

**Electricity Market Advisory Services**

**Report for Energy Consumer Australia's  
Submission to the AER's Draft Decision on the  
2026 Rate of Return Instrument Review**

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July 2026

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## Executive summary

This report sets out our assessment of the Australian Energy Regulator’s Draft 2026 Rate of Return Instrument (RoRI) Explanatory Statement. Our conclusions are that the AER should, among other things:

- Adopt a lower equity beta, which would see NSP returns adjusted down by at least three times the \$1.1 billion identified by the AER;
- Reconsider the use of a five-year term for the risk-free rate;
- Demonstrate how the outcomes from the Inflation Rate Variation (where return on debt is adjusted by actual inflation) are consistent with the trailing average portfolio return on debt (TAPRD) framework and clause 9 of the RoRI.

### *Summary of the Draft Decision*

The Draft Explanatory Statement (“Draft Decision”) makes three changes to the RoRI: a decrease in the equity beta from 0.6 to 0.55; a decrease in the MRP from 6.2% to 6.1%; and an increase in the value for imputation credits from 57% to 58%.

The effect of these changes on the WACC can be calculated by using market parameters from a February regulatory decision for Basslink, which indicates the post-tax nominal WACC would have been 6.19% instead of 6.32%. The reduction is mostly caused by the equity beta change, which lowers the WACC to 6.21%; the change to the WACC caused by the new MRP and imputation credits is responsible for a 0.02 percentage point reduction, with the imputation credit change partly offsetting the MRP change.

### *Overall assessment of the Draft Decision*

Our overarching concern with the Draft Decision is that two important parts of the Revenue and Pricing Principles are not being met:

- NSPs are being provided with the opportunity to recover revenues that persistently and structurally exceed the efficient costs the operator incurs (7A(2)).
- Actual returns are not “commensurate” or proportional to the regulatory and commercial risks associated with the services to which the charge relates (7A(5)). Instead, NSPs have been substantially over-compensated for regulatory and commercial risks.

In defending its Draft Decision, the AER states that ‘we consider the 2022 RoRI has generally *performed well* and has *supported the long-term interest* of consumers and represents a balanced outcome – the overall rate of return [set in the 2022 RoRI] reflects a balanced

assessment of data, modelling and stakeholder views, *and avoids outcomes that favour either service providers or consumers* (our emphases).<sup>1</sup>

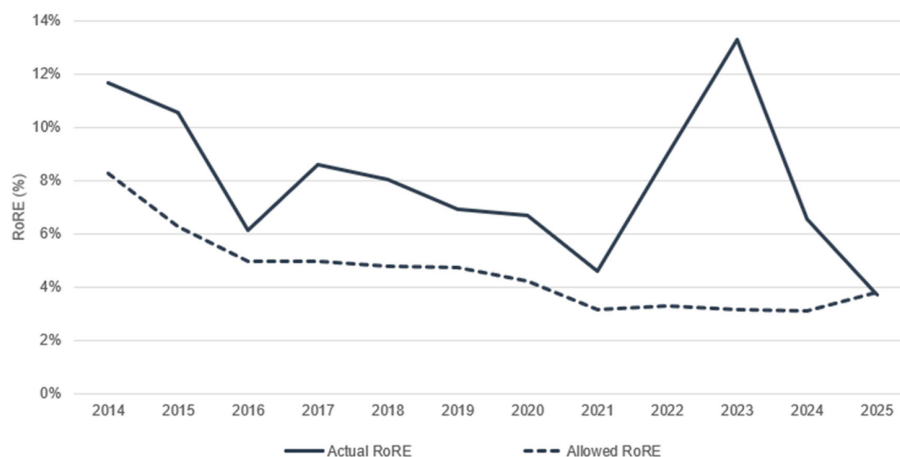
The AER has not engaged with the reasons why NSPs continue to outperform their regulated returns on equity and has dismissed the outcomes shown in the 2025 NSP performance report, which was released just before the previous round of submissions were due. Instead, the AER concludes:

*Taken together, this evidence suggests that the differences between actual RoRE and allowed returns largely driven by features of the regulatory framework and prevailing economic conditions, rather than necessarily reflecting systematic overestimation of the allowed rate of return. Consistent with the approach taken in the 2018 and 2022 RoRI reviews, we consider that historical profitability has limitations as a basis for assessing the forward-looking rate of return.*

The AER does not substantiate this claim, and the Eligible Expert Group does not provide an opinion on this claim. It cannot be the case that outperformance over the period from 2014 to 2024, as shown in Figure 1, reflects a situation where the RoRI is unbiased, or as stated by the AER, has generally *performed well* and has *supported the long-term interest* of consumers.

FIGURE 1 ACTUAL COMPARED TO ALLOWED RETURN ON REGULATED EQUITY

Figure 5-6 Actual compared to allowed real RoRE - electricity NSPs



Source: Network performance report 2026, AER.

A key premise in the AER's assertion that the RoRI is unbiased is its view that the impact of the IRV on the return on regulated equity (RORE) is outside the scope of the RoRI review.<sup>2</sup> Most RoRI stakeholders and the Eligible Experts do not appear to appreciate the relationship

<sup>1</sup> RORI Draft Decision page 15.

<sup>2</sup> RORI Draft Decision page 136

between the return on debt as defined in the RoRI and the impact of the IRV in the AER's network performance reporting of its percentage RoRE metric. For this reason, we consider it important to explain in detail in this report the relationships between: the IRV, the Trailing Average Portfolio Return on Debt (TAPRD, specified in the RoRI) and the RoRE.

#### *The relationship between the IRV and the RoRI TAPRD*

In clause 9 of the 2022 RoRI, the AER defines a 10-year Trailing Average Portfolio Return on Debt. The TAPRD is applied in the Post Tax Revenue Model (PTRM) to set forward revenue and price paths over a regulatory control period.

In setting the allowed return on debt in annual pricing resets, the AER does not apply the RoRI TAPRD. Instead, it applies what it calls the 'IRV'<sup>3</sup> to the return on debt, which it says reflects 'prevailing economic conditions.'<sup>4</sup>

Take for example the spike in inflation to 7.8% in 2022. The inflation-adjusted nominal weighted average cost of capital (WACC) for 2023-24 was substantially increased from the previous year. As a result of the 7.8% inflation adjustment, each NSP's portfolio of debt for FY 2023-24 was upwardly repriced and no longer reflects the expected inflation rates when each tranche of their debt portfolio was financed and priced. The allowed cost of debt substantially exceeded the actual cost of debt.

The IRV from the TAPRD is equivalent to retrospectively changing the yields of the entire portfolio of debt. In its network performance reporting, the AER describes the gain to equity holders under the percentage RoRE metric from this mechanism the 'inflation rate variation' – IRV.

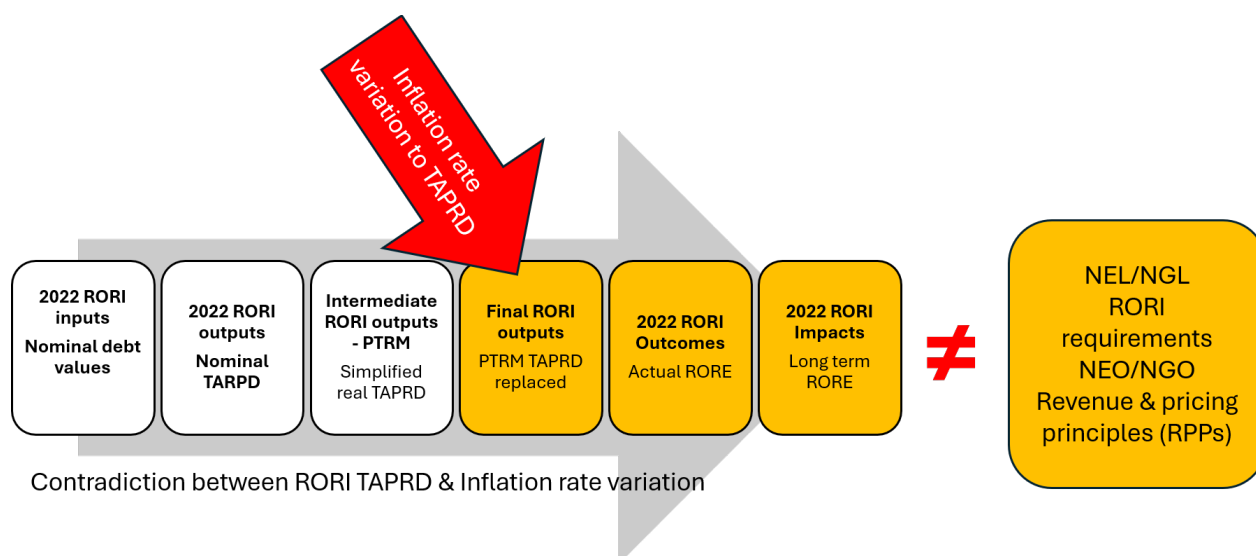
In RoRI program logic terms, the decision to reprice the entire TAPRD from the IRV comes out of leftfield, as illustrated in Figure 2 below.

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<sup>3</sup> RORI Draft Decision page 133

<sup>4</sup> RORI Draft Decision page 155

FIGURE 2 IMPACT OF INFLATION RATE VARIATION ON RORI PROGRAM LOGIC



When the allowed cost of debt varies materially from the actual cost of debt, then the actual RoRE increases (or reduces) from the allowed percentage RoRE. This mechanism is a major contributor to RoRI impacts that have not been consistent with the revenue and principles and the NEL/NGL.

The AER position in the 2026 Draft RoRI Decision is that any change to address the divergence from the TAPRD, caused by the IRV, must await a discretionary AER initiated review of inflation.<sup>5,6</sup>

Figure 1 shows that allowed and actual RoRE converged for 2024-25. This is not typical.

Looking ahead to 2027-28, the IRV is likely once again to diverge from the TAPRD due to inflation associated with the Iran war.

The RORI should be changed so that the AER has both the legal authority and a clear obligation to ensure the IRV no longer creates windfall gains or windfall losses. This change will ensure that regulated returns remain aligned with the actual risks faced by the operator and that the operator has a reasonable opportunity to recover its efficient costs.

A head of power may be required in the event otherwise desirable options for removing the IRV may contradict existing national electricity and gas rules regarding the build-up of allowed revenues and prices. The existence of a head of power in the RoRI could avoid any need for a separate rule change process and the associated delays.

<sup>5</sup> RORI Draft Decision page 136

<sup>6</sup> Since the NEL amendments creating the RORI in 2018, three RORI reviews have been initiated and two completed. There has been one AER initiated review of inflation, in 2020.

### *Retention of the uniform TAPRD*

The Draft Decision to retain the uniform TAPRD addresses two concerns we highlighted in our previous report. The first concern is that a move to a weighted TAPRD could lead to an increase in prices for consumers, all else being equal, because high interest rates are given more weight than low interest rates. This is due to the observation that capex tends to be higher when interest rates are high and lower when interest rates are low.

