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Mr Warwick Anderson
General Manager
Australian Energy Regulator

Dear Mr Anderson,

We are writing to you to offer input into the draft rate of return guideline submission process.

Investors Mutual (IML) manages in excess of A$9bn of funds on behalf of retail and institutional investors. As a firm IML has always had a long history of investing in ASX listed energy infrastructure shares across the national electricity and gas markets. Like many other investors our confidence in making these investments was, in the past, underpinned by having a predictable, transparent, robust and fair regulatory framework in place which historically provided investors such as ourselves with sufficient certainty to make such long-term investments in the sector.

Unfortunately it appears that the current draft rate of return guideline (released July 10th 2018) as well as other recent unexpected reviews of the various revenue building blocks (e.g. regulatory tax allowances) for Australia's regulated gas and electricity networks are causing a great deal of uncertainty both for investors and for the sector as a whole. To our alarm this uncertainty now appears to be creating a disincentive for many operators to continue to maintain a reliable and safe network for the long term benefit of consumers - particularly at a time of significant disruptive change in the way energy is generated and distributed.

Confidence in the regulatory framework remains a mandatory pre-requisite for long term investors in the sector such as IML. While we can understand why such ad hoc announcements and reviews are very popular from a short term point of view and encouraged by many in politics, our fear is that if this trend continues it will quickly undermine investors' confidence in the predictability of the regulatory process. The risk of error in the regulatory processes is exacerbated by the removal of the Limited Merits Review (LMR) and the potential dilution of the judicial review process (via RORG). These changes and the increase in uncertainty will ultimately lead to higher required rates of return from not just providers of equity capital, but also for debt capital which will ultimately result in higher costs to consumers.

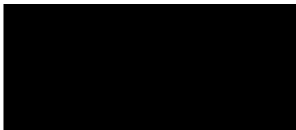
In coming to its conclusion in its draft of 10 July 2018, the AER acknowledged the need to consider the: *"ongoing need for investment to replace existing assets, to address locational peak demand and to reconfigure networks in response to changes in the mix of generators. Continued investor confidence is important in achieving these outcomes."*

This conclusion seems at odds with the proposal to cut the net market risk premium by 95bps (-21%) to 3.6% vs 2013 levels. This cut appears excessive and if applied will

significantly undermine the very investor confidence that the AER acknowledges is important to providers of equity capital such as ourselves. The low risk premium currently proposed also fails to recognise emerging risks faced by a benchmark efficient entity - including the significant increase in regulatory risk itself, with limited scope to seek impartial reviews.

While we acknowledge the parameters in question: the equity beta, market risk premium and value of franking credits all require the AER to make judgement calls, the proposed 21% reduction in the risk premium in the face of rapid technological change and increased regulatory risk appears completely inconsistent with commercial reality.

Should the draft rate of return parameters be made final, it will lead to reduced incentives for network operators to continue to invest in the sector for the longer term. This could ultimately result in lower network reliability and higher costs to consumers - both of which run counter to the goals of the national electricity and gas objectives.



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