DUET GROUP

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NSW 2000, Australia

AMPCI Macquarie Infrastructure Management
No.1 Limited (AFS Licence No. 269286)
AMPCI Macquarie Infrastructure Management
No.2 Limited (AFS Licence No. 269287)
DUET Investment Holding Limited
ABN 22 120 456 573

29 January 2010

Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

Dear Chris,

Re: South Australia Draft distribution determination 2010-11 to 2014-15

We write in response to the AERs conclusions on the prevailing cost of equity in its ETSA draft decision (AER, ETSA Utilities Draft Distribution Determination, 2010-11 to 2014-15, 25 November 2009, p.340-342).

In arriving at its decision the AER noted that, based on short-term trading yields, the return on equity as determined by SORI sits well within the observable range of trading yields for regulated utilities. Further, the AER noted that if it were to accept a MRP of 8% as proposed by ETSA, this would result in a cost of equity above all Australian listed regulated utilities except DUET Group. The draft decision also stated that over 50% of DUET Group's carrying value of investments is from either overseas activities or currently unregulated activities and therefore DUET Group is likely to attract a higher cost of equity than other regulated utilities.

In response to the AER statements outlined above we make the following three observations:

1. The Observed Cost of Equity

In ruling that the 10.57% SORI cost of equity capital is aligned with current market conditions, the AER benchmarked this return against forecast yields for Australian listed regulated energy utility businesses. This is an erroneous measure of the cost of equity as forecast yields fail to account for capital growth expectations inherent in investor's expected returns. Capital growth is an integral component of the cost of equity. Exclusion of this component of the required return to equity investors materially understates the true cost of new equity capital for regulated utilities.

When capital growth is accounted for, the AER ETSA decision is significantly below the current average cost of equity at 13.3% for the sector (see Exhibit 1 below).

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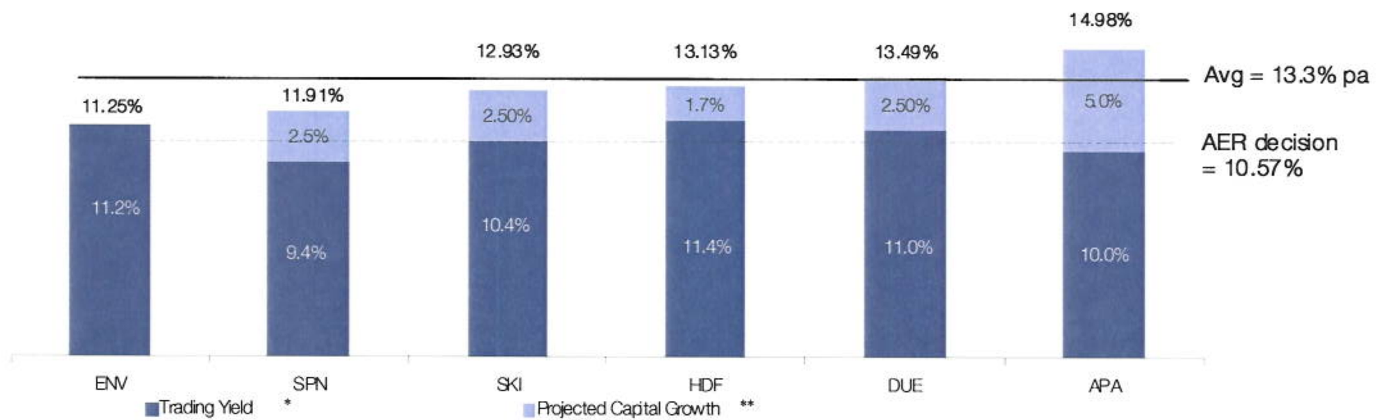
Exhibit 1

Current cost of equity
(% pa, pre-tax nominal ROE as at 1 December 2009)