The second concern is that a switch to a weighted TAPRD would be unfair to consumers. After the TAPRD was introduced, interest rates trended down and consumers therefore paid more than they would have paid if the prevailing approach had continued. Now that interest rates have stabilised and the TAPRD is starting to trend up, a change to a weighted TAPRD would remove the benefit that consumers would otherwise have received by continuing with a uniform TAPRD.

If in the final decision the AER decides to reverse its draft decision and adopt a weighted TAPRD, consumers should be compensated for the change through a one-off adjustment to NSP RABs.

### *Equity beta*

The equity beta decision is the midpoint of a range from 0.4 to 0.7 that includes as an upper bound a value calculated from international comparators, even though the AER concludes

*the relative merits of using domestic data ... outweigh those of using international data at this time. (page 2)*

The reason the international comparators are irrelevant is that they include firms with characteristics that are dissimilar to those of a regulated monopoly Australian NSP, which is AER acknowledged by the AER:

*Moreover, as discussed earlier, international equity beta estimates do not correlate well with domestic estimates. This suggests that international data may only be of limited value as an indicator of the current market conditions faced by Australian NSPs. (page 38)*

The draft decision on equity beta is difficult to follow because the reasoning does not appear to support the conclusion. The AER states that it has placed limited weight on international comparator evidence, yet the final equity beta estimate appears to have been significantly influenced by that evidence. We recommend the AER revise this section to clearly explain how the evidence supports its conclusion. As currently drafted, the decision gives the impression that the AER has been reluctant to move far from an equity beta of 0.6, despite evidence that supports a much greater reduction.

Based on its own evidence, the AER would determine an equity beta range of 0.4 to 0.56, even though we consider the upper value is based on irrelevant comparators. Nevertheless, a mid-point of this range would be 0.48 and the post-tax nominal WACC would be 6.00% rather than the 6.19% implied by the draft decision.

Instead of receiving the \$1.1 billion saving identified by the AER, consumers would benefit by more than \$3 billion as a result of this equity beta change.

#### *Addressing stakeholder feedback*

Lastly, the AER has set aside, or not responded to, substantive points raised in submissions, including ours, that need to be addressed. The AER is required to have regard to CRG and stakeholder consultation feedback and we look forward to seeing these addressed in the Final Decision.

## **1 Introduction**

The focus of this report is on the aspects of the AER's draft decision that we consider have an adverse effect on the long-term interests of consumers. We note, but do not disagree, with the decisions on MRP, imputation credits and the form of the portfolio trailing average return on debt (PTRD). However, our focus is on the issues of more significance for consumers, which are:

- The lack of performance-based analysis of the outcomes of 2022 RoRI, and the reasons why the RoRI settings resulted in out-performance by the NSPs.
- The reasons why our recommendation to specify that the return on debt provided to NSPs as the PTRD without having it re-priced for actual inflation was considered not to be a RoRI matter.
- The reasons why the method we recommended to be used to establish the equity beta, which accounts for relevant international comparators, and which results in an equity beta below 0.5, was not considered as part of the Draft Decision.

This report discusses each of these issues in turn.

## 2 General assessment of the AER's draft decision

### 2.1 Introduction

This chapter sets out our high-level assessment of the Australian Energy Regulator's (AER) Draft 2026 Rate of Return Instrument Explanatory Statement (henceforth 'Draft Decision'). In our assessment, the Draft Decision is inconsistent with the statutory requirements under the National Electricity [Gas] Objective (NEO) (7), the revenue and pricing principles (RPP) (s.7A), and the requirement that the '*AER may make an instrument only if satisfied the instrument will, or is most likely to, contribute to the achievement of the national electricity objective to the greatest degree.*' (s.18I(3)).

This chapter finds that the AER's claim that 2022 RoRI outcomes are consistent with the NEL/NGL is not based on evidence or a sound interpretation of the NEL/NGL RoRI requirements. This can be seen under a counterfactual scenario under which the definition of the return on debt in clause 9 of the 2022 RoRI (and the 2018 RoRI) had been amended and been applied without delay in regulatory determinations from around 1 July 2022.<sup>7</sup>

### 2.2 Major elements in the Draft Decision

The AER states that 'Most positions remain unchanged [from the 2022 RoRI] and underpin our draft decision for the 2026 RoRI...' The AER finds that retaining these positions is consistent with all statutory requirements.

The Draft Decision makes three substantive adjustments to the 2022 RoRI:

- The equity beta is reduced from 0.6 to 0.55.
- The MRP is reduced from 6.2% to 6.1% from within an unchanged range of possible estimates.<sup>8</sup>
- The value for imputation credits (gamma) is increased from 0.57 to 0.58.

There is also a technical adjustment to the choice of third-party yield data providers.

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<sup>7</sup> This date is selected to highlight the impact of clause 9 on returns over FY 2023 and 2024 under the counterfactual as defined.

<sup>8</sup> RORI Draft Decision page 4.

The combined effect of the proposed changes is estimated by the AER to deliver an aggregate reduction in regulated revenues of around \$1.1 billion. This is via regulatory determinations to be set using outputs from the 2026 RoRI, all else being equal.<sup>9</sup>

### **2.3 Evidence and reasoning for retaining most 2022 and earlier prevailing RoRI outputs**

In defending its proposed decision to retain all other major parameters from its 2022 RoRI, the AER applies a standard performance evaluation framework. It states that ‘we consider the 2022 RoRI has generally *performed well* and has *supported the long-term interest* of consumers, based on the following observations, [inter alia...]

- Broad stakeholder confidence – *stakeholders have generally accepted the RoRI outcomes, with limited calls for changes to the framework*
- Strong development process – the RoRI was developed through a transparent and *evidence-based process, drawing on detailed modelling, expert advice...*
- Balanced outcome – the overall rate of return [set in the 2022 RoRI] reflects a balanced assessment of data, modelling and stakeholder views, *and avoids outcomes that favour either service providers or consumers.* (our emphases).<sup>10</sup>

The Draft Decision provides no evidence for its assertion that the 2022 RoRI outputs avoid outcomes that favour either network service providers (NSPs) or consumers. The AER’s assertion that the 2022 RoRI is neutral between NSPs and consumers is not supported by specific expert evidence in the 2026 Eligible Experts’ report.

The evidence and analysis in the Eligible Experts report addresses parameter estimation and methodology. No empirical testing of AER assertions regarding the neutrality of RoRI outcomes is provided.

Contrary to the NEL, the AER did not have regard to extensive evidence provided in the Consumer Reference Group (CRG) report and stakeholder submissions including from ECA, ACOSS, JEC and IEEFA that more material changes from the 2022 RoRI are required to avoid a continuation of outcomes that are heavily biased in favour of service providers.

### **2.4 Recap of performance evaluation for Commonwealth agencies and programs**

The central claim in support of its conclusion that almost all outputs from the 2022 RoRI should be retained is that returns under the 2022 RoRI are unbiased or neutral between NSPs and

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<sup>9</sup> RORI Draft Decision page 9.

<sup>10</sup> RORI Draft Decision page 15.

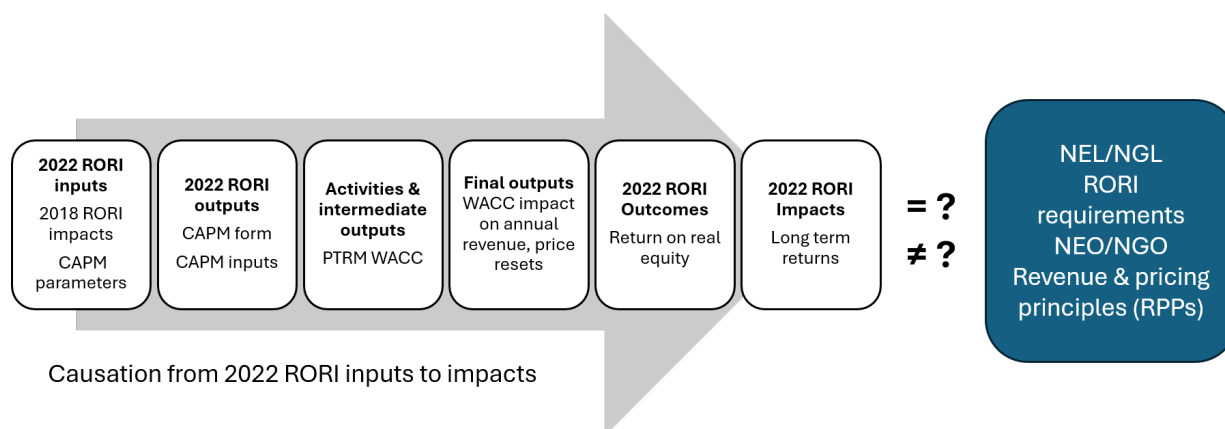
customers. It therefore appears that the AER is applying a standard performance evaluation approach to the 2022 RoRI.

We agree a performance evaluation approach is a valid and relevant approach to decision making on changing or retaining various aspects of the 2022 RoRI in the 2026 RoRI review. A performance-evaluation framework sets out how any agency measures whether a regulatory intervention – in this case the 2022 RoRI – is achieving its intended outcomes. It uses a structured causal and logic chain or ‘program logic map’ that links inputs through to final impacts.

The Commonwealth Evaluation Policy applies to the AER (via the ACCC) under the Public Governance Performance and Accountability Act 2013. In applying the Evaluation Policy to the 2022 RoRI, the additional requirements for the RoRI under the NEL and NGL, which are State and Territory not Commonwealth statutes, must also be applied. This is also consistent with the cyclical approach to economic regulation set out in various AER decisions on the ‘Better Regulation’ package adopted from around 2014 when the major elements of the current RoRI methodology were adopted.

As illustrated in Figure 3, Figure 3 Program Logic Map for 2022 RoRI a standard program logic map can be applied to the RoRI. Impacts from the 2022 (and 2018 RoRI that continued to prevail)<sup>11</sup>, can then be compared with the relevant statutory objectives for the RoRI over the relevant timeframes. The evidentiary question for the 2026 RoRI review is whether 2022 RoRI outcomes and impacts are consistent with the NEL/NGO requirements, and specifically the revenue and pricing principles (RPPs).

FIGURE 3 PROGRAM LOGIC MAP FOR 2022 RoRI



<sup>11</sup> There were very limited changes to the RORI between the 2018 and 2022 reviews, so to the extent the 2018 RORI was still in force post 2022, the discussion of impacts from the 2022 RORI remains valid.

Consistent with the logic map above, the 2026 RoRI draft decision highlights the sensitivity of RoRI outputs for network revenues and prices, and high impact of small changes to RoRI outputs.

