Westpac Institutional Bank

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COAG Energy Council Secretariat
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Email: energycouncil@industry.gov.au

Dear Sir / Madam,

Re: Review of the Limited Merits Review ("LMR") regime

Westpac is pleased to provide this submission in response to the consultation paper released on 6 September 2016 regarding the review of the LMR regime.

Westpac believes financiers have a material interest in the processes and outcomes of the regulatory regime as debt is the predominant source of capital utilized to fund transmission and distribution businesses. Westpac is a major financier to the Australian transmission and distribution sector, and furthermore is an arranger of Australian and offshore capital market programs for these businesses.

The predictability and supportiveness of the regulatory framework in which a network operates, as well as the legal and political framework that underpins it, is a key credit consideration and one that differentiates this (regulated utility) sector from most other corporate sectors. Other considerations Westpac applies to the financing of any sector include a comprehensive risk review, against Westpac's Environment, Social and Governance ("ESG") risk management framework.

The regulatory regime is the key element for financiers considering the risk profile of transmission and distribution business. Ultimately, this influences a financier's preparedness to provide finance and the terms at which finance is made available including price. For Westpac, and indeed most other debt providers, this assessment takes into account (chiefly, although not exclusively) the predictability and stability of the regulatory regime, as well as the transparency of the tariff setting and the ability to cover reasonable costs.

Lenders across debt classes such as bank debt, but particularly debt capital markets, are driven by external issue and issuer credit ratings. In assessing a regulated utility, Moody's assigns weightings to the different qualitative and quantitative factors that create the business's credit profile. It assigns a 30% weighting to the regulatory environment. Notably, amongst a number of other elements, this considers the effectiveness of the independent body or legal system that arbitrates disputes between a regulator and a regulated company in a timely fashion.

Standard and Poor's notes that the regulatory framework is of critical importance when assessing regulated utilities' credit profile. Standard and Poor's bases its assessment of this on how regulatory stability, efficiency of tariff setting procedures, financial stability, and regulatory independence protect a utility's credit quality and its ability to recover its costs and earn a timely return.

Whilst we are not able to predict what moves (if any) credit rating agencies may make should the LMR regime be removed, we believe this and/or significant changes to the current regime would be likely to be seen to increase the level of regulatory risk which would be likely be assessed as a credit negative.

Similarly, we cannot be certain whether the removal of the LMR regime would of itself necessarily immediately alter financiers' perceptions of regulatory risk, have an impact on the preparedness of financiers to lend or influence the cost of debt to utilities.

However, we believe financiers consider the LMR regime provides “checks and balances” thereby increasing confidence in the regulatory process and if it were to be removed financiers are likely to be concerned at the (lack of) accountability of the Australian Energy Regulator. Any unexpected decisions handed down by the Australian Energy Regulator in the absence of the ability to appeal based on merit to the Australian Competition Tribunal (the “Tribunal”) would very likely have negative implications for financiers’ assessment of regulatory risk.

Transmission and distribution businesses are capital intensive and access to ongoing capital is critical to fund capital expenditure programs. We would expect an altered sentiment from financiers on regulatory risk (including as a result of a downgrade by a credit rating agency) may result in an increased cost of debt for the industry and ultimately this could flow through to consumers. Given the appropriate emphasis on the long-term interest of consumers and they paying no more than is necessary, such an outcome would be less than desirable.

We acknowledge some of the perceived shortcomings of the current LMR regime such as the time and cost of reviews, which in itself can create a picture of uncertainty and instability for providers of debt capital. We believe it is more appropriate however to address the shortcomings of the current regime such as by providing increased resourcing of the Tribunal and consideration of the operation of the remittal process rather than initiate wholesale change. The current LMR framework was last reformed in 2013 and we believe it is difficult to form a complete view as to its shortcomings until this first cycle of reviews has been completed.

We are concerned that recourse to judicial review alone is the appropriate solution. Not only is there the potential for the process to be costly, determinations would need to be considered from a legal perspective alone and errors of fact and policy may not be corrected. We also believe the Tribunal remains the appropriate review body and is capable of dealing with complex technical issues.

In conclusion, Westpac recommends retention of the LMR with the Tribunal as the review body. Whilst there is scope for improvements to the current regime, we would recommend the 2013 reforms be allowed to run a full cycle so as to allow for a more comprehensive assessment of the best approach moving forward.

Westpac appreciates the opportunity to be involved in the consultation and review process.

Yours faithfully,

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