

17 March 2014

Lyndon Rowe
Chairman
Economic Regulation Authority
Level 4, Albert Facey House
469 Wellington Street
Perth WA 6000

Dear Lyndon

Rate of Return Guidelines – Meeting the Requirements of the National Gas Rules

ATCO Gas Australia makes the following specific points in relation to the Rate of Return Guidelines (the Guidelines) published by the Authority on 16 December 2013, as part of its submission of the fourth revision to the access arrangement for reference services for the Mid-West and South-West Gas Distribution Systems (Network).

Rule 87 of the NGR was amended substantially with effect from November 2012 following a rule change determination by the AEMC initiated by rule change requests submitted by the AER to the AEMC in November 2011.

ATCO Gas Australia, amongst others, lodged detailed submissions and engaged closely in both the AEMC rule change consultation and the Authority's subsequent Guidelines consultation processes¹.

In respect of the function of the Guidelines, ATCO Gas Australia's position has been and remains that rule 87 of the NGR requires that the Guidelines are to set out:

- (a) the methodologies (including the financial models, estimation methods, market data and other evidence that will be used) that the Authority proposes to use in estimating the allowed rate of return (rule 87(14)(a) of the NGR); and
- (b) the way in which the Authority intends to apply those methodologies in the determination of a return on equity and a return on debt in a way that is consistent with the allowed rate of return objective of rule 87 (3) of the NGR (rule 87(14)(a) of the NGR).

The central provisions of the NGR² concerning the Guidelines are set out in rule 87 (13) of the NGR and following.

¹ see ATCO Gas Australia submissions dated 13 March 2013 (*Guidelines for the Rate of return for Gas Transmission and Distribution Networks*); 7 October 2013 (*Draft Rate of Return Guidelines*); and 19 November, 2013 (*Development of the rate of return Guidelines*)

² National Gas Rules (Version 19)



Rule 87(1) of the NGR sets out that the rate of return is to be determined in accordance with rule 87 of the NGR. Rules 87(2) to (12) of the NGR prescribe the parameters by which the rate of return is to be determined, none of which refers to the Guidelines.

Rule 87 (13) (requiring the Authority to make and publish rate of return guidelines), rule 87 (14) (prescribing certain matters that the guidelines must set out) and rule 87 (15) requiring that rate of return guidelines must remain at all times “in force”) of the NGR all prescribe Guidelines requirements that the Authority must meet.

Rule 87(18) of the NGR expressly provides that the Guidelines are not mandatory and do not bind the Authority (or anyone). Further, if the Authority makes a decision “that is not in accordance with” the Guidelines, the Authority (not the Applicant or any other person) must state in its reasons for that decision, the reasons for departing from the Guidelines. Given the language used in rules 87(13) to (19) of the NGR, the Guidelines do not have the status of binding directions of the kind otherwise provided for in rules 87(1) to (12).

Rules 87(1) to (12) define the legal requirements for the assessment of the rate of return. The Guidelines may be referred to and used in order to assist that determination, but they are not binding on anyone and cannot, as a matter of established legal principle³, be inconsistent with the requirement of rules 87 (1) to (12).

There is a clear difference between a rule which treats a position set out in a guideline as prima facie correct unless disproved (a “threshold” approach), and one which requires that the right outcome be achieved and if that involves departure from a Guideline, it is to be explained (an “objective” approach). The language of rule 87 of the NGR does not support a “threshold” approach and is clearly in terms of an “objective” approach.

The “objective” approach is reflected in the language of rule 87 of the NGR which sets out that if the Guidelines prescribe an outcome which is inconsistent with that required by rules 87 (1) to (12), the Guidelines must fall away. Rule 87 (18) of the NGR does not impose an onus on anyone to displace the content of the Guidelines, but only that if there is to be a departure from the Guidelines, the Authority (not the applicant or any other person) must state the reasons why.

Where an applicant puts in issue a particular methodology or value identified in the Guidelines, there is no requirement in rule 87 of the NGR for such a departure to be justified on the basis of fresh material or some new event. Rule 87(18) focusses not on the establishment of evidence justifying departure from the Guidelines, but the mere fact of a decision which is not in accordance with the Guidelines. The decision itself is governed by the criteria prescribed in rule 87(1) to (12) of the NGR.

In summary:

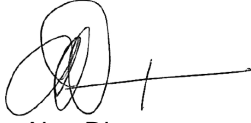
1. The Guidelines are non-binding statements of policy;
2. Applicants may put in issue particular items within the Guidelines, but are not required to justify their approach on the basis of new evidence or events;
3. If there is to be a departure from the Guidelines, the Authority (not the applicant or any other person) must state the reasons why; and
4. In assessing and making its determination of the rate of return, the Authority must make such determination in accordance with the requirements prescribed in rule 87 (and in particular rule 87 (1) to (12) of the NGR) by applying those methodologies in the determination of a return on equity and a return on debt in a way that is consistent with the allowed rate of return objective of rule 87 (3) of the NGR.

For the reasons set out in the accompanying submissions, ATCO Gas Australia considers that the ERA’s Rate of Return Guidelines fail to meet the requirements of the NGR in a number of respects. ATCO Gas Australia’s rate of return proposal has been prepared in accordance with the requirements of the new rate of return framework and is supported by

³ see *Gerah Imports v Minister for Industry Technology and Commerce & ors* (1987) 17 FCR 1; (1987) 14 ALD 351 – (ALD at 359); *Kahn v Minister for Immigration and Ethnic Affairs* (1987) 14 ALD 291

independent expert evidence. ATCO Gas Australia otherwise relies on its rate of return submissions set out in the accompanying Access Arrangement Information.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Alan Dixon', with a long horizontal stroke extending to the right.

Alan Dixon
President
ATCO Gas Australia Pty Ltd