

Statement of Alastair Watson

Treasurer for SP AusNet

1 Position

- 1.1 Currently, I am the Manager of Treasury for SP AusNet. I report to the Chief Financial Officer who in turn reports to the Managing Director. My team consists of three people, which is "Treasury" front office. There is also a team of four which do not report to me and perform the back office functions (including settlements and confirmations).
- 1.2 My role is to manage debt and equity across the whole business. This primarily involves refinancing existing debt and raising new debt. Obviously there is a significant amount of administration and risk management associated with that. Where we issue bonds offshore we also have to manage the exchange rate on those bonds. We also manage the interest rate risk on our debt in line with regulatory decisions. I am also involved in analysing and managing equity funding/raisings which I discuss below.

2 Educational background and professional experience in the energy and finance sectors

- 2.1 I trained in economics and agricultural science completing a Bachelor of Agricultural Science in 1987 and a Bachelor of Economics in 1989, both from the University of Queensland. Since that time I have also completed a Master of Business Administration from the University of Queensland, completed in 1997, and a Masters of Applied Finance from the University of Melbourne, completed in 2000.
- 2.2 On completing my agriculture degree, I worked as an agricultural economist for the Bureau of Agricultural Economics which is now known as the Australian Bureau of Agricultural and Resources Economics (**ABARE**). In 1989 I moved to Brisbane to work as a Treasury Economist at the Queensland Sugar Corporation. From there I worked for a number of mining companies and energy companies including Powercor and TXU, each time within their Treasury departments. I moved to my current role as Treasurer for SP AusNet in April 2005. So basically except for the couple of years that I worked in ABARE which was in an agricultural economics role, I guess I've got 18 years experience in treasury.
- 2.3 Currently I'm an active member of FTA which is the Finance Treasury Association. I have spoken at various conferences including the FTA Congress in 2008. There is an upcoming FTA conference on debt markets in February 2009 at which I am speaking. At that conference, I will be part of a panel discussion to provide a "corporate treasury" perspective.
- 2.4 As part of my studies I studied the CAPM. In my experience the CAPM is used for valuing proposed acquisitions especially where there is no observable market price. The CAPM allows us to determine whether we are getting an appropriate return on our capital investments and proposed capital investments.

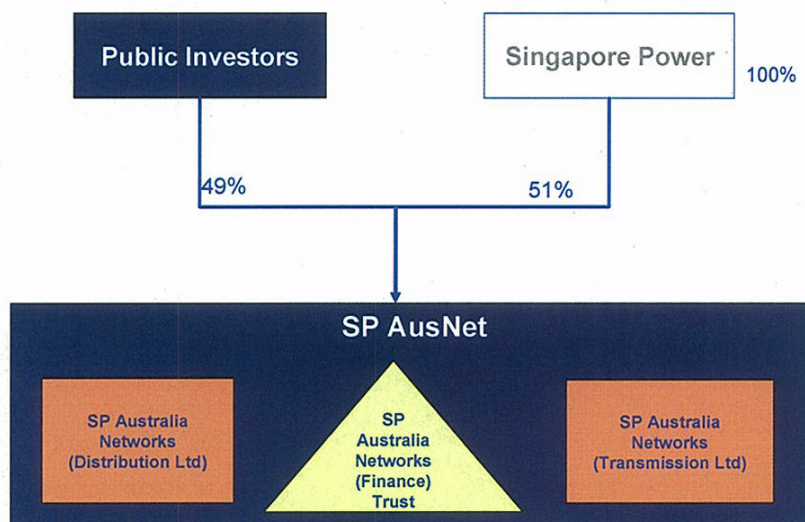
3 SP AusNet

- 3.1 SP AusNet owns and operates over \$7 billion of essential energy networks in Victoria. It has both electricity transmission and distribution and gas distribution assets. It was formed out of the privatisation of energy network assets in Victoria.
- 3.2 In terms of its corporate structure, SP AusNet comprises a stapled security consisting of one share in each of SP Australia Networks (Distribution) Ltd and SP Australia Networks (Transmission) Ltd and one unit in SP Australia Networks (Finance) Trust. Currently, Singapore Power is the majority shareholder owning 51%. Singapore Power is, in turn, owned by Temasek Holdings, which is a holdings company for investments made by the Singapore government. The remainder is made up of public investors.

3.3 So while the assets are in separate transmission and distribution entities, we fund all the business out of what we call our common funding vehicle and that's a company called SPI Electricity and Gas Australia Holdings Pty Limited.

3.4 The following diagram shows our structure:

Figure 1: Structure of SP AusNet



3.5 An important point to note in the rest of this statement, I will regard the unit holders in the Trust as holders of equity only even though taking a strict technical approach they in fact provide both equity and stapled debt finance.

