INCENTIVISING INVESTMENT IN ENERGY INFRASTRUCTURE

NETWORK SHAREHOLDERS GROUP – PRESENTATION TO AER'S WEBINAR ON DEBT

9 August 2021

NETWORK SHAREHOLDERS GROUP (NSG)

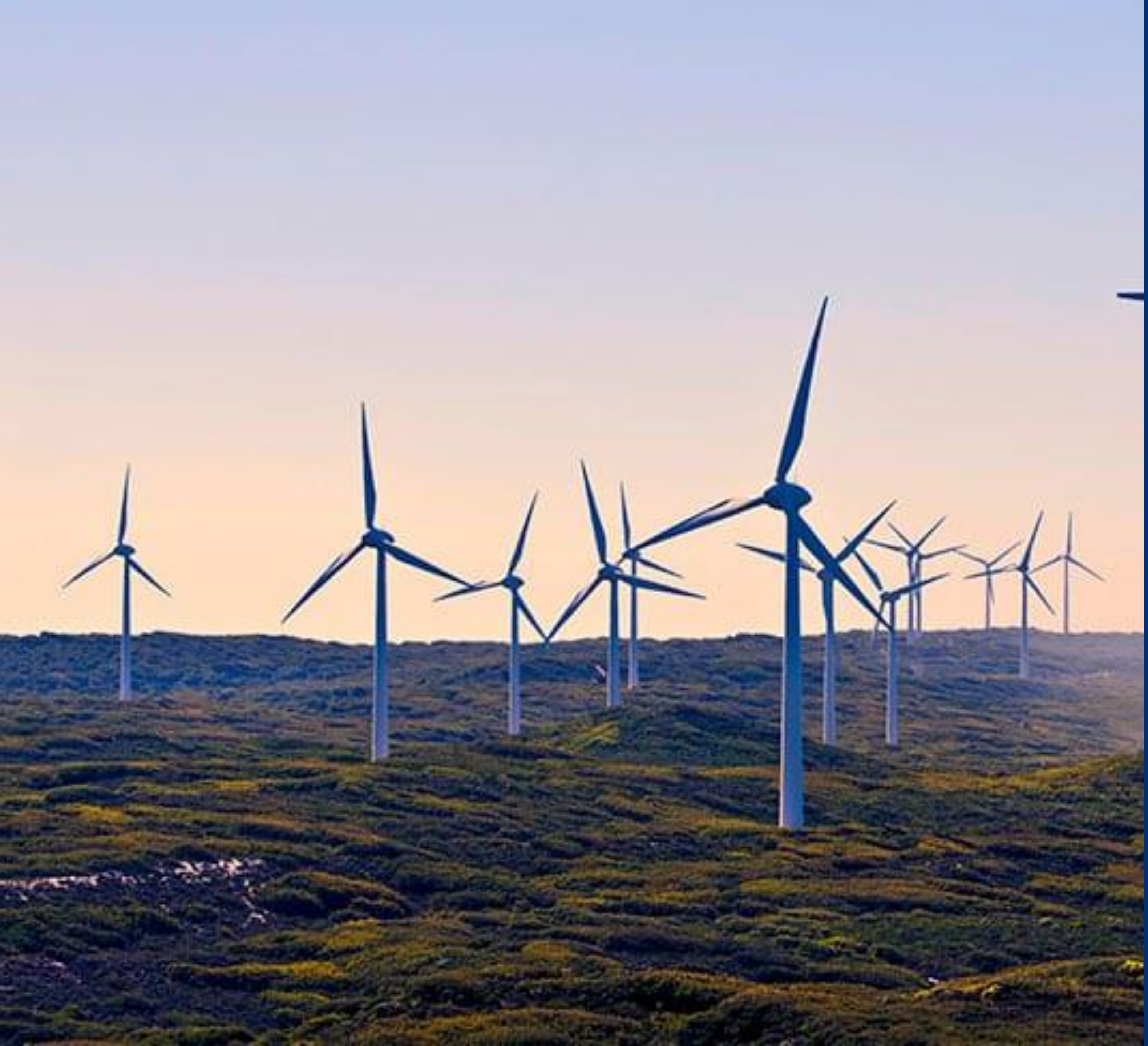
INFRASTRUCTURE INVESTORS WITH NEARLY $300 BILLION IN EQUITY INFRASTRUCTURE[1]