*The rate of return is a key driver of network revenues and, ultimately, prices paid by consumers. Small changes in the rate of return or its methodology can materially affect both consumers and regulated businesses. The National Electricity Law (NEL) and National Gas Law (NGL), therefore, require the AER to review and make the RoRI every four years through a structured and transparent process. ...This approach is intended to support a robust, evidence-based outcome and effective stakeholder engagement.<sup>12</sup>*

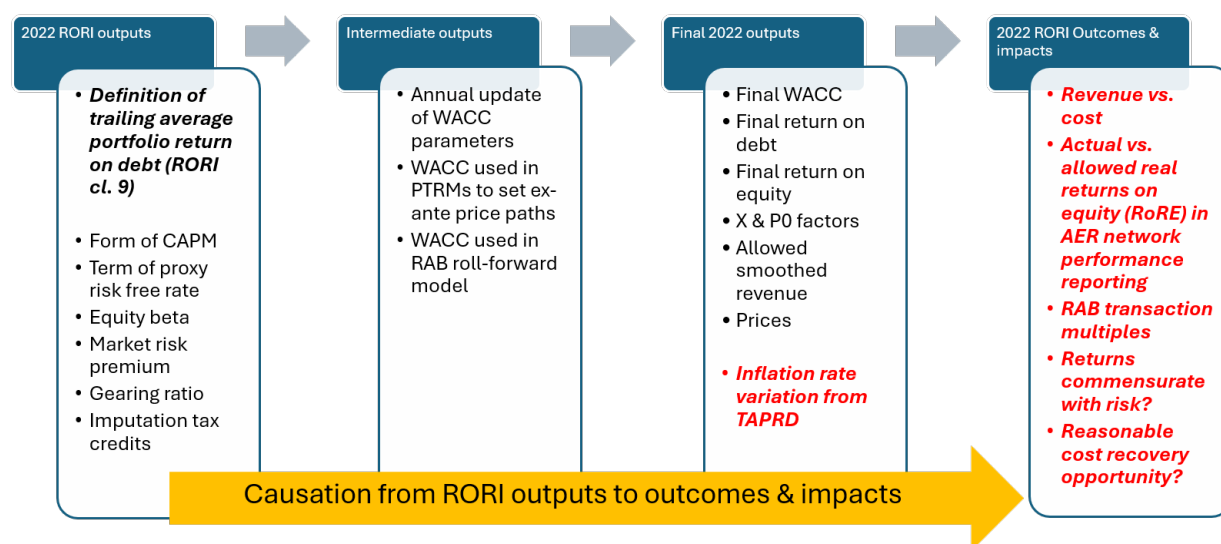
The AER acknowledges the causal connection from 2022 RoRI outputs and final outcomes (revenues and prices) and impacts for NSPs and consumers that are comparable with the RPPs.

## 2.5 2022 RoRI impacts must be evaluated against RPP and a counterfactual

In assessing 2022 RoRI impacts, it is important to identify a counterfactual or ‘what if?’ case where one or more significant outputs in the 2022 RoRI had been varied. For reasons that will become clear, we propose to define a counterfactual 2022 RoRI in relation to the application of the TAPRD, under section 9 of the RoRI, instead of the IRV from the RoRI.

In line with the program logic map in Figure 3, Figure 4 summarises the causal connections between the 2022 RoRI outputs and RoRI outcomes and impacts.

FIGURE 4 CAUSATION FROM 2022 RoRI OUTPUTS TO OUTCOMES AND IMPACTS – HIGHLIGHTING IMPACT OF IRV FROM TAPRD



<sup>12</sup> RoRI draft decision explanatory statement page 6.

Under the defined counterfactual, clause 9 of the 2022 RoRI is applied instead of the inflation rate variation. This change then flows across to the italicised variables to final RoRI outputs and subsequent outcomes and impacts.

With this approach, it is now possible to make an evidence-based assessment of whether the 2022 RoRI has generally *performed well* and has *supported the long-term interest* of consumers, including by *avoiding outcomes that favour either service providers or consumers*.<sup>13</sup>

Specifically with reference to the RPP, it is also possible to make assessments as to whether 2022 (and earlier) RoRI outcomes are consistent with:

- ‘A price or charge for the provision of [regulated network services] allows for a return commensurate with the regulatory and commercial risks associated with [the services] to which that price or charge relates’ NEL cl. 7A (5)
- ‘A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs...’ NEL cl. 7A(2)

## **2.6 Acknowledged limitations of historical network performance reporting**

The EMAS Report for Energy Consumer Australia’s Submission to the AER 2026 Rate of Return Instrument Review,<sup>14</sup> December 2025 discussion on 2022 RoRI outcomes was limited by the fact that the AER released its 2025 network performance report after analysis for the EMAS report had been completed, and shortly before the deadline for submissions to the 2026 RoRI review issues paper and eligible experts’ report closed. With the release of the 2026 network performance report in June 2026, there is more data from which to compare 2022 RoRI impacts with the RPPs.<sup>15</sup>

Before discussing the historical network performance data, there are two major limitations that need to be considered when assessing RoRI outcomes relative to the RPPs.

- Network performance reporting does not directly measure the impact of over-estimating the equity beta input on RoRI and subsequent revenue and pricing outputs. This is because the “allowed” RoRE metric includes any excess returns from over-estimating the equity beta.

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<sup>13</sup> RORI page 15.

<sup>14</sup> See [ECA - Attachment - EMAS Report for Energy Consumer Australia’s Submission to the AER 2026 Rate of Return Instrument Review - December 2025 | Australian Energy Regulator \(AER\)](#)

<sup>15</sup> Some impacts over the period since the 2022 RoRI was finalised may relate to the 2018 RoRI. Nevertheless, the impact analysis remains valid because there were limited changes between the 2022 and 2018 RoRI.

- The actual RoRE metric appears to be unable to distinguish between RoRE that is realised in a given year, on the one hand, and RoRE that accrues in the form of deferred returns.

Regarding the first factor above, if the proposed 2026 RoRI decision to reduce the equity beta input from 0.6 to 0.55 were applied retrospectively to the period since 2026, then the gap between allowed and actual RoRE is significantly greater than that shown in network performance reporting.

Regarding the second factor above, as discussed in EMAS 2025<sup>16</sup>, we agree with the AER interpretation that the spike in reported accrued RoRE over FY2022-2024 shown in AER reporting had only a limited impact on cash RoRE over those three years. It appears most of the cash impact is deferred.

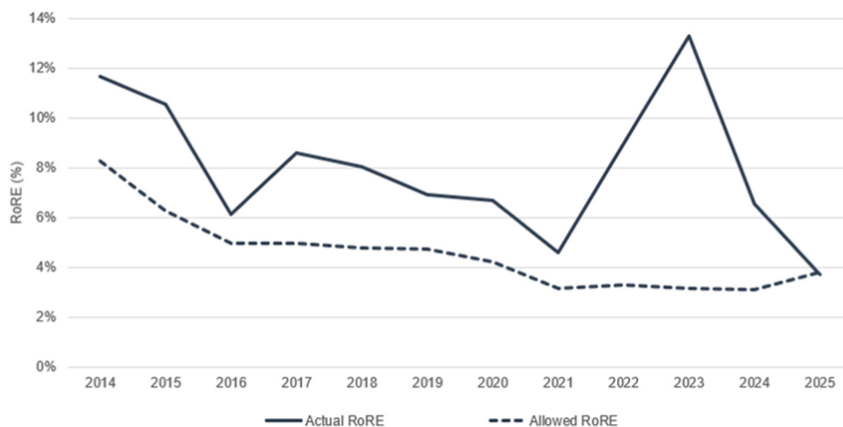
The delay between the accrued and cash impact of 2022 RoRI outcomes following the 2022 inflation spike does not invalidate the comparability between RoRI outcomes and the RPPs. The RoRE metric is therefore directly relevant to the AER's assertion that RoRI outcomes in favour of service providers have been avoided.

## 2.7 Testing the AER's claim the 2022 RoRI delivered neutral outcomes

With these qualifications, we now turn to the empirical evidence to test the AER's claim. Figure 5 below reproduces Figure 5.6 of the Network performance report 2026.

FIGURE 5 ALLOWED VS. ACTUAL RoRE

Figure 5-6 Actual compared to allowed real RoRE - electricity NSPs



Source: Electricity financial performance model. Note: Financial performance numbers are nominal. The weighted average RoRE is calculated by multiplying an NSP's real RoRE by the proportional size of the regulated equity of each NSP's sector.

<sup>16</sup> See Report to Energy Consumers Australia, EMAS, December 2025

Over the 12-year historical reporting period, actual RORE exceeded allowed RORE by a substantial margin.

There is a structural and persistent bias in favour of service providers, and this is causally related to RoRI outputs. While there are some important differences in the causes of RORE “outperformance” for gas NSPs, similar trends are also evident in the implementation of the RoRI for gas NSPs.<sup>17</sup>

Even where there are variations between the accrued “actual” RoRE outcomes shown here and deferred actual and cash RoRE impacts inclusive of the unrealised gains from outperformance on the RoRE metric, revenue and price impacts are clearly not neutral. As discussed in Section 3.4 the apparent convergence for 2025 is atypical and unlikely to be repeated over the foreseeable future.

## **2.8 Basis for AER finding that RoRI impacts are consistent with statutory requirements**

All financing related outcomes from RoRI outputs affect the financing cost building blocks “below” the earnings before interest and tax line used for the return on assets (ROA) metric. The AER asserts that the bias in favour of NSPs in its reported RORE do not reflect flaws in the 2022 RoRI outputs or the decision to apply an IRV instead of the TAPRD specified in the RoRI.

*‘Taken together, this evidence suggests that the differences between actual RoRE and allowed returns largely driven by features of the regulatory framework and prevailing economic conditions, rather than necessarily reflecting systematic overestimation of the allowed rate of return. Consistent with the approach taken in the 2018 and 2022 RoRI reviews, we consider that historical profitability has limitations as a basis for assessing the forward-looking rate of return.’<sup>18</sup>*

In this paragraph, the term ‘prevailing economic conditions’ refers to the IRV. The “spike” in returns in 2023 and its moderation in 2024 is evident. As shown in Figure 8 below, applying the IRV instead of the TAPRD is the major but not sole driver of the divergence between allowed and actual RoRE shown in Figure 5.

In the next chapter, we detail the mechanism by which the allowed return on debt materially changes from applying the IRV instead of the RoRI TAPRD.

The AER asserts that long term NSP returns are neutral (“unbiased”) between NPSs and customers.

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<sup>17</sup> See for example figure 5.8 of the Network performance report 2026.

<sup>18</sup> RORI Draft Decision page 155

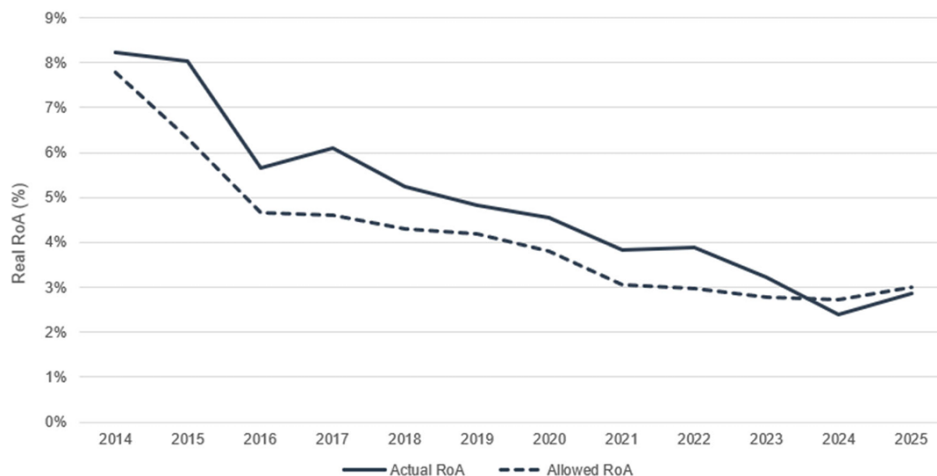
*‘...realised returns [under the 2022 and previous RoRI] vary over time and are influenced by a range of outcomes beyond the allowed rate of return. These include revenue adjustments, incentive schemes outcomes, opex and capex performance, capital structure, cost of debt and IRV.’<sup>19</sup>*

This statement appears difficult to reconcile with the evidence from AER network performance reporting that capital structure, cost of debt and the IRV are directly influenced by prevailing RoRI outputs and implementation decisions, and that the bulk of variations between the allowed and actual RoRE relate to RoRI outputs, not outcomes beyond the scope of the RoRI.