3.6 SP AusNet currently has a credit rating of A-. In the absence of strong shareholder support from Singapore Power, in my SP AusNet would likely have a BBB+ rating. Ratings agencies tend to view strong shareholders (esp. if they have a stronger credit rating than the entity in question) in a positive light and hence give an uplift to the credit rating of the entity.

4 Debt raising

4.1 As set out above, in my role I primarily manage the treasury by ensuring that we have sufficient debt facilities and funding in place for continued operation. This involves refinancing existing debt when it matures and raising new debt for a portion of our capital expenditure requirements.

4.2 We regularly report to the SP AusNet Board to explain our refinancing plan. For instance we have just put our refinancing plan for the next 24 months to the Board. Mostly we focus on a 12 month period but we do a 24 month rolling period so that we have a longer term view. We always consider a 5 year plan as well but we focus on the next 24 months. Two particular issues that the Board focuses upon are the quantum of debt that needs to be raised and the "refinancing risk" which is a concept I explain below.

4.3 We have a Treasury Policy in place which provides guidance on how we should manage the risks associated with debt raising. The Policy was approved by the Board and my team's work is done in accordance with the Policy.

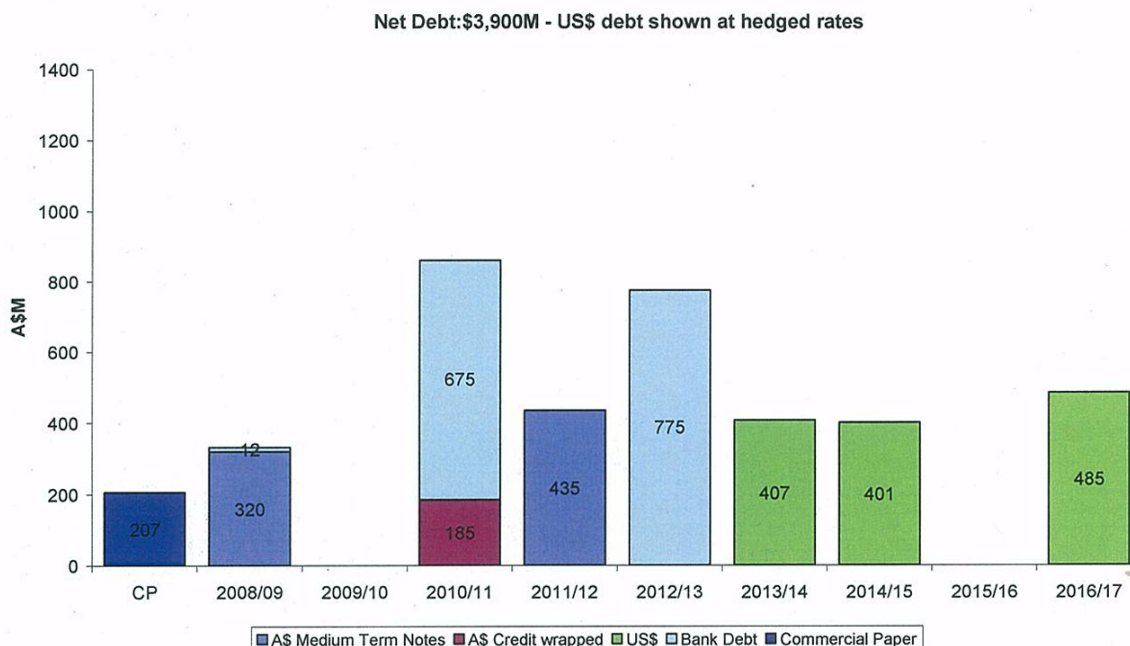
Quantum of debt to be raised

4.4 Our financial planning is aided by an extensive business model. The model for SP AusNet was put together before our float in December 2005. I had input into the model, especially the debt part of it. I use the model to work out how much debt needs to be raised in any given year.

4.5 We work out how much debt we need to raise in any given year based on a combination of factors. Firstly, what instruments are maturing and need to be refinanced. Secondly, what proportion we will have to borrow to fund the capex. Capex can be funded either through internal cash flow (ie. retained earnings) or through external funding (ie. equity and/or debt). For capex debt funding, the amount of debt you require is the residual funding requirement after retained earnings and any new equity raised.

4.6 The following diagram shows the debt instruments that were in place as at 31 March 2008 and the financial year in which they mature:

Figure 2: Diversified Debt Portfolio as a March 2008



4.7 It is important to note that Figure 2 shows our debt maturity profile. Figure 2 does *not* show the term of the debt when it was issued nor the term of the new replacement debt we will issue to replace these debts as they fall due.

4.8 In addition to refinancing existing debt, for the business as a whole we've got about \$2.7 billion worth of capital expenditure over the next 5 years and a portion of that will be funded by debt.

Refinancing risk

4.9 A significant consideration for SP AusNet's treasury operations is "refinancing risk". If you have a huge amount of debt maturing at one point in time you may not be able to refinance it. Not being able to refinance it means you are potentially in default. Thus this is a very important risk that we spend considerable amount of time and effort to avoid.