MACQUARIE	ifm investors	spark infrastructure	AMP CAPITAL	AustralianSuper	MORRISON&CO	OMERS	Caisse de dépôt et placement du Québec
AUM: $204bn	**AUM:** $155bn	**AUM:** $18bn	**AUM:** $190bn	**AUM:** >$200bn	**AUM:** $20bn	**AUM:** $112bn	**AUM:** $390bn
Equity Infra: $100.5bn	**Equity Infra:** $68.9bn	**Equity Infra:** $3.6bn	**Equity Infra:** $20.4bn	**Equity Infra:** >$20bn	**Equity Infra:** $16bn	**Equity Infra:** $23.6bn	**Equity Infra:** $33.9bn
Markets: Australia, UK/Europe, North America, Asia	**Markets:** Australia, UK/Europe, North America	**Markets:** Australia **ASX Listed**	**Markets:** Australia/NZ, UK/Europe, North America/ Latin America, Asia	**Markets:** Australia, UK/Europe, North America, Asia	**Markets:** Australia/NZ, UK/Europe, North America, Asia	**Markets:** Australia, UK/Europe, North America/ Latin America, Asia	**Markets:** Australia, UK/Europe, North America/ Latin America, Asia

Australian energy investments

TransGrid, Ausgrid, Endeavour Energy, SPARK RENEWABLES, flow systems, evergen, SA Power Networks, Powercor AUSTRALIA, CITIPOWER, ElectraNet, Macarthur Wind Farm, tilt renewables

[1] All data supplied by NSG members, values are in AUD.



Key questions

- Why is the AER proposing to abandon the BEE when estimating debt?
- If a debt index is to be adopted, why shouldn't it include all debt?
- Why change the weighting in the trailing average?
- Are the changes proposed by the AER:
  - Producing a better unbiased estimate?
  - Being assessed in a consistent manner to stakeholder views?
  - In the long term interests of consumers?

ESTIMATING THE EFFICIENT COST OF DEBT

What was the approach in 2018?

- The 2018 RORI adopted a benchmarking approach based on debt yield data from third-party data providers and benchmark for term and credit rating. The BEE was assumed to:
  - Adopt 60% gearing
  - Refinance 10% of its debt each year for a term of 10 years
  - Have a BBB+ credit rating (the yield estimated by 1/3 A broad band and 2/3 B broad band from external data providers)

- The AER considers the current approach to estimating debt remains broadly appropriate, is <u>not</u> proposing significant changes to key elements but rather refinements to improve outcomes for consumers.

A HIGH BAR FOR CHANGE?

Significant changes proposed but will they produce the best unbiased estimate?

- The changes being proposed are significant and not fit for purpose
  1. The EICSI is not an efficient benchmark and nor does it 'better reflect the debt costs incurred by networks'
     - It is a new approach that is not based on theory or practice – an average provides no information about efficiency
     - Increases risk for both consumers and investors - transfers some financing risk to consumers whilst removing the opportunity for some NSPs to recover their efficient costs
     - There is no agreement that the index is properly constructed or applied – introduces regulatory discretion risk
     - Reduces transparency and simplicity whilst increasing volatility

  2. Weighting the trailing average by forecast capex to recognise significant ISP projects exacerbates the financing challenge when interest rates are low
     - Requires information that would not be available about ISP and contingent projects
     - If pursued to improve financeability then show that it does <u>and</u> is better than other alternatives (e.g. assess impact on financeability)

- These proposed changes reflect the exercise of AER's discretion (that result in a reduced allowance) – not changes in efficient practice or efficient costs.

- Would these changes be proposed if they signalled a higher debt allowance?

