



# Engagement Process for Independent Panel for Rate of Return Guidelines (2018)

21 June 2018

**Economic Regulation Authority**

WESTERN AUSTRALIA

## Economic Regulation Authority

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## Background

The Economic Regulation Authority (ERA) is currently undertaking a review of the gas rate of return guidelines.

The ERA originally published the guidelines on 16 December 2013. The guidelines detailed the method the ERA intended to use to estimate the allowed rate of return for gas transmission and distribution service providers.

The ERA is required to review these guidelines and produce a final version by 16 December 2018.

At present, the rate of return guidelines are not binding. However, the Coalition of Australian Governments' (COAG) Energy Council is currently developing a framework for a binding rate of return instrument. These reforms will have implications for the application of the rate of return guidelines to future determinations.

The Commonwealth Government's draft legislation to introduce the binding rate of return instrument introduces new consultation requirements for regulators.

In preparing its first rate of return instrument, the ERA will be exempt from the requirement to seek advice from a consumer reference group and is not required to seek advice from experts.

However, the ERA has to commission and consider a report by an Independent Panel in making the instrument.

This document explains how the ERA will engage an Independent Panel to review its guidelines.

The ERA is seeking interested and suitably experienced people to join the panel.

## Nominating interest

The ERA invites Stakeholders and interest parties to nominate potential panel members by **4:00 pm (WST) Friday 29 June 2018** via:

Online: [www.erawa.com.au/consultation](http://www.erawa.com.au/consultation)

Email address: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

Postal address: PO Box 8469, PERTH BC WA 6849

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# 1 Independent Panel review of draft guideline

1. As an independent regulator, it is the ERA's responsibility to ensure its decisions are well-reasoned and based on robust consultation.
2. The ERA aims to explain its decisions in a way that allows stakeholders to follow a clear chain of logic from evidence to decision.
3. The ERA recognises that there are times when an additional perspective on this process can provide stakeholders with further confidence in our decision-making.
4. Consistent with the draft legislation the ERA intends to establish an Independent Panel to review and report on its draft guideline.
5. In preparing its first rate of return instrument, the ERA had expected to be exempt from the requirement to establish an Independent Panel. Therefore, the ERA has not previously consulted on the establishment of and role of this panel.
6. In establishing the ERA's Independent Panel, the ERA has had regard to the Australian Energy Regulator's (AER) consultation process, stakeholder feedback and final positions.<sup>1</sup>

## 2 Independent Panel objective

7. The objective of the Independent Panel is to assist the ERA to make the best possible final guideline by providing an independent perspective on its development.
8. Forming the panel should also promote stakeholder confidence that the final guideline is capable of achieving the National Gas Objective.

### 2.1 What question will the panel be asked

9. The ERA will ask the Independent Panel to address the following question as part of its terms of reference.

In your view, is the draft guideline supported by sound reasoning based on the available information such that it is capable of promoting achievement of the National Gas Objective?

10. To answer this question the Independent Panel will:
  - produce a report on the draft guideline which the ERA will consider when making a final guideline; and
  - comment on the draft guideline, but will not be asked to propose its own alternative or amended guideline.

<sup>1</sup> AER, *Consultation paper – Process for reviewing the rate of return guidelines*, July 2017

AER, *Position paper – Review of the rate of return guidelines – Process for guideline review*, November 2017

11. The ERA recognises that in the AER's consultation process most stakeholders recommended that the panel should address the draft guideline itself and the evidence relied on, rather than being restricted to the process and explanation of judgements that leads to the draft guidelines.
12. The role of the Independent Panel is not to have a separate body proposing its own means of promoting the National Gas Objective. Having such a body would not promote the best regulatory process, and may not lead to better outcomes.
13. Estimation of the rate of return is complex and reasonable parties may differ about the specifics of estimation methodologies.

## 2.2 Factors to consider

14. The terms of reference will require the panel to consider the following factors:
  - the impact of the guideline as a whole rather than issue-by-issue analysis;
  - the revenue and pricing principles in the National Gas Law;
  - the rate of return provisions in the National Gas Rules;
  - the COAG Energy Council's ongoing reforms to implement a binding rate of return instrument;
  - whether the ERA has had regard to relevant information in reaching its conclusions;
  - whether there is a clear link between the ERA's conclusions and the information on which it relied;
  - whether, in the view of panel members, the methodology set out in the draft guideline will allow stakeholders to replicate the ERA's estimate at a point in time; and
  - interactions with other components of the ERA's regulatory determinations and the relevant rules affecting estimation of those components.
15. The AER's reasons for considering these specific factors are detailed in Table 1. The ERA supports these reasons.