4.10 There are a number of current examples where companies have ended up in default or verging on default because they have failed to manage their refinancing risk: Centro, ABC Learning, Allico, the Babcock Group are some recent examples that have been reported in the media.

4.11 Centro was an interesting example. In late 2007 Centro had a large amount of debt and what I read in various media reports was that they had a bridge in place for over a billion dollars which I think was originally put in place for acquisition purposes. It was going to mature in late 2007 or early 2008. They were looking to refinance before August 2007 but then the credit crisis hit. Margins blew out and I read that they took the view that they could afford to wait until markets

settled down and margins reduced. It got to December, and they were still without any prospect of refinancing their bridge, so they had to disclose this to the market. A number of the banks who had lent them that money refused or were very reluctant to rollover the debt facility and demanded that Centro had to reduce their debt; for example by (i) selling assets and/or (ii) raising equity. However, given the dramatic fall in their share price which was the result of the announcement that they could not refinance their debt, a large equity raising was also not possible. It was only recently that an agreement has been reached between Centro and its lenders, which mean the lenders are effectively in control.

- 4.12 In addition, companies such as ABC Learning and Allco were placed into administration largely because these companies were highly geared and they could not refinance maturing debt. Similarly the lenders have effectively taken control of Babcock and Brown. Another company that has been negatively impacted by refinancing issues is Oz Minerals, which is having difficulties refinancing a bridge. Oz Minerals is not highly geared and looks to me to be a reasonably strong company. However, this clearly demonstrates that the viability of even strong companies can come under question if they have refinancing problems.
- 4.13 There is no absolute dollar limit or proportion of debt that a business must set to adequately manage refinancing risk. Rather it depends on the size and nature of the business. For SP AusNet with our size and asset profile, the maximum that I consider we should have up for refinancing in any one year is about \$800 million to \$1 billion which is approximately a quarter of our debt due in any one year. However, if we were a much smaller business and we had a billion dollars which might be 50% or 60% of our total debt, it would be a different story and a 50% to 60% exposure to refinancing risk would be unacceptable.
- 4.14 Above I noted that the level of refinancing that is advisable in any one year depends partly on what industry the business is in. Based on my experience working for other utility companies, two mining companies and the Queensland Sugar Corporation, the amount of debt refinancing that can be tolerated in any one year is a product of how geared the company is, and utility companies are generally more highly geared. The term of the issue is also dependent on the industry. Utility companies have long term assets that have asset lives of some 30, 40, or 50 years; whereas a mining company, may have some assets (mine life) of as little as two years or three years. Although obviously some mined may have quite long lives as well. So in my experience it is very unlikely that a mining company whose has got a five year mine life can go out there and raise 20 year debt. The lenders would be very reluctant to give a company such long term debt when the useful lives of their assets is much shorter. Nonetheless, the mining companies I have worked for still look to diversify the maturity of their debt. A number of mining companies project finance their mines so they have a specific tranche of debt for a specific mine. Others, including the companies I worked for, manage it on more of a portfolio basis so that they have various mines of various lives, they're continually exploring and developing new mines so their debt portfolio may be longer term and more portfolio based.
- 4.15 So taking all these factors into consideration SP AusNet has included in its Treasury Policy a limit or guideline such that we should not have any more than 25% of our debt maturing in any one year. It also provides guidance about how much short term debt and commercial paper we have. For short term debt the maximum amount is 10% of our total debt portfolio. For total debt, we shouldn't have more than 25% of our portfolio falling due in any one year but it should be noted that this includes 10% commercial paper and short term facilities. We try and maintain an average debt portfolio of at least five years but generally aim for longer.

Choices for sourcing debt and choosing what to include in the portfolio

- 4.16 The other thing we aim to do besides diversifying debt maturity is to diversify the source of our debt so that we do not become overly reliant on one market. SP AusNet has a well diversified debt portfolio in this respect as our debt is sourced from a number of different markets. This is shown in Figure 2 above in that each colour represents a separate source of debt and the different sources of existing debt are set out in the key. Ultimately you want to have a well diversified debt maturity portfolio because although it would be theoretically possible to borrow all your requirements in short term debt, the refinancing risk (even in a very good credit

environment) would be too large for a business to accept. In the current environment, adopting such a strategy would mean the company would be lucky to last a week!