This can be seen by comparing the return on real equity impacts in Figure 5 with the Return on Assets (RoA) metric shown in Figure 6 from the AER’s 2026 NSP performance report.<sup>20</sup>

FIGURE 6 NETWORK PERFORMANCE REPORTING – RETURN ON ASSETS METRIC

**Figure 5-1 Actual compared to allowed real RoA - electricity NSPs**



Source: Electricity/Gas financial performance model, allowed real rate of return - PTRM 'WACC' sheet. Note: Financial performance numbers are nominal. Calculation details are in the profitability model and RoA explanatory note published alongside this report. The weighted averages are weighted by the RAB/CAB of each NSP.

The RoA metric captures any variations in returns attributable to revenue adjustments, incentive schemes, opex and capex performance and depreciation.<sup>21</sup> The RoA metric excludes the impact of variations in financing costs captured by the RoRE metric arising from RoRI outputs. Decisions regarding RoRI outputs are the major cause of actual RoRE exceeding allowed RoRE over the 12-year period.

<sup>19</sup> RORI Draft Decision page 133

<sup>20</sup> See AER Electricity infographic – from its 2025 electricity and gas networks performance report, December 2025

<sup>21</sup> See Figure 5-4 on page 71 of the AER’s Network performance report 2026 for details of the AER’s estimated contribution of factors below the EBIT line – gearing, cost of debt and IRV.

## **2.9 Limitations of Eligible Experts report relative to claim 2022 RoRI is unbiased**

The empirical question for testing the reasonableness of AER decision making over the 2026 RoRI is whether the revenue and pricing outcomes are unbiased between service providers and consumers. It is significant that the Eligible Experts' report for the 2026 RoRI review did not test or validate the AER's neutrality claim regarding outcomes from the 2022 RoRI.

The focus of the Eligible Experts' report is on how different RoRI input parameter choices affect efficiency and consumer outcomes in a general sense. Professor Partington is the only Eligible Expert to acknowledge the existence of network profitability reporting.

However, Professor Partington's discussion is qualitative rather than quantitative. There is no comparison of allowed vs. actual returns, or whether outcomes fall within a reasonable band defined in the 2018 RoRI review. He does not undertake any causal analysis or statistical testing required to support AER claims regarding the neutrality of 2026 RoRI outcomes. His discussion misses the fact the 'IRV' in AER's profitability arises from the return on debt under the IRV instead of the TAPRD in the 2022 RoRI.

## **2.10 Other relevant information not considered**

The AER unreasonably rejected evidence on outcomes that returns to equity holders under the 2022 RoRI outputs are strongly biased in favour of service providers. The ratio of actual-to-allowed equity returns (profit multiple) is well outside the accepted 0.9 to 1.3 range under effective incentive regulation.<sup>22</sup>

In discussing RAB multiples, the 2026 Draft Decision states:

*Overall, our further investigation leads us to conclude that the current and expected rates of return are at least sufficient, as part of the overall regulatory compensation to investors, and that the allowed return has not been below investor expectations. However, in view of the limitations with this type of analysis, we do not consider the evidence is sufficiently strong to make an adjustment to the position we have reached in our consideration of individual parameters.*

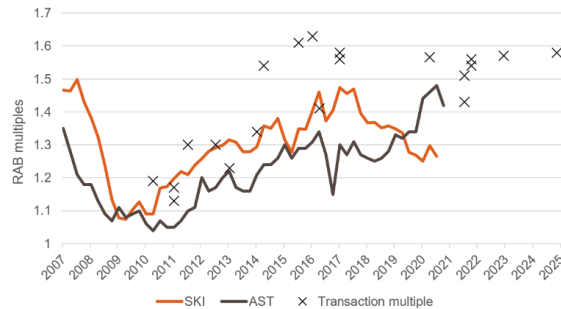
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<sup>22</sup> See 'Understanding the role of RAB multiples in regulatory processes', Darryl Biggar, 20 February 2018

## FIGURE 7 RAB MULTIPLES

These transactions imply RAB multiples of around 1.57x for Endeavour Energy and 1.58x for Transgrid. These estimates are materially above the range of 0.9x–1.3x identified in 2018.<sup>297</sup>

Figure 14.1 AER regulated networks – transaction and trading multiples



Source: Morgan Stanley Research; AER analysis.  
 Note: These values have not been adjusted for factors that may drive RAB multiples above 1. SKI is Spark Infrastructure and AST is AusNet Services.

Figure 7 shows transaction multiples much greater than the accepted range under incentive regulation. This outcome does not reconcile with the AER’s conclusion that returns are neutral between suppliers and customers.

### 2.1 The impact of the counterfactual in evaluating 2022 RoRI performance

For the reasons discussed in the following section, under the counterfactual discussed earlier, the gaps between allowed and actual RoRE would not have arisen. This is because, in the performance of its regulatory functions, the AER would have applied the RoRI in setting allowed RoRE, not the IRV.

Note that, even under the counterfactual where the IRV does not apply, there may be room for debate as to whether RoRI impacts are consistent with the RPP. This reflects the persistent positive contribution to actual RoRE exceeding “allowed” RoRE because of other factors including: the equity beta, the term of the risk-free rate, the cost of debt (other than due to cl. 9 of the RoRI) and gearing.

### 3 Inflation and the return on debt

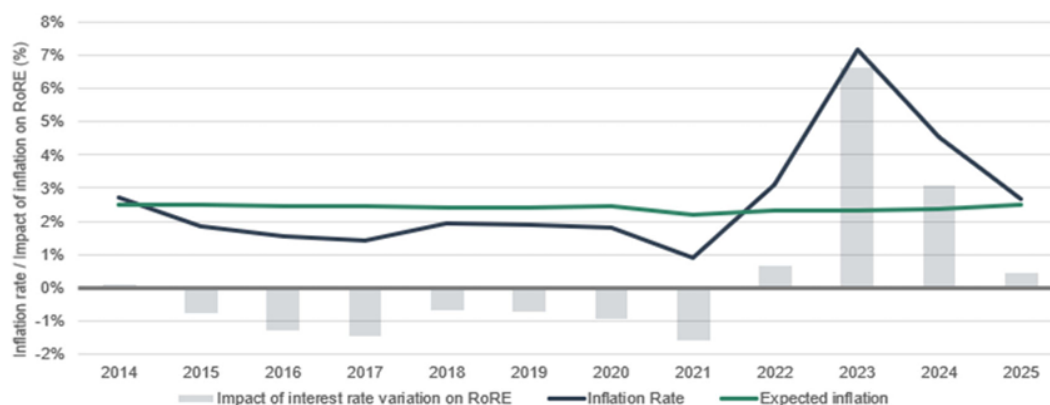
#### 3.1 Introduction

Most RoRI stakeholders and the Eligible Experts do not appear to appreciate the relationship between TAPRD as defined in the RoRI and the IRV impact on percentage RoRE in network performance reporting. This is evident in the discussion at the 22 June 2026 Public Forum regarding “windfall” losses and gains between a simple or weighted TAPRD. This section explains why evidence on the return on debt is relevant to the 2026 RoRI and that the 2026 RoRI review must prevail over any discretionary AER initiated review of the regulatory treatment of inflation.

Regarding the impact of the IRV on RoRE outcomes, this is reported by the AER in Figure 8 below.

FIGURE 8 IMPACT OF IRV ON THE RoRE METRIC

**Figure 5-5 Impact on real RoRE from inflation rate variation - electricity NSPs**

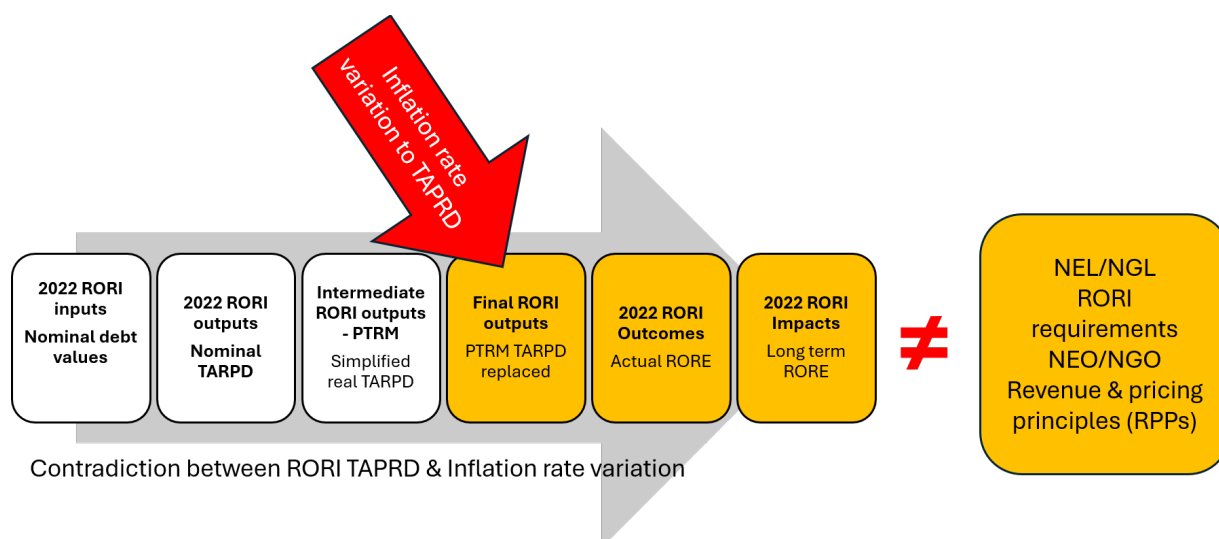


Source: AER Network performance report, 2026

Figure 8 shows that, before 2023, there was a sustained period of seven consecutive years where the IRV reduced positive gaps between actual and allowed RORE shown in Figure 5.

The RoRI program logic map in Figure 4 is illustrated in Figure 9 below.

FIGURE 9 IMPACT OF 'REGULATORY TREATMENT OF INFLATION' ON RoRI OUTCOMES



The AER's position is that network performance data, and specifically the percentage RoRI metric, cannot be used to evaluate the 2022 RoRI because the observed spike in Network RoRE, especially in FY 2023, is a product of the AER's 2020 review of the regulatory treatment of inflation, and not a RoRI impact. It considers the impact of inflation to be beyond the scope of the 2026 RoRI review and any change to the regulatory treatment of inflation must await a discretionary AER review.<sup>23</sup> We disagree for the reasons set out below.

