is difficult to justify; we agree with the Partington and Satchell conclusion on the limitations of using international comparators and hence they should not be used.

Do not hesitate to be in contact should you have any questions.

Sincerely,

Andrew Richards
Chief Executive Officer