- 4.17 A good example of failing to diversify the source of debt, and thankfully we weren't effected, was the effective closure of the credit wrap market. In the credit wrap market, the credit wrappers, for a fee, insured a company's bonds. Before the downgrade in a number of credit wrappers' credit rating, this allowed an energy utility company with the credit rating of say BBB+ to issue bonds at a credit rating of AAA. A number of utilities issued a lot of credit wrap bonds. This may create some refinancing problems in the future as this credit wrapped debt comes up for maturity. If the credit wrapped bond market remains closed (as a number of market participants have predicted) refinancing these bonds will need to be done via bank debt and/or other bond markets (most likely offshore bond markets given the difficulty in issuing bonds in Australia).
- 4.18 If a market is not available and you're reliant on that market then it's not just a simple switch to another market. You need to build up relationships with lenders and that can take time and effort. For example, for our sterling bond that we issued in June last year, it was a conscious process of going to a new investor market and starting to build a relationship with that market so that in future we can go back to that market and issue. The first time you access a new market it is very likely you will need to pay a premium because the investors are unfamiliar with your credit and until they become familiar and more comfortable with the company and how it operates the investors will demand a premium above their domestic companies that they know well.
- 4.19 To achieve this diversity and term before debt becomes due, there are a number of markets SP AusNet could potentially access. The following is not an exhaustive list but some of the prime markets we would look at when considering any refinancing include:
- (a) the Reg S in Asia – the Reg S is a market governed by US rules but mostly we source the money out of Singapore and Hong Kong;
 - (b) the 144A market in the US – 144A is a rule that governs the raising of debt in the US;
 - (c) the Sterling market in the UK;
 - (d) the Australian bond markets;
 - (e) the US Private Placement market;
 - (f) Bank debt; and
 - (g) Commercial paper.
- 4.20 In considering what bond to issue some important factors are:
- (a) the amount to be raised – each market tends to have a benchmark size meaning that investors will only consider buying bonds as part of a “liquid” issue. A liquid issue is important for investors as it allows them to “trade out” of a deal if for some reason they need to. For instance, if you went to a market where the benchmark size was \$250 million and you were only prepared to issue \$100 million you are unlikely to be able to raise debt in that market and you would need to go to another market (which may be more expensive).
 - (b) the term of the bond – in the same way that each market has a benchmark size, buyers also have a preferred term. If you can match the preferred term that the market is looking for then the benefit will be large volumes and potentially cheaper pricing. For example, US\$ 144A and Reg S and the Sterling markets have a preferred term of 10 years or longer . If an issuer is unable to or does not want to “match” what the bond market wants in terms of tenor, then that market is unlikely

to be available and another market would need to be considered, assuming another market can be found;

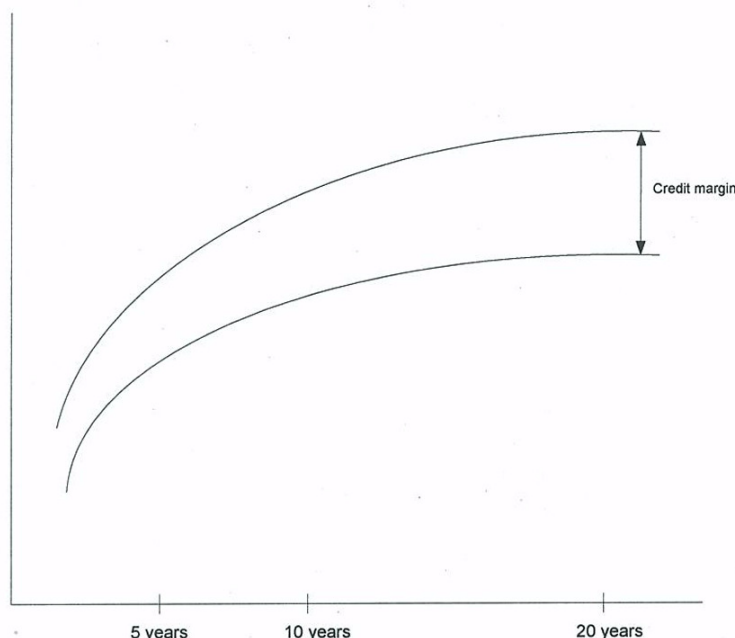
- (c) whether the bond is fixed or floating - all the bonds that we've raised have been fixed rate except for a couple of the Australian bonds. We've occasionally raised floating rate debt. However, from an investors' point of view, almost entirely they want fixed rate bonds. Whereas bank debt is almost always floating rate debt;
- (d) covenants – some markets are more stringent and require more covenants than others;
- (e) currency - obviously if you raise debt in say sterling, then you will have to swap that back into Australian dollars (entering into swaps also has additional costs); and
- (f) price – this is probably the most important factor and ultimately depends on supply and demand given the particular features of the bond outlined above.

