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17 August 2020

Mr [redacted]
General Manager, Networks Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

By email: [redacted]
Cc: [redacted]

Dear [redacted]

Re: Response to AER Energy Debt Data Draft Working Paper

Thank you for the opportunity to respond to the AER's draft working paper on Energy Network Debt Data.

We endorse the Energy Network Association's (ENA) submission on the Draft Working Paper, which provides a detailed explanation of the broader issues and solutions in relation to the AER's approach to the Energy Infrastructure Credit Spread Index (EISCI) for setting the return on debt allowance, and highlight the following matters:

1. *Shortcomings of the EICSI index* – the ENA submission identifies shortcomings with the current construction of the EICSI, such as that the index:
   - weights one-year debt ten times more than ten-year debt
   - equally weights a $1 million bank loan and a $500 million bond issuance, and
   - includes only a subset of the costs in relation to bank loans.

   We encourage the AER to address these matters in revisiting the EICSI.

2. *Implementation issues* – the EICSI approach can only be calculated in arrears. We encourage the AER to reconsider how a benchmark efficient regulatory allowance can be set on this basis.

3. *Distorts incentives to the detriment of consumers* – we endorse the ENA's submission about the potential incentive effects of moving from an independent third-party data source to a regulatory allowance based on industry data. If the regulatory allowance is based on industry data, then any deviation by a network from the benchmark efficient financing approach impacts the regulatory allowance. This distorts incentives, which will either increase cost or risk (or both) ultimately borne by consumers.

4. *Under-compensation over the last five years* – the ENA submission (Figure 5) demonstrates that the industry debt data shows that regulatory compensation to network businesses has been below the actual cost of debt incurred by a network business following the AER's benchmark efficient debt management approach. We encourage the AER to reconsider how this is presented in its final decision, compared with its draft working paper.

5. *Other ENA positions* – we endorse the following other ENA positions:

> It is appropriate for network debt data to be used to test in broad terms whether:

(i) the AER's assumption about the prudent and efficient debt management approach (i.e. issuing 10-year BBB+ debt on a staggered maturity basis), and

(ii) the cost of that benchmark efficient approach as delineated by a mix of third-party indices used to determine the cost of debt allowance remains fit-for-purpose.

> It would not be appropriate to apply any weight to the EICSI when setting the allowed return on debt until the substantive issues identified with it have been addressed.

Next steps

We look forward to continuing to work with the AER to address the challenges set out in this letter to arrive at an outcome in the long-term interests of investors and consumers. If you have any questions on this letter, please contact me on [redacted]

Yours sincerely

[redacted]

[redacted]

Head of Regulation