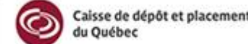


Draft Rate of Return Guideline

A discussion with the Network Shareholders Group

Spark Infrastructure, Morrison & Co, AMP Capital, IFM Investors, MIRA, AustralianSuper and CDPQ

Thursday 4 October 2018

Who are we & what is our role?

- We are **responsible custodians** of the retirement and general savings for many millions of individual Australians
- We have invested over **$12 billion efficiently priced capital** in Australian electricity network businesses
- Our businesses deliver electricity to over 9.3 million of people
- Our objectives are aligned with our consumers – affordability, safety, reliability and transition to digitalised grid
- We do this by investing prudently and responding effectively to the incentives under the regime to continuously achieve efficiencies whilst delivering services customers value

The capital needed to ensure affordable and reliable networks for consumers will be funded by investors like us

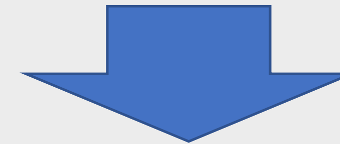
Overview of our submission

- The draft RORG:
  - Does not reflect an objective assessment of the information, evidence and views of stakeholders
  - Implies the rate of return adopted in all decisions over the last 5 years is too high
  - Implies that the forward looking risk is significantly lower than the last five year period
  - Is inconsistent with market evidence and expected market conditions
  - Disregards consensus views of experts jeopardising the credibility of the regulatory process
  - Departs from foreshadowed incremental review
  - Erodes investor confidence in the validity of the regulatory process and outcomes

The significant reduction in effective returns will have an impact on incentives and investment and be detrimental to the long term interests of consumers

What are the impacts?

- The draft RORG will have the opposite effect to that intended:
  - Lower investment incentives
  - Lower incentive for operating and capital outperformance
  - Higher risk on reliability and service outcomes
  - Delayed new investment in grid transformation
  - Higher regulatory and sovereign risk leading to higher required risk premiums
  - Higher cost of debt as credit ratings deteriorate

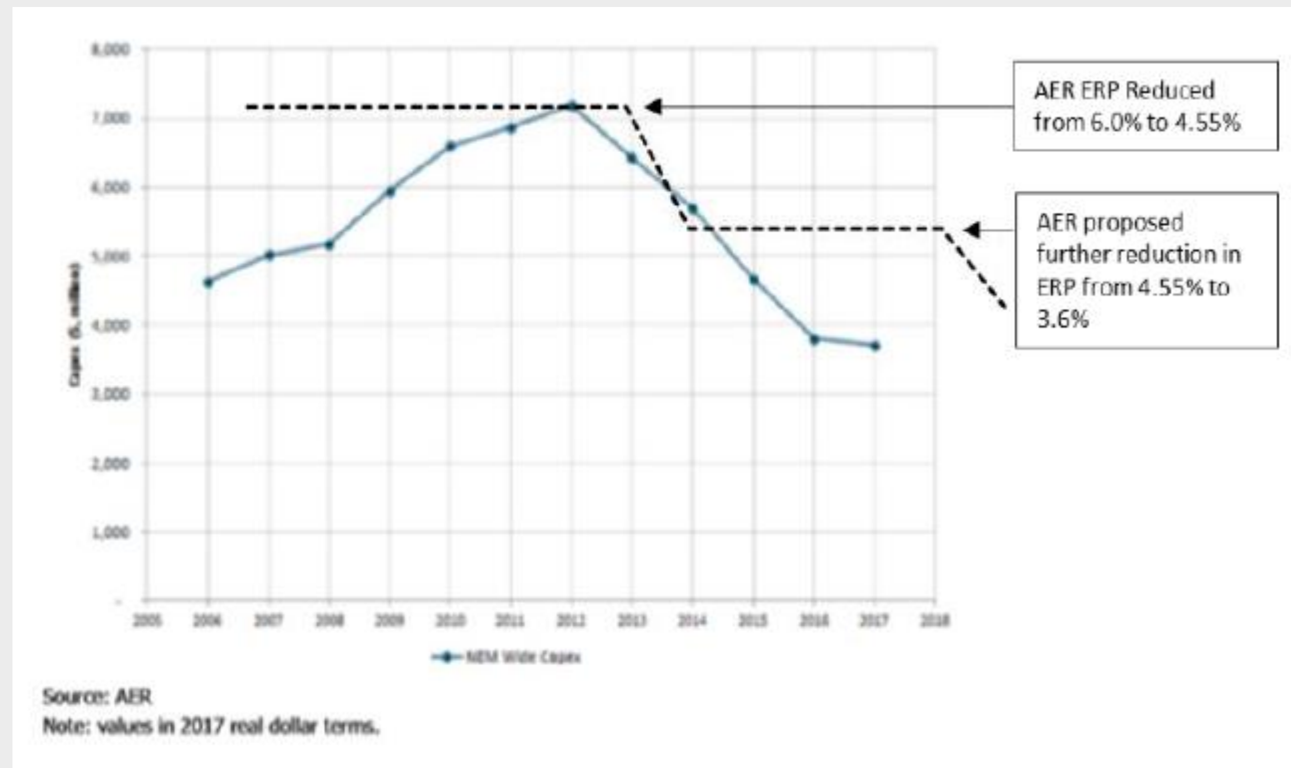


- Higher costs to consumers over the medium and long terms

The draft RORG does not deliver network cost savings to consumers or facilitate the investment required to deliver the savings identified in the Integrated System Plan and achievable through network transformation