### 3.1 Do discretionary AER initiated inflation reviews prevail over the RoRI?

Since the NEL amendments creating the RoRI in 2018, the RoRI has force of law (NEL18G). The 2022 RoRI is binding on the AER in relation to the performance or exercise of an AER economic regulatory function or power (NEL18H).

The AER can make a 2026 RoRI 'only if satisfied that the RoRI will, or is most likely to, contribute to the [NEO/NGO] to the greatest degree.' (NEL18I(3)). The RoRI must include a weighted average of an allowed return on equity and an allowed return on debt (NEL18I(4)). In doing so, it must have regard to the revenue and pricing principles (NEL18I(5)).

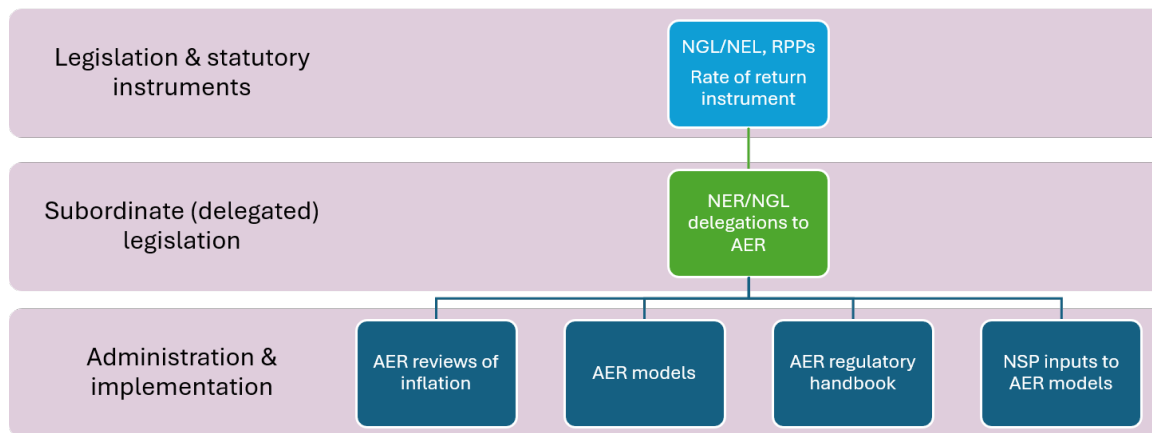
Three RoRI reviews have been initiated and two completed. Over the same time there has been one AER initiated review of inflation, in 2020.<sup>24</sup>

The status of RoRI relative to any AER initiated review of inflation, and indeed the inflation rate variation from the RoRI, is represented in Figure 10.

<sup>23</sup> RoRI Draft Decision page 136.

<sup>24</sup> See AER - Final position paper - Regulatory treatment of inflation - December 2020.

FIGURE 10 STATUS OF RoRI vs. AER INITIATED REVIEWS OF INFLATION



It therefore appears that the RoRI prevails in the event of any conflict with decisions emanating from periodic regulatory treatment of inflation reviews initiated by the AER from time to time. This highlights the need for the AER to demonstrate that its decisions on the IRV are consistent with clause 9 of the 2022 RoRI.

### 3.2 The relationship between the IRV and the RoRI TAPRD

Clause 9 of the 2022 RoRI defines a 10-year TAPRD. The TAPRD is applied to debt inputs in the Post Tax Revenue Model (PTRM) to set forward revenue and price paths over a regulatory control period.

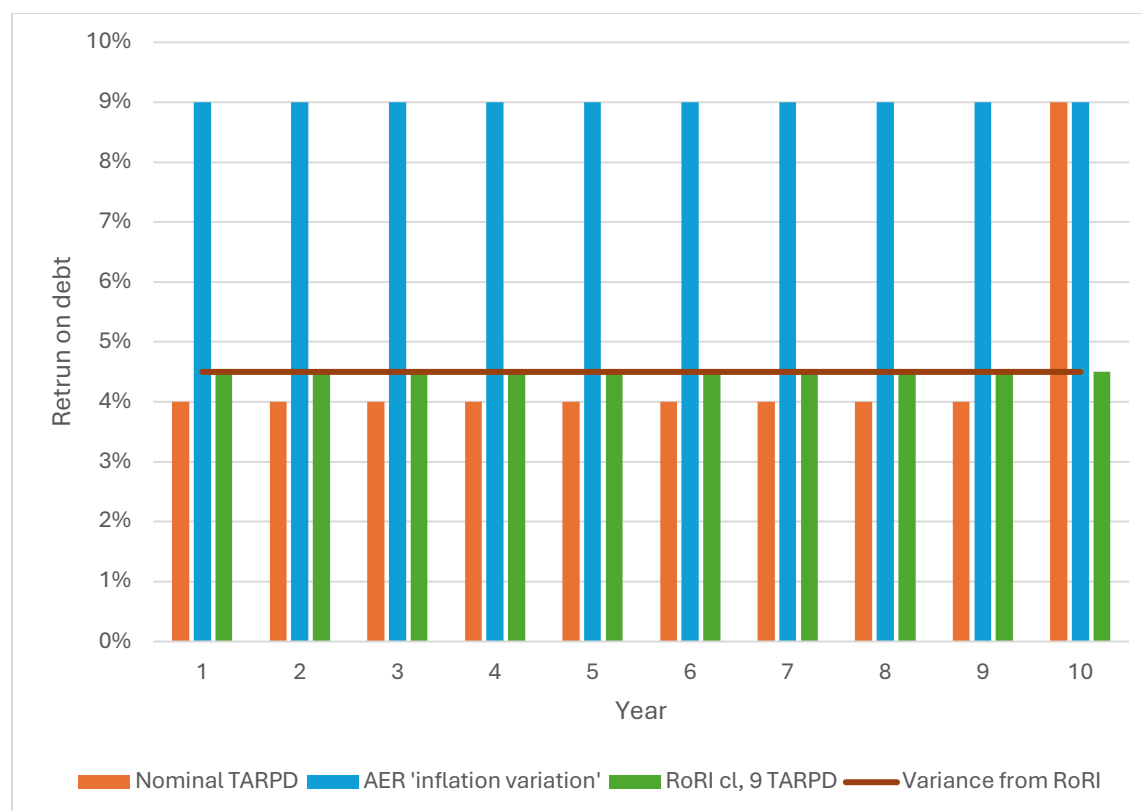
It appears that the ‘Inflation rate variation’ (IRV)<sup>25</sup> or ‘prevailing economic conditions’<sup>26</sup> modify the allowed return on debt relative to the outcome that would arise under the TAPRD framework alone. The impact of the IRV for the “spike case” in year 10 is illustrated in Figure 11.<sup>27</sup>

<sup>25</sup> RORI Draft Decision page 133

<sup>26</sup> RORI Draft Decision page 155

<sup>27</sup> For simplicity, a uniform nominal cost of debt is applied over years 1-9 in the above example, whereas Figure 8 shows a run up in the nominal inflation adjustment before the inflation spike in 2023.

FIGURE 11 IRV IMPACT ON ALLOWED DEBT FINANCING COST (INFLATION SPIKE CASE)



Instead of adjusting for the 7.8% inflation outturn (orange bars) only for year 10 (green bars), it appears the return on debt over the previous 9 years is repriced retrospectively, resulting in return on debt denoted by the blue bars.

With these simplified inputs, in this example, the allowed ROD used to set revenues and prices is 9% instead of 4.5%. The variance is 4.5%.

Figure 12 provides a typical example of how the 7.83% spike in inflation in 2022 was applied in the AER's pricing model for 2023-24.

FIGURE 12 EXAMPLE OF ADJUSTMENT TO NOMINAL WACC

#### AER pricing model - Ergon Energy 2023-24

[Back to Index](#)

##### Financial

Inputs the WACC, x-factors, allowed revenues, and annual adjustments

| Input table 3   Financial information |      | Source   | Unit    | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---------------------------------------|------|----------|---------|---------|---------|---------|---------|---------|---------|---------|
| Real vanilla WACC                     | PTRM | Per cent | General | 3.46%   | 3.43%   | 3.40%   | 2.40%   | 2.24%   | 2.18%   | 2.26%   |
|                                       |      |          |         | 1.48%   | 1.91%   | 1.78%   | 1.84%   | 0.86%   | 3.50%   | 7.83%   |
|                                       |      |          |         | 4.99%   | 5.40%   | 5.24%   | 4.28%   | 3.12%   | 5.75%   | 10.27%  |

The 7.83% inflation resulted in a very large adjustment to nominal WACC in 2023-24 to 10.27% (inclusive of a 3.7% increase in the Real WACC from 2.18% to 2.26%) from 5.75% the previous year.<sup>28</sup>

If the IRV is applied to the entire cost of debt in the final WACC, then the AER implicitly assumes:

- all term debt is floating, or
- all debt is refinanced annually, or
- past yields are irrelevant once inflation deviates from forecast.

If so, these assumptions may not be consistent with:

- the trailing-average method in the RoRI,
- the definition of the benchmark efficient entity,
- classical finance, or
- the AER's own stated debt-portfolio model

### **3.3 Are gains and losses from the IRV an efficient allocation of risk?**

In the 2026 Draft RoRI Explanatory Statement, the AER reproduces a paragraph from the 2025 network performance report arguing that NSPs bearing risk from actual inflation varying from expected inflation is an efficient risk allocation because 'NSPs have greater resources or ability than consumers to mitigate against variations from expected inflation.'<sup>29</sup> It is possible that AER may consider that over time IRV impacts are symmetrical and hence neutral between NSPs and customers over time.

In 2022, the IRV to the TAPRD worked in favour of NSPs while in 2020 (and indeed over seven consecutive years before then) the IRV worked in favour of consumers. Applying the values in Figure 9, it is possible to estimate the dollar impacts of the IRV from the TAPRD in each year for which there is RORE data. This is shown in

Table 1 below.

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<sup>28</sup> Note the apparent anomaly that the IRV impact in public AER pricing models occurs a year later than the impact in network performance reporting of the RoRE metric. The reasons for this timing difference is not explained in the RoRE methodology appendix to network performance reports.

<sup>29</sup> RORI Draft Decision page136

TABLE 1 INDICATIVE DOLLAR IMPACT OF INFLATION RATE VARIATION TO TAPRD 2015-2024

| Impact of Inflation Rate Variation to the TAPRD | \$2025 Billion |
|-------------------------------------------------|----------------|
| Benefit to customers before 2022 (7 years)      | \$2.6          |
| Benefit to networks from 2022 (3 years)         | \$4.6          |
| Net impact – net gain for NSPs over 10 years    | \$2.0          |

Source: EMAS analysis of Network performance report 2026 supporting data. Note that for simplicity, we have excluded the estimated impact for 2025.