**Table 1 AER reasons for the specific factors to which the panel should have regard**

Factor	Comments
The impact of the guideline as a whole rather than issue-by-issue analysis.	This will encourage the independent panel to engage with potential trade-offs and to focus on the overall achievement of the national gas objectives.
The revenue and pricing principles in the NGL.	These add some practical guidance for the panel in interpreting the balance to be struck in promoting achievement of the national gas objectives.
The rate of return provisions in the NGR. The panel should also have regard to any material reform underway.	While the NGO should most prominently guide the panel's thinking, it is important that the panel also has regard to the relevant rate of return provisions in the gas rules as they directly affect our decision-making.
COAG Energy Council's ongoing reforms to implement a binding rate of return instrument.	As part of the COAG Energy Council's proposed implementation of a binding guideline, there will need to be changes to the rules framework for estimating the rate of return. This is because the framework for the current non-binding guideline is specified within the national gas and electricity rules. When the independent panel has regard to the current rules framework, it should also have regard to whatever information is available about the framework that would result from the reform process.
Whether the ERA has had regard to relevant information in reaching its conclusions.	This is a typical requirement to assess the procedural fairness of a decision.
Whether there is a clear link between the ERA's conclusions and the information on which it relied.	Estimation of the rate of return is complex and reasonable minds may disagree on aspects of the guideline. As a result, it is critical that there is a clear chain of logic between information and conclusions. Stakeholders signalled at the AER's pre-issues paper forum that this was an important requirement to have confidence in the process.
Whether, in the panel's view, the methodology set out in the draft guideline will allow stakeholders to replicate the ERA's estimate at a point in time.	Linked to the above point, we consider stakeholders should be able to read the guideline and then replicate to a reasonable degree of accuracy our estimates at a point in time. This is important for transparency and predictability. Stakeholders signalled at the AER's pre-issues paper forum that this was an important requirement to have confidence in the process.
Interactions with other components of our regulatory determinations and the relevant rules affecting estimation of those components.	This is to make sure that any views from the panel are made in the context of the existing building block revenue framework and having reference to other relevant factors (for example, any methodologies defined in the binding Post Tax Revenue Model/Roll Forward Model methodologies).

Source: Adapted from AER, *Position Paper – Review of the rate of return guidelines – process for the guideline review*, November 2017, pp. 15-16.

## 2.3 Importance of National Gas Objectives

16. Under the current rules, the ERA sets the allowed rate of return to achieve the National Gas Objective and the allowed rate of return objective. In setting the allowed rate of return, we must also have regard to the revenue and pricing principles.
17. The National Gas Objective governs our regulatory determinations and has primacy, including over the allowed rate of return objective.
18. The allowed rate of return objective is a rate of return commensurate with efficient financing costs and the risks involved in providing energy network services.



19. The panel's deliberations should primarily be the National Gas Objective with reference to the revenue and pricing principles. The ERA views this as appropriate because:
- the National Gas Objective is the overarching objective for the natural gas regulatory framework;
  - a focus on the National Gas Objective and the revenue and pricing principles will still engage with key concepts required to promote the allowed rate of return objective; and
  - the draft binding rate of return legislation will change the rules framework for estimating the rate of return (including the removal the allowed rate of return objective), however, the National Gas Objective will remain unchanged.

### 3 Selection of panel members

20. The ERA will commence identifying and contacting potential panel members following the release of this paper.
21. The ERA will use the attached terms of reference as a guide to the expected role of the panel.
22. The ERA will select the panel members.
23. Where stakeholders wish to recommend an individual, they should do so confidentially to avoid creating difficulties for those nominated in case they are either unavailable or ultimately not selected.
24. The skills and background the ERA is seeking are described below.
- Finance and/or economic experience will assist the panel to understand the technical aspects of the guideline development process.
    - It is not the role of the panel to substitute for or duplicate the input of the experts. Rather, the panel will consider whether the ERA's decisions in the draft guideline are based on sound reasoning.
  - Experience with the regulation of utilities, with public policy and/or in oversight bodies.
  - Consumer perspectives are important to have on the panel, as the objective of the regulatory framework is to promote the long term interests of consumers.
  - Institutional investment experience overlaps to a degree with having a finance and/or economic background. However, it is desirable, if possible, to also have panel members with investment experience to assist the panel to evaluate whether the methodology is sufficient to promote investor confidence and efficient investment.

25. In selecting panel members, the ERA will consider the following factors:
- The ERA will seek to establish a panel representing a range of backgrounds, however, the final make-up of the panel will depend on the availability of suitable panel members.
  - Panel members should not have been engaged to provide advice in any ERA and AER regulatory determination processes in the previous two years. Similarly, panel members should not have participated in or presided in Australian Competition Tribunal proceedings within the preceding two years.
  - Panel members should be available for 10 weeks following the commencement of the panel.
    - The ERA will only engage panel members with suitable availability over the duration of the report's preparation.
    - The ERA does not expect that independent panel members will work full time over the 10 weeks, but we will aim to engage panel members for the equivalent of 1 full day per week.
    - The Chair will be allocated a notional 15 days over the 10 week period.
26. The ERA will aim to appoint three panel members to capture a range of relevant experience.