4.21 Some of the features of the main markets that SP AusNet issues into are summarised in the following matrix:

Market	Location	Currency	Term	Covenants/comment
Bank debt	Australia	\$AUS	Less than 5 years. Currently mostly limited to 3 years or less.	Prudential requirements mean banks are likely to have an exposure limit against any one company
Commercial Paper	Australia	\$AUS	Up to 1 year but generally issued for 3 months on a rolling basis	The CP market is currently closed to most issuers.
Australia	Australia	\$AUS	4-7 years	The A\$ bond market has been closed to non financial issuers for around 18 months
Reg S	Asia	\$US	7-10 years	
144A	US	\$US	7- 30 years	
US Private Placement	US	\$US	5, 7, 10, or longer	Bond buyers require strong covenants similar to banks
Euro	European Union	€	5, 7 and 10 years	
Sterling	UK	£	10, 20, and 30 years	

- 4.22 Subject to the banks' credit limits, generally bank debt is always available. Currently, bank debt is probably a cheaper source of debt than bond markets, but that's not always the case, it can vary quite a bit. Bank debt is generally only available for short terms (as mentioned 3 to 5 years), whereas it is the bond markets that can offer longer term funding. We usually like to keep ourselves underweight on bank debt because it can act as "reserve capacity." Bond markets can close occasionally, for example in 2008 there were quite lengthy periods when bond markets were closed no matter how strong a company was. In such circumstances, knowing that bank debt is still available significantly reduces your refinancing risk. We also keep committed but undrawn bank debt facilities in place as a matter of prudence. There is a cost in doing this, but again this cost needs to be weighted against the risk of not being able to access debt when it is required. Also it's good to reserve capacity from the banks if you are considering an acquisition. In acquisitions generally you arrange bridging finance from the banks, which you then refinance with an appropriate amount of longer term debt and equity. Thus if you were considering acquisitions then it is appropriate to also keep some of this reserve bank debt capacity to finance an acquisition. Otherwise, you may not have funding available, no matter how great an opportunity is.
- 4.23 In the past we have issued much longer term bonds and would like to do so again in the future, if the cost was acceptable. Back in 1996 we issued US\$100 million of bonds for a 20 year term. Currently margins are so high that issuing very long term debt is expensive, but assuming that margins do come down from the historic highs we would consider issuing 20 year or 30 year debt. It should be noted, that under conditions that give rise to a normal yield curve, the longer the term the greater the credit margin which is the premium that you have to pay on top of the BBSW. This is illustrated in Figure 3 below.

Figure 3: Upward sloping yield curve



- 4.24 Despite the higher margins for longer term debt, when weighing the costs and benefits it may still be worth while to access longer term debt because it mitigates refinancing risk. I could pay a relatively smaller margin on short term debt, but the cost would be that this has significantly increased my refinancing risk. By issuing a 20 or 30 year bond you are basically buying the removal of refinancing risk for almost the lifetime of the assets, but at a higher cost. In my view, the optimal strategy is to have a mixture of short, medium and long term debt but at the same

time making sure that the debt that is maturing in any one year, plus the short term debt, is not a significant part of your debt portfolio.

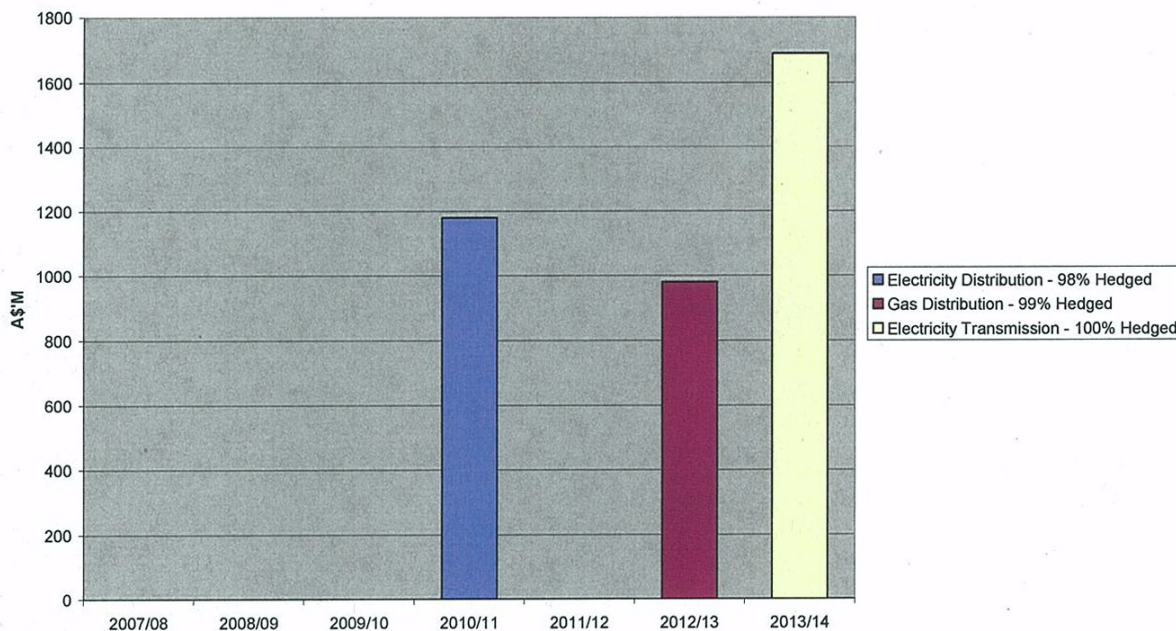
- 4.25 To keep the price as low as possible for any given tenor or term of debt, part of Treasury's role is to seek to foster competition amongst our lenders. Pricing tension is a product of competition to buy bonds. The people who buy those bonds can be put in two separate categories. There are those who trade bonds through buying and selling. These people tend to be interested in shorter term bonds up to ten years. However, there is also a group of buyers who have a particular interest in long term bonds such as pension funds. They use long term bonds to match their liabilities. They can have 30 year liabilities and they want a 30 year asset to match. However, this market is not as deep as other markets and at the moment buyers such as pension funds are holding onto their money and seeking the best and least risk returns.
- 4.26 When the credit markets open up we will consider issuing longer term bonds and increasing our weighted average term to maturity.
- 4.27 In considering funding I am interested in managing refinancing risk by securing a diversified portfolio of bonds with different terms to maturity, sourced in different markets and that don't mature all at once. Creating pricing tension to keep the cost as low as possible is also a consideration. Note that I do not consider as a significant factor in raising debt the issue of interest rate risk and that is because I manage that type of risk separately.

