6 November 2020

Mr Warwick Anderson
General Manager, Networks Finance and Reporting
Australian Energy Regulator

Sent via email to: InflationReview2020@aer.gov.au

Dear Mr Anderson,

Submission to Regulatory treatment of inflation – draft position paper

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 people who are marginalised and facing disadvantage. 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 draft position paper.

In order to ensure fair and efficient outcomes, PIAC considers that risk should be borne by those parties who are best able to manage that risk. Consumers are not well-placed to manage inflation risk and this must be reflected in how regulatory inflation is treated.

PIAC considers that any change that materially shifts the risk (either the quantum of the risk or the circumstances under which a risk may eventuate) between consumers, businesses and investors must be backed by thorough modelling showing how this is in consumers' interests.

Inflation estimate term

PIAC does not support changing to a (typically) 5-year term over which to estimate expected inflation. We consider the current approach remains appropriate (using a 10-year period to match the inflation estimate term with the term of the rate of return estimate).

We note concerns have been raised that the current approach can result in a mismatch between the expected inflation removed from the nominal return (based on a 10-year term) and the RAB indexation (based on a 5-year term). PIAC does not consider this warrants changing the inflation estimate term, as the AER has noted in the draft position paper:

> Over the longer-term our current approach will result in unbiased and correct outcomes because in the long-run we consider expected inflation remains anchored to the midpoint of the RBA target band.[1]

An important feature underlying many aspects of the regulatory framework for network businesses is that, while there may be small deviations of mismatches in particular aspects or from year to year, there is no structural bias inherent in the framework (i.e. swings and roundabouts). We are concerned that moving to a 5-year term at this point may introduce a structural bias against consumers' interests.

1 AER, *Regulatory treatment of inflation – draft position paper*, October 2020, 47.

Level 5, 175 Liverpool St
Sydney NSW 2000
Phone: 61 2 8898 6500
Fax: 61 2 8898 6555
www.piac.asn.au
ABN: 77 002 773 524

Glide-path

PIAC supports the AER's proposed use of a glide-path from the year 2 estimate to 2.5 percent in year 5. We also consider it appropriate that it be symmetric and enduring. As the AER notes, the method will be an improvement on the current approach during periods of sustained high or low inflation and will be a minimal change from the current approach during normal circumstances.

Timing of implementation

PIAC recommends the AER introduce these changes in parallel with any changes arising from the upcoming review of the Rate of Return Instrument. Given the interactions and inter-relations between the treatment of inflation and the rate of return, aligning implementation should help consider the issues more holistically and avoid unintended consequences.

Continued engagement

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

Yours sincerely,

Miyuru Ediriweera
Senior Policy Officer, Energy and Water
Public Interest Advocacy Centre

Direct phone: +61 2 8898 6525
E-mail: mediriweera@piac.asn.au