Over a 10-year period where the IRV was material, the impact is biased in favour of NSPs by \$2 billion. It therefore appears the IRV has not been neutral between suppliers and customers over the long run. This is because of the asymmetry between the inflation rate forecast of between 2% and 3% and the zero lower bound (~2.5%), on the one hand, and the reality that inflation can exceed 7% (~5.5%). While the divergence on the downside can be structural and persistent, even if the duration of an upward divergence is less than half the duration of the downward divergence, the net impact from a three year upward divergence outweighs that from the seven-year downward divergence.

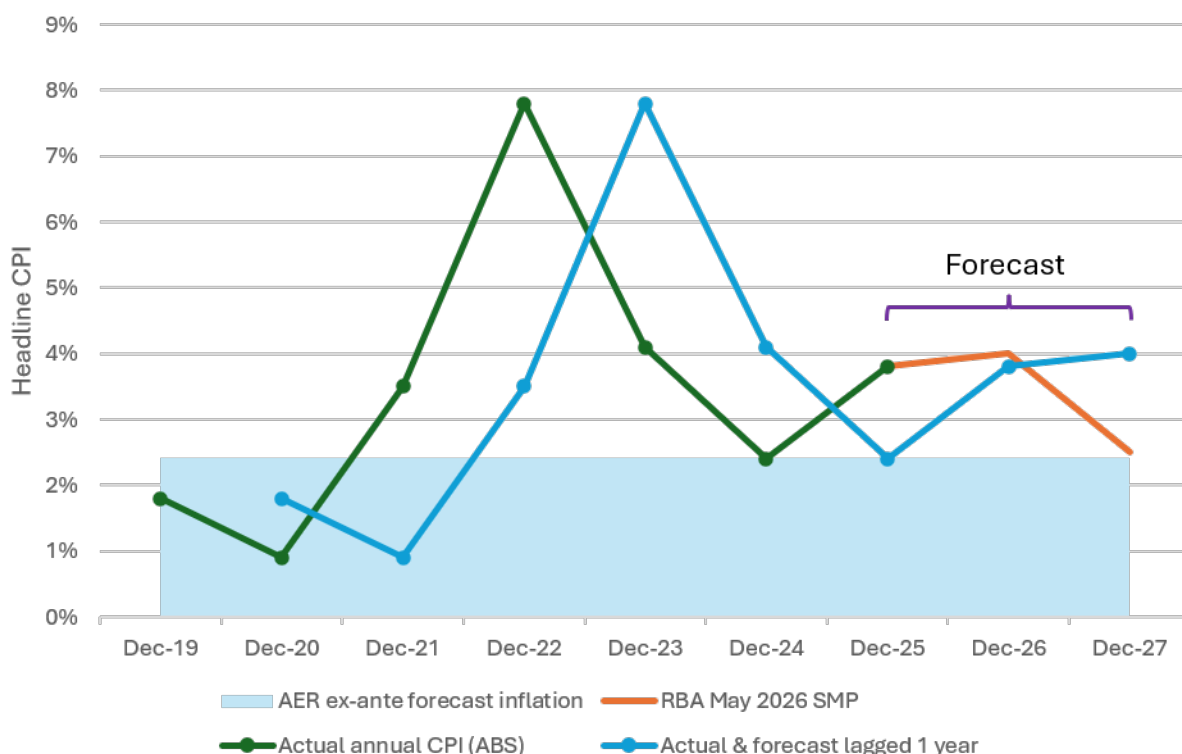
### 3.4 The effect of current inflation on future returns

Figure 13 shows the relationship between the AER's typical ex-ante inflation forecast (shaded area), CPI to December, and the one-year lagged impact on network revenues. The shape of the one-year lagged CPI and RoRE charts for the period up to 2025 is similar because the IRV drives up actual RoRE.

The actual and allowed RoRE outcomes for 2024-25 (represented as December 2025 for the Blue line)<sup>30</sup> converge in large part because CPI for the period to December 2024 matched the AER forecast. This is unusual.

<sup>30</sup> Note the blue line refers to the mid-points of June years while the AER forecast, CPI and SMP forecast all refer to calendar years.

FIGURE 13 - HISTORICAL AND FORECAST LAGGED CPI



Sources: AER, ABS, RBA May 2026 SMP forecast archive. Victorian DNSPs are lagged 2 years.

The period of unusually low inflation and interest rates that generated customer IRV benefits prior to 2022 appears to have ended. Recent and forecast inflation outcomes remain above the long-run forecast benchmark used in many determinations, suggesting that future IRV effects may continue to be skewed toward positive outcomes for NSPs.

If that proves to be the case, the cumulative net gain attributable to IRV would continue to increase beyond the estimated \$2 billion through to June 2025. Given the known inflation outcome for December 2025, from 1 July 2026 the IRV from the TAPRD is once again likely to be material. Moreover, if the RBA's forecast for the period to December 2026 is broadly correct, the IRV will also be material in the period from 1 July 2027. While the unrealised gains are not converted to revenue immediately, the IRV could be expected to elevate allowed network revenues and RoRE over the longer term.

This highlights the need for an amendment to the RoRI to create an obligation and head of power for the AER to remove material gains or losses of the IRV to the TAPRD, to the extent required to ensure consistency ensuring returns are commensurate with the regulatory and commercial risks, and a reasonable opportunity to recover at least the efficient costs the operator incurs.

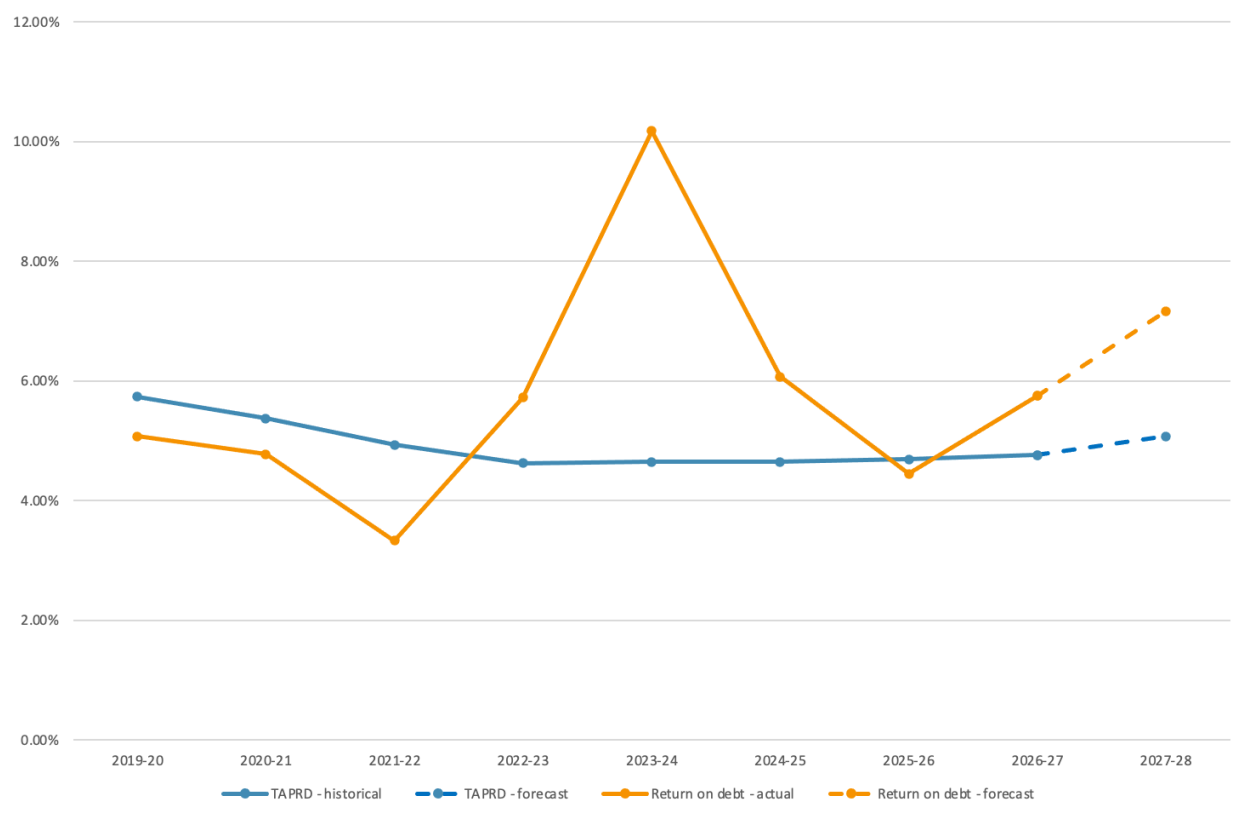
A head of power may be required in the event otherwise desirable options for removing the IRV may contradict existing national electricity and gas rules regarding the build-up of allowed revenues and prices. The existence of a head of power in the RoRI could avoid any need for a separate rule change process and the associated delays.

### 3.5 The outlook for the IRV impact on the allowed return on debt

Figure 14 compares the TAPRD with the actual compensation for the return on debt received by NSPs (using Ausgrid as an example). The figure shows that the surge in inflation following Covid-19 resulted in NSPs earning a return on debt that peaked just above 10.17%. In comparison, the TAPRD was 4.65%.

The increase in the return on debt to 5.75% in 2026-27 is due to the recent unexpected increase in inflation, and we expect that the return on debt in 2027-28 will increase to 7.2% due to inflation associated with the Iran war.<sup>31</sup>

FIGURE 14: ACTUAL RETURN ON DEBT COMPARED TO TAPRD



<sup>31</sup> We have used the recent forecast by [Westpac](https://www.westpac.com.au) of 4.7% inflation for the year to December 2026.

We have calculated that the effect of the unexpected inflation for 2026-27 and 2027-28 is worth \$334 million to Ausgrid. The benefit to Ausgrid may be greater if the economic disruptions associated with the Iran war continue into 2028-29.

Extrapolating this benefit to all NSPs indicates the unexpected inflation of 2026-27 and 2027-28 will cause a wealth transfer from consumers to electricity NSPs of approximately \$2.7 billion.<sup>32</sup>

### **3.6 Comparing RoRI impacts with the Revenue and pricing principles (RPPs)**

The analysis above highlights the following contradictions between the proposed 2026 RoRI outputs and the RPPs that are concerned with RoRI impacts.

- Actual returns are not “commensurate” or proportional to the regulatory and commercial risks associated with the services to which the charge relates. Instead NSPs have been substantially over-compensated
- A regulated network service provider is provided with an excessive opportunity to recover well in excess of the efficient costs the operator incurs...’ NEL cl. 7A(2)

It is also clear the 2026 Draft Decision requires the AER to have regard to CRG and stakeholder consultation feedback. This was ignored in the Draft Decision on the justification that the IRV is outside the scope of the 2026 review, although as we demonstrate above, the IRV has a major effect on the RORE NSPs receive and the eventual prices consumer pay, and the IRV effectively reprices an NSP’s TAPRD, which is a core RoRI issue.

### **3.7 Retention of the uniform TAPRD**

The Draft Decision to retain the uniform TAPRD addresses two concerns we highlighted in our previous report. The first concern is that a move to a weighted TAPRD could lead to an increase in prices for consumers, all else being equal, because high interest rates are given more weight than low interest rates. This is due to the observation that capex tends to be higher when interest rates are high and lower when interest rates are low. We provided our analysis of this issue in our previous report.