5 Hedging

5.1 As noted above, there are a number of different risks that we manage. I have discussed refinancing risk above but there are other risks too. Firstly we consider the risk that an interest rate would move over time. The interest rate has the potential to move adversely over time against your desired outcome. Because the regulator establishes the WACC at the beginning of the regulatory period, in terms of our business, interest rate risk is anything that departs from that benchmark that the regulator has set.

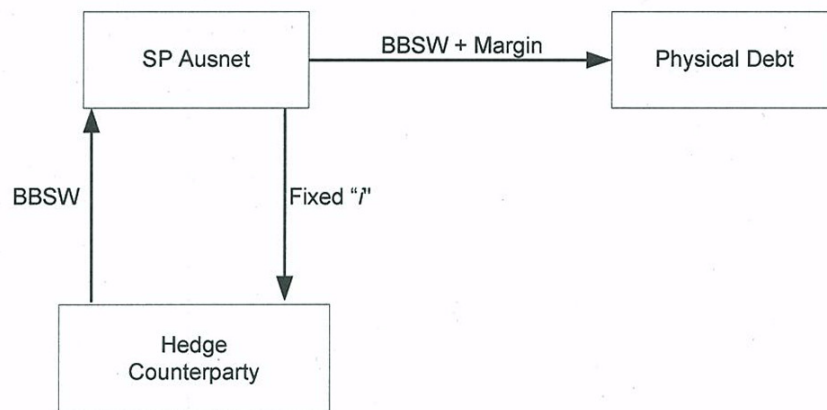
5.2 The following diagram shows SP AusNet's interest rate hedge profile:

Figure 4: SP AusNet's Hedge Profile (as at 30 Sep 2008)



- 5.3 It shows that hedging is aligned with the regulatory reset for each of the regulated businesses. For instance, say we were to issue a 10 year bond, we would hedge the interest rate against the BBSW so that it matches as closely as possible the interest rate assumed by the regulator for the relevant regulatory period. Because there may be two regulatory resets before the bond matures, two different hedges will be taken out. This is a little simplistic given our common vehicle funding arrangements but even where funding is combined we aim to have a portfolio of hedging instruments that align with the various regulatory resets.
- 5.4 The documentation which governs our hedging instruments are ISDA (an acronym that stands for International Swap Dealers Association) agreements. These agreements set out the terms and conditions between SP AusNet and a bank if we enter into a swap. Basically, the swap works as I have depicted in the following diagram:

Figure 5: Illustration of an Interest Rate Hedge



- 5.5 Considering the debt portfolio and the practice of hedging to match exposures with the regulatory resets, it can be seen that for any given borrowing of say 10 years, we will over its life enter into at least two hedging instruments to cover the risk of movement in interest rates between the date at which we entered into the bond and the dates of the revenue resets that will occur during that bond's lifetime.
- 5.6 The way we manage the currency risk when we issue offshore debt and fixed rate Australian debt is similar. In the case of foreign debt, we enter cross currency swaps to cover the risk that our interest and principal payments are denominated in foreign currency (say on the US\$ denominated debt that is shown in Figure 2). We swap these to Australian dollar floating rate debt. We then "layer" our fixed interest rate swaps "on top" of this floating rate debt to ensure our interest rate risk is aligned to the relevant regulatory period. Thus as mentioned we can therefore independently manage our interest rate risk from our funding risk. In terms of a fixed rate A\$ bond which extends over a regulatory reset period, we would swap this fixed rate debt into floating rate debt (for the life of the bond if we already have fixed interest rate swaps in place) or for that portion of the bond which extends over the regulatory period (if we did not already have fixed interest rates swaps in place which hedged debt in line with the existing regulatory period).
- 5.7 As mentioned above SP AusNet manages its interest rate risk and funding risk independently. We utilise interest rate swaps to manage our interest rate risk so that it matches as closely as possible the interest rates assumed by the Regulator over a regulatory period. Also as mentioned it would be unacceptable to also have all of our debt maturing at the time of the regulatory reset. To do so could potentially lead to a default situation if we were unable to

refinance this debt. As a consequence we have a portion of our debt maturing on a periodic basis to ensure we reduce our refinancing risk to a manageable level.

