3 July 2018

The Hon Rob Lucas MLC
Treasurer
GPO Box 2264
ADELAIDE SA 5001

Dear Treasurer

We thank you for the opportunity to meet with members of the Network Shareholder Group on Monday 25 June 2018 represented by AMP Capital, AustralianSuper and Macquarie Infrastructure Real Assets.

In that meeting, we reiterated the outstanding concerns that remain with the proposed binding rate of return legislation that is due to be considered by the South Australian Government Cabinet in July prior to the Bill's introduction in the SA Parliament by the end of the same month.

In summary, we accept the COAG Energy Council's previously stated policy to ensure greater certainty by requiring the AER, in consultation with stakeholders, to develop a binding Rate of Return Guideline (RORG). Industry not only expected this change but was an active participant in the consultation process for reviewing the Limited Merits Review framework in September 2016 where the adoption of a binding RORG was proposed.

However, the legislative package released for consultation goes significantly further than implementing this policy. Our key concern remains that if the Bill is implemented as proposed, the effect will be to undermine what has been considered a stable regulatory environment, increase regulatory and sovereign risk and consequently increase the cost of both debt and equity investments in, and new financings of, regulated electricity assets. It would inevitably result in investors seeking higher risk premiums as compensation for this reduction in good governance, increasing prices to customers at the same time as reducing investment incentives.

The current rules provide important guidance to the Australian Energy Regulator (**AER**) about how to determine returns that would be consistent with the National Electricity Objective (**NEO**), National Gas Objective (**NGO**), and Regulatory Pricing Principles (**RPPs**) and have a life beyond one Rate of Return Guideline period. This is critical to investors making long term investments.

The last draft of the Bill we viewed included requirements in the Bill for the AER only to <u>have regard</u> to the RPPs and to make an instrument that will, or is most likely to, contribute to the NEO or NGO, which in our view is an insufficient standard. The AER may also have regard to other information and there is no requirement to demonstrate that the RORG would achieve the NEO, NGO and RPPs.

Further, the RORG provides certainty for only four years, whereas the lifecycle of electricity network investments is decades long, and hence certainty and predictability that future RORGs will achieve the NEO, NGO and RPPs is important in incentivising efficient investment in a time of unprecedented technological disruption in networks. Moreover, any potential errors made in the RORG will also remain in place for those four years and will not be subject to review.

Whilst we have been assured that the AER will have more than 'regard' for the RPPs and give primacy to NEO, NGO and RPPs over other information, this is not reflected in the drafting of the Bill. We have also been advised by Senior Committee Officials (SCO) of the COAG Energy Council that this policy intent could be made clearer either in the explanatory memorandum or the second reading speech.

We appreciate your assistance to make enquiries on this particular matter with the Minister for Energy and Mining when the matter is considered by the South Australian Government Cabinet. For your reference, we have also written in similar terms to the Minister.

Once again, we thank you for the opportunity to meet representatives of our group and for committing to follow up these specific issues. Please contact Nick Xerakias at GRACosway on 0410 417 173 or nxerakias@gracosway.com.au for further discussion or questions.

Yours sincerely

Rick Francis
Managing Director & CEO
Spark Infrastructure

Steven Fitzgerald
Head of Asset Management
HRL Morrison

Michael Cummings
Global Co-Head of Asset Management
AMP Capital

Nik Kemp
Head of Infrastructure
AustralianSuper

Michael Hanna
Head of Infrastructure – Australia
IFM Investors

Francis Kwok
Co-Head of Asia-Pacific
Macquarie Infrastructure and Real Assets

Appendix – Amendments to section 18I of the NEL and 30D of the NGL

Section 18I of the NEL

18I AER to make rate of return instrument

(1) This section applies if a rate of return on capital or the value of imputation credits is required for performing or exercising an AER economic regulatory function or power.

(2) The AER must make an instrument (a rate of return instrument) stating—

(a) for a rate of return on capital—the way to calculate the rate; and

(b) for the value of imputation credits—the value or the way to calculate the value.

(3) 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 and the revenue and pricing principles to the greatest degree.

(4) ~~In making a rate of return instrument, the~~ The instrument made by the AER must ~~have regard to~~ provide a return on investment —

(a) ~~the revenue and pricing principles~~ commensurate with the regulatory and commercial risks faced by a benchmark efficient entity; and

(b) ~~other information the AER considers appropriate~~ that provides incentives to reduce costs or otherwise improve productivity.

Section 30D of the NGL

30D AER to make rate of return instrument

(1) This section applies if a rate of return on capital or the value of imputation credits is required for performing or exercising an AER economic regulatory function or power.

(2) The AER must make an instrument (a rate of return instrument) stating—

(a) calculate the rate; and

(b) for the value of imputation credits—the value or the way to calculate the value.

(3) The AER may make an instrument only if ~~satisfied~~ the instrument will, or is most likely to, contribute to the achievement of the national gas objective and the revenue and pricing principles to the greatest degree.

(4) ~~In making a rate of return instrument, the~~ The instrument made by the AER must ~~have regard to~~ provide a return on investment —

(a) ~~the revenue and pricing principles~~ commensurate with the regulatory and commercial risks faced by a benchmark efficient entity; and

(b) ~~other information the AER considers appropriate~~ that provides incentives to reduce costs or otherwise improve productivity.