ASSESSMENT AGAINST AER CRITERIA

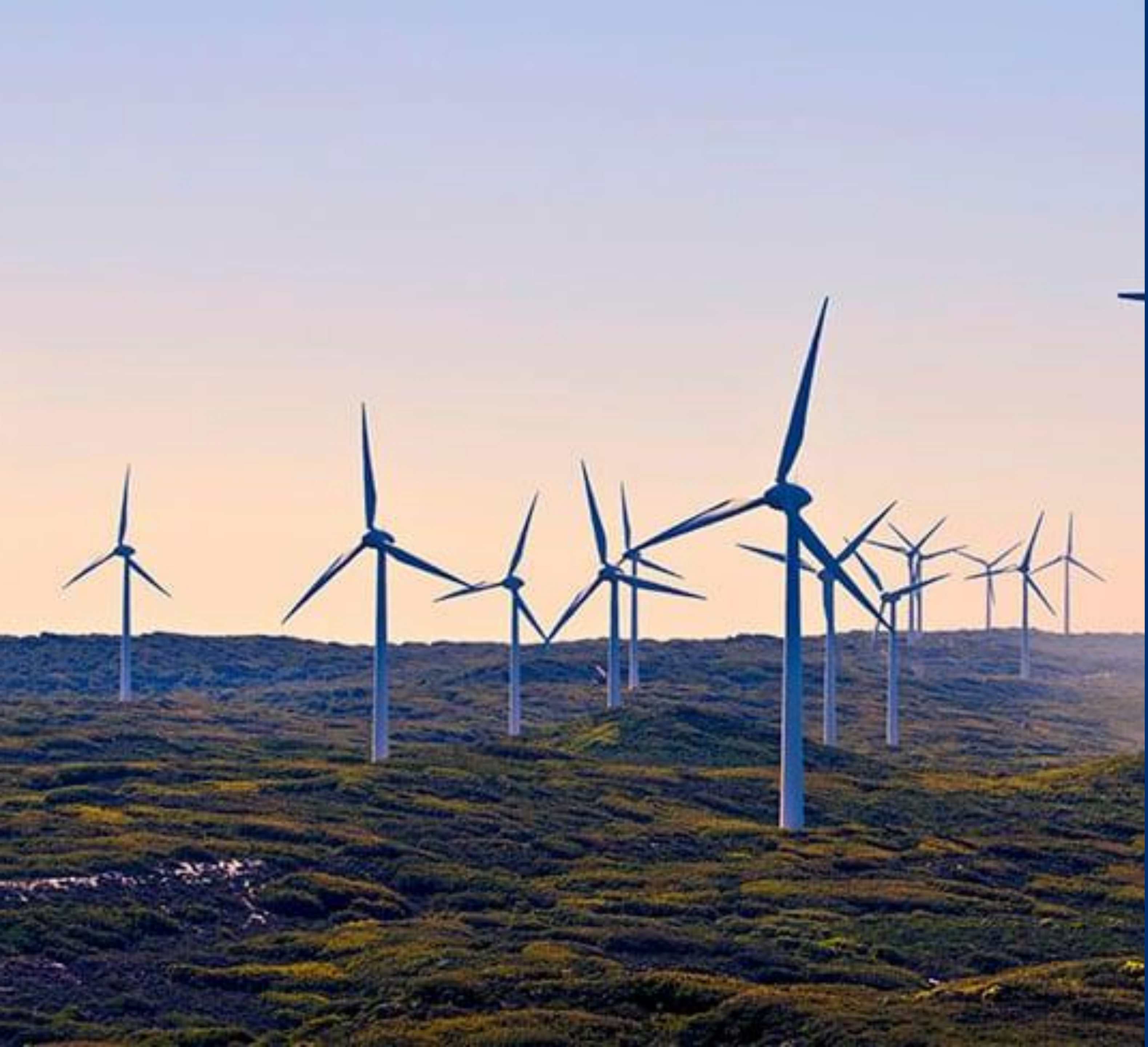
Consistency in treatment of AER propositions with stakeholder contributions

AER considerations, approach and criteria – have these been satisfied for the proposed changes to debt?
Do the changes reflect new theoretical developments, recently published data or changing market practice?
How has the AER assessed the relative merits of new evidence and new issues?
Reflective of economic and finance principles and market information? • Is the information etc consistent with well-accepted economic finance principles, and informed by sound empirical analysis and robust data
Fit for purpose? • Consistent with the original purpose for which it was complied and have regard to the limitations of that purpose • Promote simple over complex approaches where appropriate
Can the approach be implemented with good practice? • Supported by robust, transparent and replicable analysis that is derived from available credible datasets
Are the models: • Robust and not sensitive to errors or input estimation? • Not subject to arbitrary filtering or adjustment which does not have sound rationale?
Is the market data and information: • Credible and verifiable? • Comparable and timely? • Clearly sources?
Is there sufficient flexibility to allow changing market conditions and new information to be reflected in outcomes as appropriate?

HOW ARE CHANGES BEING ASSESSED?

What are the relative merits of new evidence and new issues?

AER view of the advantages of EICSI	Does the information support the claimed advantages?
More accurately reflects the cost of debt	• Can it be an accurate reflection of the cost of debt if not all debt costs are included? • Is a backward looking index reflective of future costs? • How is inflation accounted for?
Can streamline process to inform benchmark characteristics	• What does the index tell us about the efficient benchmark? • How does applying the index inform benchmark characteristics? • How are the benchmark characteristics relevant if they are not being adopted?
Reflects a benchmark because it reflects costs across all networks rather than any network individually	• Do the costs included in the index reflect efficient costs? • How can the index reflect costs of all networks if not all networks included and not all costs are included?
The desirable properties of the incentive regime are preserved as networks have an incentive to pursue efficiency gains across times and consumers benefit in the long term when those costs are revealed	• Is providing a debt allowance that is lower than efficient cost an efficient incentive? • Does continuous and unpredictable change provide stability and efficient incentives? • Will NSPs with higher efficient costs than the average have an opportunity to recover at least their efficient costs? • If actual costs are considered to be efficient – then why exclude some? • Does the approach change the allocation of financing risk? • Is the approach sustainable so that it avoids ‘flip-flopping’?
We currently use actual industry data for other relevant parameters such as gearing and beta – extending this to the benchmark return on debt would help assess an efficient and consistent estimate of the overall rate of return.	• How does using the index assist in setting the benchmark return if it does not reflect an efficient benchmark? • Is using the index to set the allowance the same as using industry data to inform the choice of benchmark?



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