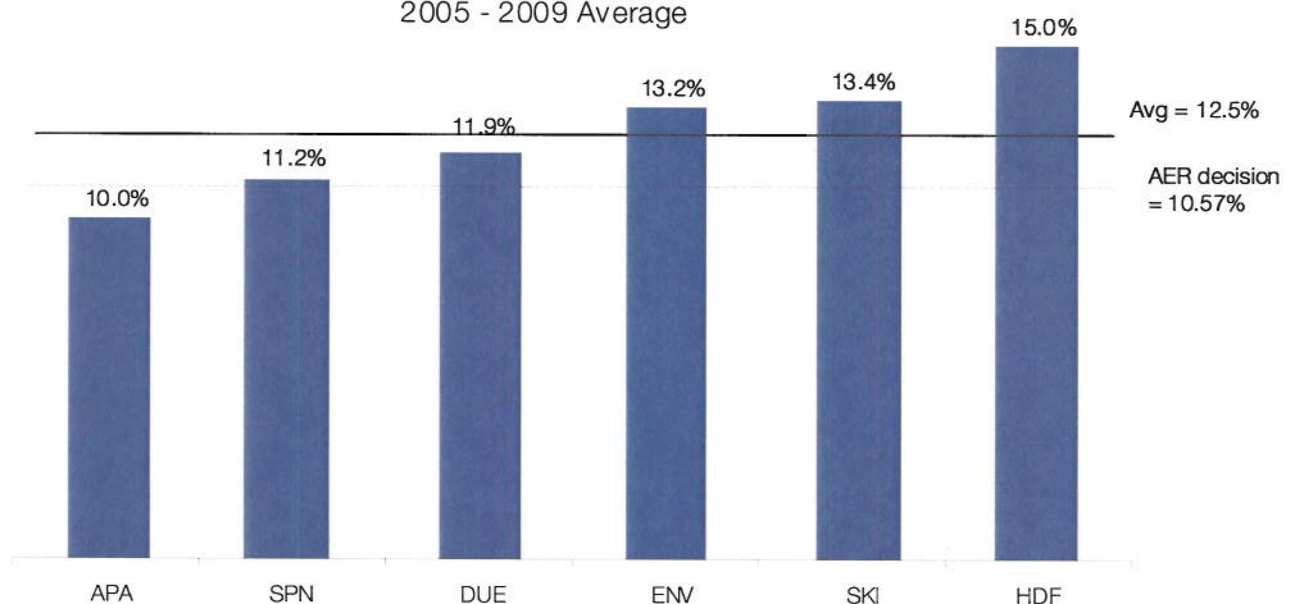
* Source: Bloomberg and ASX company announcements (forecast dividend over market price at 1 December 2009)
** Source: RBS (projected 3 year DPS growth)

Further, the AER based its yield calculations upon an 18-day averaging period ending 13 October 2009. When the results derived from this methodology are compared with the historical average trading yield, there is a significant difference, with the AER's methodology understating the yield that equity investors require from a listed regulated utility (see Exhibit 2 below).

Exhibit 2

5 Year Historical Prospective Trading Yields
(dividend guidance/quarterly VWAP)

2005 - 2009 Average



Source: Bloomberg and ASX company announcements

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2. DUET Group's Cost of Equity
The AER's observations regarding DUET Group's asset portfolio and its statement that equity investors require higher returns because DUET Group owns an asset in the U.S. and derives a portion of its income from unregulated sources do not take account of two key issues:

Duquesne Light is a heavily regulated transmission and distribution network owner and operator. Its electricity transmission business is regulated by the Federal Energy Regulatory Commission (FERC) and the Pensylvania Public Utilities Commission (PaPUC) and its electricity distribution business is regulated by PaPUC. These regulated businesses account for 81% of Duquesne Light's revenue and they generate stable, predictable cash flows with a risk profile commensurate with DUET Group's Australian regulated utility assets; and
The Dampier to Bunbury Pipeline (DBP), which we assume to be the unregulated revenue source of the DUET Group referred to in the ETSA draft decision is regulated by the ERA, has 100% of its capacity contracted until 2019 and tariffs for all shippers (other than Alcoa) revert to the regulated tariff in 2016. The contracted revenue affords DBP stable, predictable cash flows and removes regulatory uncertainty until at least 2016. As a result, in our considered view, DBP has a lower operating risk profile than most Australian regulated utility assets.

On this basis, DUET Group's cost of equity remains a very relevant and important data point when calculating the cost of equity for Australian regulated utilities.

3. The Purpose of Sector Capital Raising in 2008 - 2009
In the ETSA draft decision, the AER contends that the price of equity raised by the listed utilities is not a relevant measure because the funds were not applied exclusively to capital expenditure projects but rather used partly to repay debt.

All of the companies in our sector who raised equity in 2008 and 2009 are facing the need to provide new funding to support large increases in forecast capex for their businesses. For each utility, annual regulatory depreciation is now significantly lower than the projected level of annual capex. Consequently, new equity must be raised to fund these capex programs. Current and foreseeable global capital market conditions create the need to fund expansions at debt to equity ratios lower than in the past. Therefore, a direct link can be drawn between the need for new capital expansion and the need for equity funding to support capital expansion programs and the price of equity reflected by these capital raisings is directly relevant to the prevailing cost of equity for Australian regulated energy utilities.

The simple conclusion from the information presented in this letter is that the prevailing cost of equity for our sector remains significantly higher than the cost of equity determined in SORI and recent regulatory decisions, including the ETSA draft decision.

We would be happy to discuss, elaborate or clarify any of the matters raised in this letter.

Yours Sincerely

Peter Barry
CEO
DUET Group

Cc Steve Edwell, Chair, AER
David Bartholomew, COO, DUET Group
Jason Conroy, CFO, DUET Group