## 4 Independence and transparency

27. The ERA recognises the importance of the panel being independent in its deliberations.
28. To give stakeholders confidence of this, clear mechanisms to preserve independence and ensure transparency of the panel are necessary. These are particularly important as the ERA will fund participation of Independent Panel members.
29. To ensure the independence and transparency of the panel's review the following steps will be taken:
- The ERA will engage the panel using a published terms of reference.
  - The ERA will not engage panel members who have provided advice to the ERA and AER or other stakeholders as part of a regulatory process within the past two years. This extends to members of the Australian Competition Tribunal.
  - Any interactions between the panel and the ERA will be documented and published on the ERA's website.
  - The panel will have responsibility for drafting its own report, which will be published in full (subject to a confidentiality check) on the ERA's website. The ERA expects panel members to strive to reach consensus, but will not restrict panel members from expressing differences within the report if that is the ultimate view of the members.

## 5 Administrative arrangements

### 5.1 Length of panel participation

30. The ERA will convene the Independent Panel as soon as possible. The draft guideline is scheduled to be released in late June or early July 2018.
31. The panel process will run for 50 business days following the commencement of the panel.
32. In choosing this window, the ERA is aiming to balance:
  - allowing the panel sufficient time and flexibility while working part-time to engage with the draft guideline; and
  - providing sufficient time after completion of the panel's report for the ERA to engage fully with the panel's findings before making the final guideline.

### 5.2 Access to information

33. The Independent Panel will have access to all information considered in the development of the draft guidelines.
34. The panel will be asked to sign confidentiality undertakings in order to view any confidential material considered in making the draft guideline.
35. The ERA will undertake a confidentiality check of the Independent Panel's report prior to its release to prevent the release of any confidential material.

### 5.3 Independent Panel's report

36. The Independent Panel will detail its findings in a report which the ERA will publish on its website.
37. The ERA will consider the Independent Panel's report when making our final guideline.
38. The panel's findings will not be binding. The Independent Panel's Report will be an important and useful source of evidence for the ERA when preparing the final guideline.
39. We expect the panel's report to be an important addition to the body of evidence provided through the submission process.

# ATTACHMENT 1

## Terms of reference for the Independent Panel

### Background

The ERA will publish a draft rate of return guideline which sets out the methodology the ERA will use to estimate the rate of return in its revenue determinations for gas pipeline service providers.

This guideline will be made under a framework set out in the National Gas Law and the National Gas Rules. The overall objectives of the frameworks are set out in the National Gas Objectives:<sup>2</sup>

*The objective of this law is to promote efficient investment in, and efficient operation and use of, natural gas services for the long term interests of consumers of natural gas with respect to price, quality, safety, reliability and security of supply of natural gas.*

### Task

In your view, is the draft guideline supported by sound reasoning based on the available information such that it is capable of promoting achievement of the National Gas Objective?

In your review, please have regard to the following factors:

- the effect of the guideline as a whole rather than issue-by-issue analysis;
- the revenue and pricing principles in the National Gas Law<sup>3</sup>;
- the rate of return provisions in the National Gas Rules;
- the impact of the COAG Energy Council's ongoing reforms to implement a binding rate of return instrument;
- whether the ERA has had regard to relevant information in reaching its conclusions;
- whether there is a clear link between the ERA's conclusions and the information on which it relied;
- whether, in the panel's view, the methodology set out in the draft guideline will allow stakeholders to replicate the ERA's estimate at a point in time; and
- interactions with other building block components and the relevant rules affecting estimation of those components.

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<sup>2</sup> National Gas Law, s. 23.

<sup>3</sup> National Gas Law s.24.

Please set out your conclusions in a publishable report that will be available to all stakeholders via the ERA's website. Where the panel does not agree on conclusions or recommendations in the report, the report should set out the range of final views by panel members without specifically attributing them to individuals.

### **Information**

To assist in your review, you will have access to all source material available to the ERA in making its draft guideline, including but not limited to:

- submissions;
- independent expert reports;
- underlying datasets; and
- relevant calculations or models.

The panel is also able to ask questions of the ERA or stakeholders.

The panel should take minutes of meetings with the ERA or other stakeholders so that these can be published on the ERA's website subject to the ERA undertaking confidentiality checks.

### **Timing**

The report is due no later than 50 business days following the commencement of the panel.

### **Secretariat support**

The panel will have access to secretariat support from ERA staff with respect to organising meetings, document templates, publication of the report, office space (where necessary) and IT support.

However, drafting of the report will be the panel's responsibility.

### **Confidentiality**

Independent panel members will be required to sign a confidentiality undertaking with the ERA to allow access to confidential and proprietary information.

Five business days prior to the publication of the report on the ERA's website, the panel will provide the ERA with the final report for confidentiality checking. The ERA will confirm any suggested redactions with the panel prior to publication.