- 5.8 There is an important point of detail to note with respect to hedging. At paragraph 4.23 I explained that the interest rate we pay is higher than the BBSW and the difference between the rate at which we borrow and the BBSW is the credit margin. We can easily hedge against changes in the BBSW and we commonly do so but we can not hedge the credit margin. So while the hedging helps with managing the risk of the whole market interest rates moving, our hedging commonly leaves us exposed to changes in the margin between the BBSW and the rate at which we borrow. This margin is specific for a company's credit rating, the industry in which it operates and for the company itself.
- 5.9 At present there are no hedge instruments commonly traded that hedge the credit margin because the size of the credit margin largely depends on the characteristics of a particular company. It may be possible to develop a hedge product that allows a business to hedge against the margins of a group of other say 'A' or 'BBB' rated companies. This could be done against a number of credit default swaps based on a portfolio of companies with similar characteristics (eg same industry and the same credit rating), but the Australian market is probably too thin and this is potentially one of the reasons why the banks have not come up with such a product. Any assessment of the margin to be hedged would be easily influenced by the movements in an individual company's credit default swap rate. I have, indeed, discussed the possibility of hedging against a pool of companies with similar characteristics with potential hedge counterparties but to date the banks have been unable to come up with a viable hedge product. Even if we could develop such a product this will still not take away the company specific risk (that is the risk that the rate at which we as an individual company can borrow at compared with the group) and as a result we would still bear some basis risk.

6 The current returns on equity

- 6.1 Of course as well as debt we obtain financing for our activities in the form of equity and one of the ways that we have recently decided to raise equity is through adopting a distribution reinvestment plan (DRP). A DRP is essentially the same as a dividend reinvestment plan but the name difference reflects that our unit holders own stapled securities that include units in a trust not just shares.
- 6.2 We decided to introduce the plan because (i) of demand from our retail investor base for a DRP and (ii) as an additional, straight forward funding option to assist in funding a portion of our growth capex. Through the DRP, our security holders can elect to reinvest their distributions in the form of additional stapled securities, they can choose to continue to receive their distributions paid in "cash" or they can take a mixture.
- 6.3 Security holders' decisions whether to participate are, of course, influenced by how much they expect to earn on the additional units they receive. The security price at the last distribution date was \$0.96. Given that our interim distribution was approximately 5.93 cents per security, this means the effective yield on these securities is over 12%. This does not include any capital gain which an investor would normally expect and also does not include any franking benefits etc. which some investors may receive.

7 The effect of the Global Financial Crisis

- 7.1 I have been working in the finance industry since 1989. Since then there has been the Asian Currency Crisis and various other downturns but the current Global Financial Crisis is the most significant downturn I have witnessed in that time. One indicator of the severity of the crisis that particularly strikes me is that as a result of the credit crisis, credit margins for triple B or for that matter any credit, have never been higher – not even in the great depression back in the 1930s were credit margins as high as they are now. This is shown in Exhibit 8 of a Morgan Stanley report on the Global Credit Outlook 2009 – *The Year of Credit*, dated December 12 2008.
- 7.2 The Australian bond market has essentially been closed to non financial issuers for around 18 months. In the US, the bond markets have been closed for intermittent short periods of time

over the period of the crisis. Where markets are closed this means that you can't issue bonds during those periods because no one wants to buy them or at least no one wants to buy them in meaningful volumes.

7.3 Unfortunately no one can predict the length of the crisis. If the market thought that everything would be fine again in one or two years then you would expect to see margins on say 5 year debt to be less than or close to margins on two year debt. Thus the return for lenders would reflect the relatively high cost of debt and risk for the first two years, then a comparably lower cost of debt and less risk for the remaining 3 years. This is not the case and 5 year margins (and longer term margins) have increased as much or more than two year margins. What this is saying is that the market does not know how much longer these high margins will remain. Thus lenders are demanding a return that rewards risk for a period much longer than just one or two years.