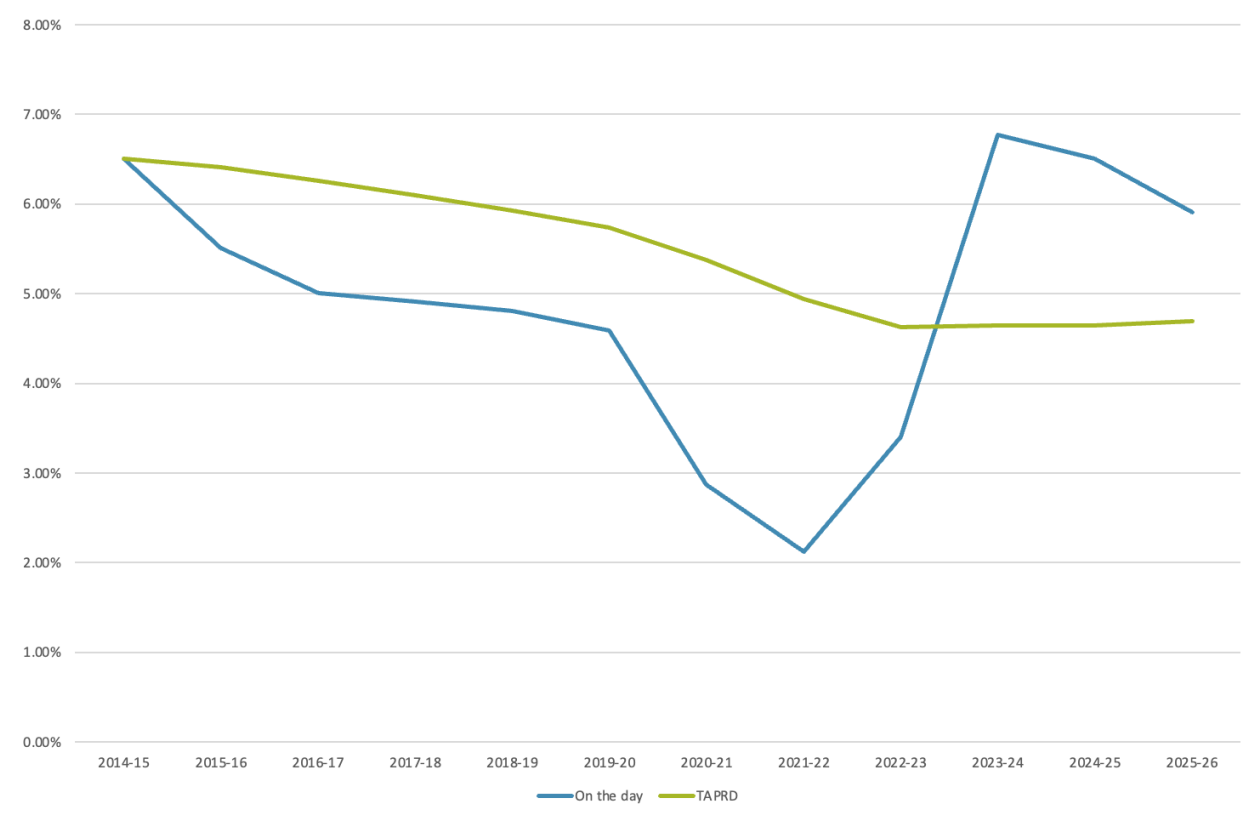
The second concern is that a switch to a weighted TAPRD would be unfair to consumers. After the TAPRD was introduced, interest rates trended down and consumers therefore paid more than they would have paid if the prevailing approach had continued. Now that interest rates have stabilised and the TAPRD is starting to trend up, a change to a weighted TAPRD would remove the benefit that consumers would otherwise receive from continuing with a uniform TAPRD.

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<sup>32</sup> This calculation is based on Ausgrid representing 1/8<sup>th</sup> of total annual electricity NSP revenue.

We illustrated this issue in our previous report, by showing the following figure of prevailing interest rates against the TAPRD. We indicated that the net gain to Ausgrid has been around \$500 million and that similar net benefits have been achieved by other NSPs.

**Figure 15. Return on debt for Ausgrid under the TAPRD compared to what it would have been if the on-the-day approach had continued**



## 4 Cost of equity

### 4.1 Introduction

Our comments on the cost of equity relate to equity beta, debt beta and the term of the risk-free rate.

### 4.2 Our understanding of the draft decision on equity beta

In considering the AER's Draft Decision on equity beta, we first observe the effect of the equity beta change. The following table shows the WACC based on the market parameters for the revenue decision for Basslink on 27 February 2026.

The table indicates that most of the change in the WACC is due to the change in equity beta and debt beta – the nominal post tax WACC is reduced from 6.32% to 6.20% due to the equity beta and debt beta changes, while the additional changes to the MRP and Imputation credits reduces the WACC to 6.19%.

|                                   | Status quo | Draft decision | Draft decision equity beta and debt beta only |
|-----------------------------------|------------|----------------|-----------------------------------------------|
| <b>Market parameters</b>          |            |                |                                               |
| Nominal risk-free rate            | 4.46%      | 4.46%          | 4.46%                                         |
| Real risk-free rate               | 1.78%      | 1.78%          | 1.78%                                         |
| Inflation rate                    | 2.64%      | 2.64%          | 2.64%                                         |
| <b>Cost of debt</b>               |            |                |                                               |
| TAPRD                             | 5.83%      | 5.83%          | 5.83%                                         |
| Real pre-tax cost of debt         | 3.12%      | 3.12%          | 3.12%                                         |
| <b>Cost of equity</b>             |            |                |                                               |
| MRP                               | 6.20%      | 6.10%          | 6.20%                                         |
| Debt beta                         | 0.00       | 0.10           | 0.10                                          |
| Equity beta                       | 0.60       | 0.55           | 0.55                                          |
| Post-tax nominal return on equity | 8.18%      | 7.82%          | 7.87%                                         |
| Post-tax real return on equity    | 5.40%      | 5.04%          | 5.10%                                         |
| <b>Gearing</b>                    |            |                |                                               |
| Proportion of equity funding      | 40%        | 40%            | 40%                                           |
| Proportion of debt funding        | 60%        | 60%            | 60%                                           |
| <b>Tax</b>                        |            |                |                                               |
| Corporate tax rate                | 30%        | 30%            | 30%                                           |
| Imputation                        | 57%        | 58%            | 57%                                           |
| <b>WACC</b>                       |            |                |                                               |
| Nominal vanilla WACC              | 6.77%      | 6.63%          | 6.65%                                         |
| Real vanilla WACC                 | 4.03%      | 3.89%          | 3.91%                                         |
| Nominal post tax WACC             | 6.32%      | 6.19%          | 6.20%                                         |
| Real post tax WACC                | 3.59%      | 3.46%          | 3.47%                                         |

We have attempted to understand the basis of the AER's draft decision on equity beta. The AER stated it has based its decision largely on domestic data:

*Overall, we consider that the relative merits of using domestic data to inform our point estimate, notwithstanding their largely historical nature, outweigh those of using international data at this time. (page 2)*

In regard to the relevant domestic estimates of the equity beta, the AER stated:

*For our domestic comparator set, the average equity beta estimate is 0.56 over the longest period. The estimates of the 5 majority-regulated firms (AusNet Services Limited, DUET Group, Envestra Limited, GasNet Australia Group and Spark Infrastructure Group) tend to be around 0.4. (page 21)*

Based on this information, we assumed the AER would have chosen a value of equity beta in the range of 0.4 to 0.56.

However, the AER's has considered an equity beta range extending from 0.4 to 0.7:

*Overall, we consider that an equity beta value of 0.55, from a possible range of estimates of between 0.4 to 0.7, to be appropriate for the 2026 RoRI. (page 22)*

The 0.7 figure appears to come from international data, even though the AER has said it has not based its decision on this data:

*For our international sample, the average equity beta estimate is 0.68 over the longest period. This is broadly consistent with our estimates of other international samples (as proposed by stakeholders or used by some regulators) which tend to be around 0.7. (page 21)*

It therefore appears that the AER has placed substantial weight on the international data, despite saying that it has not, as it has used this international data to justify choosing an equity beta value that is near the upper range of values it obtained from its analysis of domestic data (0.55 is the upper estimate of 0.56 rounded to the nearest 0.05).

While the AER has placed weight on international data for equity beta, it has not done so for gearing. The comparator set used for gearing is 4 of the 5 domestic majority regulated firms (AusNet Services Limited, DUET Group, Envestra Limited and Spark Infrastructure Group) plus APA, which the AER indicates have an average gearing of 57%, based on the longest data set. In comparison, the average gearing of the international comparators is 46%.

Overall, the AER's draft decision is the equivalent of using 4 of the majority regulated firms (plus APA) for gearing and all the domestic firms for equity beta (AusNet Services Limited, DUET

Group, Envestra Limited, GasNet Australia Group and Spark Infrastructure Group, APA, Alinta, AGL, Gasnet and HDF). The following table shows that the WACC calculated from this selection is almost the same as the WACC from applying the draft decision.<sup>33</sup>

|                                   | Draft decision | Draft decision (equivalent) |
|-----------------------------------|----------------|-----------------------------|
| <b>Market parameters</b>          |                |                             |
| Nominal risk-free rate            | 4.46%          | 4.46%                       |
| Real risk-free rate               | 1.78%          | 1.78%                       |
| Inflation rate                    | 2.64%          | 2.64%                       |
| <b>Cost of debt</b>               |                |                             |
| TAPRD                             | 5.83%          | 5.83%                       |
| Real pre-tax cost of debt         | 3.12%          | 3.12%                       |
| <b>Cost of equity</b>             |                |                             |
| MRP                               | 6.10%          | 6.10%                       |
| Raw gearing (average)             |                | 57%                         |
| Raw equity beta (average)         |                | 0.53                        |
| Debt beta                         | 0.10           | 0.10                        |
| Asset beta                        |                | 0.28                        |
| Equity beta                       | 0.55           | 0.56                        |
| Post-tax nominal return on equity | 7.82%          | 7.88%                       |
| Post-tax real return on equity    | 5.04%          | 5.10%                       |
| <b>Gearing</b>                    |                |                             |
| Proportion of equity funding      | 40%            | 40%                         |
| Proportion of debt funding        | 60%            | 60%                         |
| <b>Tax</b>                        |                |                             |
| Corporate tax rate                | 30%            | 30%                         |
| Imputation                        | 58%            | 58%                         |
| <b>WACC</b>                       |                |                             |
| Nominal vanilla WACC              | 6.63%          | 6.65%                       |
| Real vanilla WACC                 | 3.89%          | 3.91%                       |
| Nominal post tax WACC             | 6.19%          | 6.21%                       |
| Real post tax WACC                | 3.46%          | 3.48%                       |

### 4.3 Assessment of the draft decision on equity beta

Based on our previous report, our starting point is to calculate the equity beta by using a set of comparator firms that have characteristics that are similar to the NSPs.

