ETSA Utilities

ETSA Utilities ABN 13 332 330 749
a partnership of:
Spark Infrastructure SA (No. 1) Pty Ltd
ABN 54 091 142 380
Spark Infrastructure SA (No. 2) Pty Ltd
ABN 19 091 143 038
Spark Infrastructure SA (No. 3) Pty Ltd
ABN 50 091 142 362
each incorporated in Australia
CKI Utilities Development Limited
ABN 65 090 718 880
HEI Utilities Development Limited
ABN 82 090 718 951
each incorporated in The Bahamas

9 February 2010

Mr Adam Petersen
Director – Network Regulation South
Australian Energy Regulator

By email: Adam.Petersen@aer.gov.au

Dear Adam,

Benchmarking debt raising costs associated with the completion method

I refer to ETSA Utilities' original regulatory proposal dated 1 July 2009 (**Original Proposal**), the Australian Energy Regulator's (**AER**) draft determination for ETSA Utilities dated 25 November 2009 (**Draft Determination**), and ETSA Utilities' Revised Regulatory Proposal dated 14 January 2010 (**Revised Proposal**).

ETSA Utilities' Original Proposal incorporated an allowance of 11.2 basis points per annum (**bppa**) for costs associated with the completion method of debt refinancing.

In confidential Appendix K of the AER's Draft Determination, the AER set out its conclusion that:

a) It did not consider that the costs of the completion method for refinancing debt represent efficient costs incurred by a benchmark network service provider;

b) It did not appear to the AER that ETSA Utilities had "closely investigated" the two alternative approaches being the "commitment approach" and the "underwriting approach"; and

c) Whilst Standard and Poor's may evaluate a firm's rating where that firm does not have an implemented refinancing plan, there was no automatic downgrade.

At page 131 of its Revised Proposal, ETSA Utilities noted the issues raised by the AER in the Draft Determination regarding the incorporation of debt raising costs associated with refinancing. ETSA Utilities also indicated that it had engaged PwC to evaluate both the incorporation of an allowance for debt raising costs associated with refinancing and the quantum of any such allowance. The report by PwC can now be provided to the AER and is attached.

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With respect to the principal concerns raised by the AER in its Draft Determination, ETSA Utilities considers that:

a) This independent PwC report confirms that:

- it is common practice to refinance debt at least three months prior to the maturity date (as ETSA Utilities has done); and
- it is common practice to do so including for tranches of debt that may be smaller than the tranche of debt referred to by ETSA Utilities in its Original Proposal.

To the extent the AER's Draft Determination suggests that refinancing costs may arise in part as a consequence of a large tranche of debt requiring refinancing, which may not reflect the financing choices of an efficient benchmark firm, the PwC report answers this by setting out evidence that firms refinance maturing debt for amounts of $100 million and over at least 3 months prior to the maturity date of that debt. As the quantum of debt to be refinanced is determined by reference to a benchmark, based on an assumption that 1/10th of the debt value of the regulatory asset base will fall to be refinanced each year, the actual amount that ETSA Utilities may require to have refinanced, and whether this amount is considered to reflect the financing choices of an efficient benchmark firm or otherwise, is irrelevant.

b) After a proper examination of the alternatives, the attached PwC report concludes that the cash costs associated with the completion method represent the lowest cost of the three options (completion, commitment, and underwriting) for securing suitable arrangements for renewing debt three months from maturity of that debt.

It is also relevant to note that the PwC report finds that the efficient cash cost associated with the refinancing of $100 million of debt is approximately $1.3 million, which equates to 13 bppa, based on the completion method. This is higher than the 11.2bppa incorporated in ETSA Utilities' regulatory proposal, indicating that ETSA Utilities has taken a conservative approach to estimating the costs associated with the completion method.

c) It is recognised that Standard and Poor's may not automatically downgrade firms that do not have an implemented refinancing plan. However, at issue is whether it is prudent and proper for a benchmark firm to refinance consistent with the manner in which ETSA Utilities proposes to refinance its maturing debt as discussed in the Original Proposal. The refinancing of debt at least 3 months prior to the maturity date of that debt ensures both that the business does not default on the principal repayment of a debt issue, as well as removing the risk of any negative credit ratings action. The AER has not provided evidence that would suggest that ETSA Utilities' approach to refinancing is inconsistent with what would be expected of a benchmark firm. To the contrary, the PwC report confirms that it is common practice to refinance debt at least three months prior to the maturity date.

ETSA Utilities considers that the debt raising costs associated with the completion method, as set out in ETSA Utilities Original Proposal, are a legitimate cost incurred by the business for which an allowance is required and is consistent with the National Electricity Rules and National Electricity Law.

Should you have any questions in relation to this letter or the attached report, or require any further material, please contact Patrick Makinson on 08 8404 5865.

Regards

E R Lindner

Eric Lindner

General Manager Regulation

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