7.4 When I think about the credit crisis there have been various stages over the last 14/15 months. To start off with there was the period from October 2007 to January 2008 when margins blew out but not too much. They increased a bit compared to what they were in the beginning of 2007 or in 2006. There was a definite increase in margins after Bear Stearns was bailed out by JPMorgan. Then there was a period of relative calm where margins settled at high levels but probably not that much higher than what you had in 1997 during the Asian crisis. So not out of alignment with past difficult credit environments.

7.5 The second stage was in September and October 2008 when Lehman Brothers collapsed and there was the bailout of banks all around the world. That is when credit margins blew out tremendously and in October/November 2008 credit spreads were at historic highs, higher than when they were during the great depression. So in terms of impact on credit margins and the impact on the credit environment this is the worst period ever. The severity of this crisis and the fact that there has not been a crisis so deep in our professional lives are such that even if credit markets return to a more normal state with bonds issued more regularly, it may be that some market expectations (such as the credit margin) may have changed for an enduring medium or long term period.

8 Deloitte Report

8.1 I have been provided with a table from a Deloitte Report which I understand has been commissioned by the AER. For my business it records the following:

Distribution	Amount (\$M)	<1 Year	1 to 5 Years	>5 Years
SP AusNet	3,671	537	2,051	1,083

8.2 Deloitte did not speak to me in putting their report together.

8.3 The total debt amount of \$3,671 million appears to be a balance sheet number based on the 2007 Annual Report.

8.4 When we consider our debt portfolio, an important measure is the weighted average term or weighted average maturity. It is important as it provides both SP AusNet's management and the SP AusNet Board with a snapshot of the term of our debt. For example, if our weighted average term of debt was say 6 months then this would suggest we have a very high refinancing risk. On the other hand if our weighted average term was 30 years, then our refinancing risk is likely to be very small but we are likely to be paying a significant premium to have in place such long term debt. I regularly report this measure to senior management and to the Board.

8.5 At the moment the weighted average term to maturity is approximately 6 years. This has been purposely lengthened over the last few years; in 2006 we issued a 10 year bond in the Reg S

market. Since that time we have made a conscious effort to lengthen the average term. The intention to lengthen the average term was to reduce SP AusNet's refinancing risk such that the debt maturity was more spread out and there was less debt maturing in the 1 to 5 year period. This is a long term process as the only opportunity to lengthen the term of your debt is when it is refinanced.

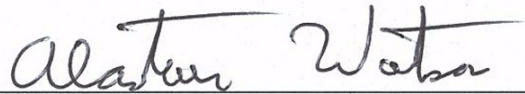
- 8.6 We would have looked to increase the weighted average term further but for the Global Financial Crisis. Ordinarily we would be interested in accessing 20 or 30 year debt for at least a portion of our debt portfolio; however the Crisis means that those markets are currently either closed and/or the margins are extremely high and as a result we will look towards short to medium term debt until credit markets settle down. We have this flexibility as a result of our previous efforts on lengthening the average term. If we had not done this (and therefore would have faced a large portion of our debt maturing in the next 3 to 5 years) accessing short term debt (ie. 3 years) may have led to an a higher level of refinancing risk.
- 8.7 There is, perhaps, a more important point than correcting the numbers in the Deloitte report and that is the use to which the numbers are appropriately put. The numbers above give a picture today (or actually at the reporting date in 2007) of how much term *remained to run* on each instrument. They do not show what the term of the instrument was when the debt was issued. To show that, I provide the following table showing the term at the date when SP AusNet (or its predecessor company) entered into them.

Instrument	Nominal value (millions)	Term when issued
Commercial paper	\$290	Rolling 3 months
Bank debt	\$270	5.25 years
Bank debt	\$250	7.25 years
Credit wrapped bond	\$299	7 years
Credit wrapped bond	\$322	7 years
Credit wrapped bond	\$185	10 years
A\$ bond debt	\$170	4 years
A\$ bond debt	\$150	4 years
A\$ bond debt	\$235	7 years
A\$ bond debt	\$200	7 years
US\$ Bond	\$407	10 years
US\$ Bond	\$400	10 years
US\$ Bond	\$361	10 years
US\$ Bond	\$123	20 years

Weighted average		7.6 years
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9 Conclusion

- 9.1 As you can see from the above table, our debt when issued is predominantly long term debt not short term debt. If I had to choose between a 5 year and 10 year instrument as typical of the instrument that we issue, it would have to be a 10 year instrument. A 5 year instrument would simply be too short when compared with our practices and procedures that I have described in section 4 of this statement and would significantly increase the refinancing risk of the business.
- 9.2 Also, it would be highly artificial to assume that we could refinance all our debt every 5 years to coincide with the regulatory reset process. We can hedge changes in the level of long term interest rates between the date we issue bonds and the date of a revenue reset but that hedging does not in any sense "convert" long term debt or debt costs into short term debt or short term debt costs.
- 9.3 Even with hedging in place against the BBSW, we remain exposed to variations in the credit margin.



Alastair Watson

Treasurer, SP AusNet

30/1/09