The facts: Investment in the network infrastructure is at its lowest point in over a decade

- Combined Distribution NSP Capex



Over $4billion in investment required each year to keep the lights on – this is not riskless investment

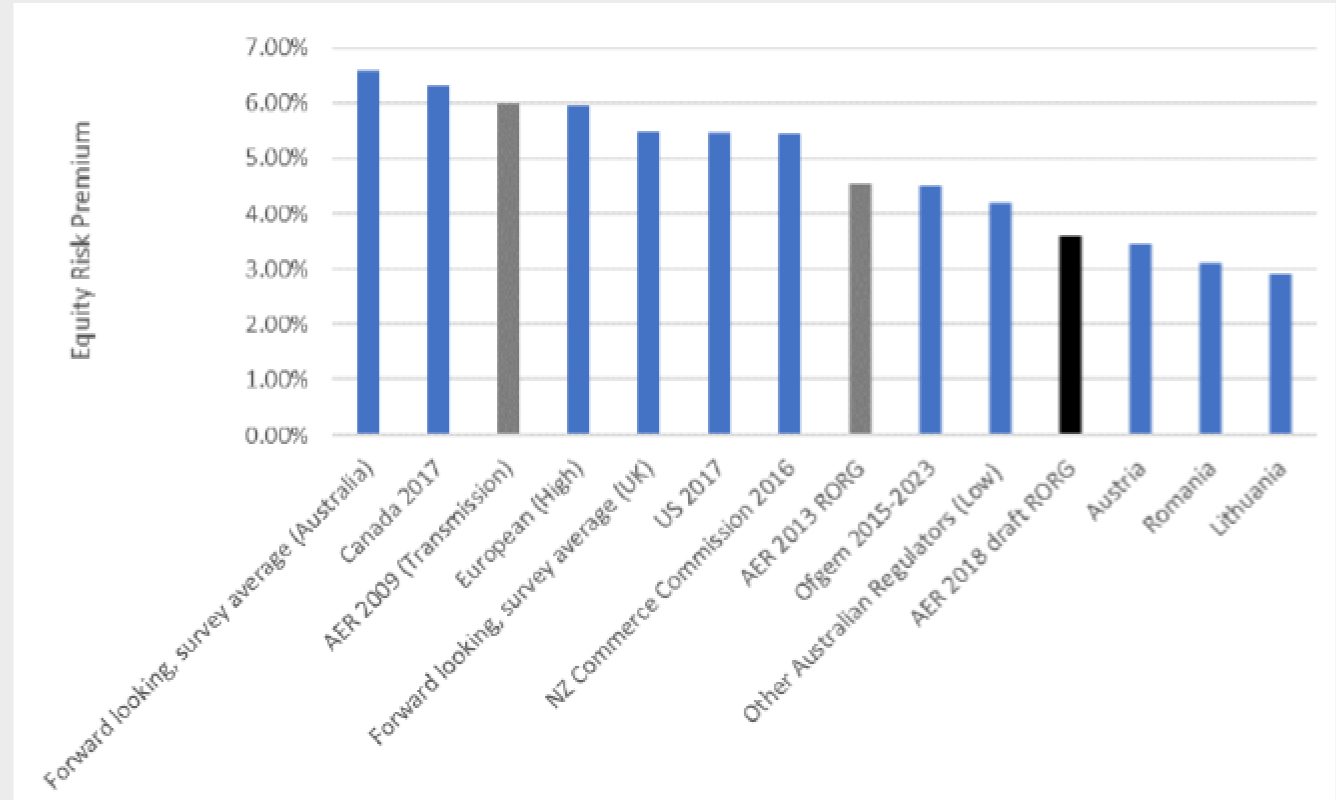
The facts: Investors' returns have decreased significantly in the last decade

- Reductions in regulated returns for energy networks in the National Electricity Market

How has the AER satisfied itself that the risk facing investors has decreased correspondingly?

• The AER's proposed ERP compared with other jurisdictions

The facts: The draft RORG delivers an ERP in the bottom third of international comparators (and worse with the impact of gamma)



Why would we want Australia to be a less attractive place to invest?

How has judgement been applied?

- Equity beta estimates have increased – no effect because the low beta bias has been removed
- Systematic risk has increased (observed in recent movements in equity beta for live firms) – no effect because changes in the estimates for 'live' firms over the last five years has been ignored
- Forward looking estimates of MRP have increased with falling risk free rate – no effect because the inverse relationship between ERP and the RFR has been ignored
- Forward looking estimates of DGMs and analyst surveys have increased – no effect because forward looking estimates of MRP have been ignored
- HER estimates of MRP have increased – no effect because more weight has been placed on geometric mean estimates
- No change to the AER's estimate of gamma – no effect because the approach been changed

A change in the approach to reduce returns suggests a pre-determined view

How has discretion been exercised?

- The current estimate of equity beta remains in the AER's range and the range has increased – the AER has reduced the estimate
- The current estimate of MRP remains in the AER's range – the AER has reduced the estimate
- The AER changed the definition of the BEE to be listed firms only and then estimated a distribution rate for an even smaller sub-set – the effect is to increase the estimate and reduce net returns

Is there any information that could persuade the AER that the regulated return should increase?

Next steps

- How will the AER interpret and respond to the views of the Independent Panel?
- Will there be further engagement with the stakeholders?
- Will the AER have regard to the need to demonstrate independence, compliance and acceptance in the absence of re-openers and review processes?

Confidence in the process and outcomes must be maintained to maintain lower cost of capital