<sup>33</sup> We have back-calculated the average value of raw equity beta.

Australian NSPs and relevant international comparators are regulated energy carriage monopolies. They are not integrated energy utilities that buy and sell energy in competitive markets. They are protected from almost all systematic risks over an economic cycle. They have legally defined monopoly franchise areas, which means they are not subject to competition in the supply of a defined set of regulated electricity or gas services.

NSPs operate under a carriage or tolling revenue model where revenues are unrelated to the value of the energy being carried or wheeled, or how this value may change at different locations and times, and over an economic cycle. If there are wholesale shortages or network bottlenecks, resulting in very high wholesale prices or large variations in prices between different locations, this makes no difference to an NSP's costs or revenues. Similarly, if an NSP undertakes capital expenditure to build new or augmented assets, and the commissioning is delayed by years, NSPs do not face any cost increases or losses because of the impact of the delay on related upstream and downstream energy markets.

If energy demand during an economic downturn decreases below the long-term average, NSPs do not experience a drop in revenue. For electricity NSPs, the revenue cap form of regulation prevails, and prices are adjusted for any preceding energy shortfalls. For gas NSPs, historically, the AER has made generous assumptions regarding forecast volumes in deriving unit prices, and this has so far neutralised any exposure to gas volume decreases.

During an economic downturn, NSPs do not experience any increase in bad debts resulting in higher unrecoverable revenues, or any increase in working capital requirements due to slower bill payments. NSPs do not engage in forward energy trading and therefore avoid potential gains and losses from repricing of forward hedging instruments during a downturn.

Of the 48 entities in the AER's 2026 international sample, we have found only three firms that are comparable to NSPs in terms of systematic risk: Hydro One of Canada, Vector of New Zealand and National Grid of Great Britain. In our view, inclusion of the other 45 entities provides irrelevant information in a statutory decision-making process.

We provide the evidence in the Appendix for why these 45 entities are not relevant.

Of the domestic comparators, we agree with the AER that the most comparable to NSPs are the four domestic majority regulated firms of AusNet Services Limited, DUET Group, Envestra Limited and Spark Infrastructure Group.

If the AER had chosen to base its draft decision on this set of domestic comparators for both gearing and equity beta (using long term data), the nominal post tax WACC would be reduced from 6.21% to 5.82%, as shown in the following table.<sup>34</sup>

|                                   | Draft decision<br>(equivalent) | Draft decision<br>(consistent) |
|-----------------------------------|--------------------------------|--------------------------------|
| <b>Market parameters</b>          |                                |                                |
| Nominal risk-free rate            | 4.46%                          | 4.46%                          |
| Real risk-free rate               | 1.78%                          | 1.78%                          |
| Inflation rate                    | 2.64%                          | 2.64%                          |
| <b>Cost of debt</b>               |                                |                                |
| TAPRD                             | 5.83%                          | 5.83%                          |
| Real pre-tax cost of debt         | 3.12%                          | 3.12%                          |
| <b>Cost of equity</b>             |                                |                                |
| MRP                               | 6.10%                          | 6.10%                          |
| Raw gearing (average)             | 57%                            | 60%                            |
| Raw equity beta (average)         | 0.53                           | 0.40                           |
| Debt beta                         | 0.10                           | 0.10                           |
| Asset beta                        | 0.28                           | 0.22                           |
| Equity beta                       | 0.56                           | 0.40                           |
| Post-tax nominal return on equity | 7.88%                          | 6.90%                          |
| Post-tax real return on equity    | 5.10%                          | 4.15%                          |
| <b>Gearing</b>                    |                                |                                |
| Proportion of equity funding      | 40%                            | 40%                            |
| Proportion of debt funding        | 60%                            | 60%                            |
| <b>Tax</b>                        |                                |                                |
| Corporate tax rate                | 30%                            | 30%                            |
| Imputation                        | 58%                            | 58%                            |
| <b>WACC</b>                       |                                |                                |
| Nominal vanilla WACC              | 6.65%                          | 6.26%                          |
| Real vanilla WACC                 | 3.91%                          | 3.53%                          |
| Nominal post tax WACC             | 6.21%                          | 5.82%                          |
| Real post tax WACC                | 3.48%                          | 3.10%                          |

A 0.4 percentage point difference in the WACC is a very substantive difference. For reference, the AER has indicated its draft decision, which effectively reduces the WACC by 0.14 percentage points (as shown in the table at the start of this section) would result in aggregate savings to consumers of \$1.1 billion [over 8 years].<sup>35</sup> A consistent calculation of the equity beta, as we

<sup>34</sup> For this analysis we have assumed the average raw gearing is 60%, which is higher than the figure of 57% that includes APA (because APA's gearing is lower than the other firms).

<sup>35</sup> Our understanding of the number of regulatory years to which the 2026 RORI will apply, based on verbal advice from AER.

propose, would result in savings to consumers that are three times this amount (in the order of \$3 billion).

We have not been able to find the reasons in the draft decision for why the AER has not considered setting the equity beta on this basis, or for that matter on the sample that we recommended, which is to include the three international firms we consider are candidates for including in a comparator set.

The reasons for why the AER did not engage with our proposal is particularly puzzling given their figure 6.5, which shows that the firms in their international sample had equity betas that were clearly inflated over the Covid period. In comparison, the same figure shows the equity beta estimates from our proposed sample were relatively stable over the Covid period, which is what would be expected of a pure-play NSP in comparison to firms that are affected by non-monopoly characteristics.

Most of the AER's explanatory statements on the equity beta relate to the use of international data, including how to convert the data using a debt beta, or on the choices made by other regulators.

We agree with the AER's main finding regarding international estimates:

*Moreover, as discussed earlier, international equity beta estimates do not correlate well with domestic estimates. This suggests that international data may only be of limited value as an indicator of the current market conditions faced by Australian NSPs. (page 38)*

But we are perplexed as to why the AER then used the international data to form the equity beta range of 0.4 to 0.7, and to select a point in the middle of this range (0.55), which is also the (rounded) value that is calculated using the full domestic comparator set.

In our view, the AER should include in its comparator set only those firms that are comparable to an Australian NSP – either the domestic firms with majority non-regulated revenue, which would result in an equity beta of 0.4, or the combined domestic and international comparator set we recommended, which would result in an equity beta no more than 0.5.

#### **4.4 Debt beta**

The AER has decided to use a debt beta of 0.10, which corrects the error of not applying a debt beta in previous decisions. As we explained in our previous report, a debt beta needs to be used for levering and relevering whenever the notional gearing differs from the average gearing of the comparator set. We recommended a debt beta of 0.125 on the basis that this value was consistent with the WACC that is calculated by using the average gearing of the comparator set.

We note that the AER did not engage with our proposal and has selected a value of 0.10 simply on the basis that this was the most common recommended value.

If the AER were to base its decision on domestic data, the choice of debt beta becomes less meaningful as the average gearing of domestic firms is similar to the 60% notional gearing chosen by the AER.

The decision is more meaningful when considering international data. We have calculated that the difference between using a debt beta of 0.1 and a debt beta of 0.125 (which is what we recommended in our previous report) is to reduce the equity beta from 0.72 to 0.71.

Given that the AER appears to have chosen its equity beta as the mid-point of the range of domestic and international comparators, this change in the debt beta could have a meaningful effect on the mid-point value of equity beta, and therefore on consumer bills. We recommend the AER consider our proposal to use the value of debt beta that achieves the same WACC as calculated using a zero debt beta and the notional gearing set at the average of the comparator set.

#### **4.5 Term of the risk-free rate for the return on equity**

In our previous report, we recommended the AER define NPV=0 as occurring when:

- a) the present value of revenue equals the present value of costs; and
- b) the internal rate of return is as low as possible without compromising incentives to invest.<sup>36</sup>

Based on this definition, allowing an investor to earn a higher IRR by setting the term at 10 years, without concluding that setting the term at 5 years would compromise incentives to invest, would be inconsistent with NPV=0.

In our view the move to a 5-year term for the return on equity would not compromise an NSP investor's incentive to invest as that has not been the experience in regulatory settings where the 5-year term has been applied, such as in Western Australia and in New Zealand.

We note that the AER has not responded to this issue in its Draft Decision. This is an important matter that has a significant effect on consumer bills and warrants detailed consideration.

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<sup>36</sup> EMAS, page 45.

## Appendix A. AER sample of international firms

The table below assesses the exposure to systematic risk for the firms from the updated international sample attached to the AER's Draft 2026 RoRI decision.

| Draft 2026 RoRI      | Relevant information | Not relevant information | Exposure to systematic risk                                                                            |
|----------------------|----------------------|--------------------------|--------------------------------------------------------------------------------------------------------|
| <b>AEE US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>AEP US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>AQN CN Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>ASC IM Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>ATO US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>AVA US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>BKH US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>CMS US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>CNP US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>CU CN Equity</b>  |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>D US Equity</b>   |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>DUK US Equity</b> |                      | ✓                        | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |

|                       |   |   |                                                                                                        |
|-----------------------|---|---|--------------------------------------------------------------------------------------------------------|
| <b>ED US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>EIX US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>EMA CN Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>ENG SM Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>ES US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>ETR US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>EVRG US Equity</b> |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>EXC US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>FE US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>FTS CN Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>H CN Equity</b>    | ✓ |   | Network carriage service provider with statutory monopoly                                              |
| <b>HE US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>HER IM Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>IDA US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>LNT US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |

|                       |   |   |                                                                                                        |
|-----------------------|---|---|--------------------------------------------------------------------------------------------------------|
| <b>MGEE US Equity</b> |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>NEE US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>NG/ LN Equity</b>  | ✓ |   | Network carriage service provider with statutory monopoly                                              |
| <b>NI US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>NWE US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>NWN US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>OGS US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>PCG US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>TXNM US Equity</b> |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>PNW US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>POR US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>PPL US Equity</b>  |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>RGCO US Equity</b> |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>SO US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>SR US Equity</b>   |   | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |

|                      |  |   |                                                                                                        |
|----------------------|--|---|--------------------------------------------------------------------------------------------------------|
| <b>SRE US Equity</b> |  | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>TRN IM Equity</b> |  | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>UTL US Equity</b> |  | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>VCT NZ Equity</b> |  |   | Network carriage service provider with statutory monopoly                                              |
| <b>WEC US Equity</b> |  | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |
| <b>XEL US Equity</b> |  | ✓ | Vertically integrated energy utility subject to extensive energy trading, demand and competition risk. |

## About EMAS

Electricity Market Advisory Services is a bespoke consulting firm specialising in modelling electricity markets. While our focus is on the Western Australian wholesale electricity market, we also undertake financial modelling of electricity network and retail businesses. We have a range of models that can be used for financial analysis, simulations and forecasts.

Our services include:

- Dispatch modelling to assist in operating and investment planning processes;
- Curated data services, including demand simulation and intermittent generation output;
- Customised report generation;
- Modelling specific WEM processes including Relevant Level, Electricity Storage Resource Obligations, Individual Reserve Capacity Requirement, and Reserve Capacity Target/Prices; and
- Estimating and advising on rates of return for network businesses.

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