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19 May 2015

Ms Tina Higgins
Principal Council Officer - Upper House
Committees
Parliament of New South Wales
Parliament House
Macquarie Street
SYDNEY NSW 2000

electricityleasing@parliament.nsw.gov.au

Dear Ms Higgins

Inquiry into the leasing of electricity infrastructure

1 We refer to your email to Mr Matthew Grounds dated 14 May 2015.

Additional Information

- 2 UBS operates a number of separate businesses in Australia. One of those businesses is UBS Securities Australia Limited ("**UBS Securities**"), which provides research to institutional investors. Another is UBS AG's investment banking and advisory function, which provides financial advice to corporations and governments.
- 3 Since July 2014, the investment banking function at UBS AG has been advising the NSW Government in relation to the long term lease of the State's electricity infrastructure. That work involves the preparation of a Cabinet scoping study and advice.
- 4 Independently of the work being performed by UBS AG, UBS Securities published a research report on the morning of 17 March 2015 regarding both the long term lease of electricity infrastructure and the potential use of proceeds from the lease. Following publication of that report, the Head of Research at UBS Securities read it and was immediately concerned that it could mislead readers. After consultations with the report's authors, an addendum report was prepared and submitted by the analysts for approval to release at around 3.20pm.
- 5 Consistent with UBS's policies on research independence, the advisory team from UBS AG did not influence the UBS Securities' decision to issue an addendum. Due to the significant reputational impact to the UBS brand that can result from the publication of a corrective report, the Head of

Research informed UBS's Head of Country (at approximately 1pm) once he formed the view that an addendum was required.

- 6 Subsequently, and without the knowledge of UBS Securities, two senior representatives of UBS AG had communications with the Premier's Office concerning the media attention UBS Securities' report was attracting, and the need to differentiate the views of UBS Securities from those of the UBS AG advisory team. In the present case there was a clear risk, as has been borne out by subsequent events, that the views of Research would be erroneously reported as being the views of the government's expert advisors.

Transcript

- 7 Enclosed is a copy of those pages of the uncorrected transcript on which corrections are marked by hand.

Questions taken on notice

- 8 The following responses are given to the matters highlighted in the uncorrected transcript:
- (a) page 90: copies of the original and revised reports are enclosed;
 - (b) page 92: see the response to supplementary questions 1 to 4 below;
 - (c) page 96: an organisational chart showing Messrs Grounds, Fowler, Williams, Key, Leitch and Lilley and their respective reporting lines is enclosed;
 - (d) page 97: UBS does not consider that it is permitted to provide that information, as it is commercial in confidence. UBS respectfully submits that the request for this information must therefore be put to the Premier's office. UBS notes its understanding is that contract details will be disclosed by the NSW Government in late May 2015.

Supplementary questions

- 9 Set out below are the responses of the individual witnesses (questions 1 to 25) and UBS generally (questions 26 to 28) to the supplementary questions addressed to each of them.

<i>To Mr Matthew Grounds and/or Mr Guy Fowler</i>
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1. *From what date was UBS engaged by the NSW Government in connection with the proposed electricity network transaction(s)?*

14 July 2014.
2. *How much has UBS been paid to date for their work on the electricity transaction?*

Nil.
3. *What is the present estimate of the total value of the engagement of UBS in connection with the proposed electricity network transaction(s)?*

See response at paragraph 8(d) above.

4. *If you do not provide a dollar amount answer to the above two questions, why will you not provide that information?*

(We are not seeking any confidential information relating to any contract between UBS and the State Government, or the basis of any charging, only the amounts.)

See response at paragraph 8(d) above.

To Mr Matthew Grounds

5. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

Following the publication of the research reports on 17 March 2015, I have attended individual interviews with legal counsel. The matters discussed at those interviews are the subject of legal professional privilege. I have also had an interview with the Australian Securities and Investments Commission ("**ASIC**") in respect of which there is a non-disclosure direction.

Prior to appearing before this Committee on 11 May 2015, I also attended meetings with UBS' legal counsel along with the other UBS representatives, including those who the Committee had requested jointly give evidence. The matters discussed at those meetings are the subject of legal professional privilege.

6. *Mr Williams in evidence said that – before he spoke to the analysts Mr Leitch and Mr Lilley about the need to revise the report – he spoke to Matthew Grounds at "approximately midday".*

- (i) *Mr Grounds told the inquiry that he was not the "boss" of Mr Williams. He said that "research is independent of the investment banking business". Taking this into account, can you please explain why this conversation took place and how it does not constitute a breach of section 912A of the Corporations Act?*

Mr Williams first spoke to Mr Leitch and Mr Lilley about the report shortly after it was published and before he spoke to Mr Grounds. He subsequently spoke to me at around 12pm and alerted me to an issue with the report, and then at around 1pm to inform me of his decision to issue an addendum. This was because I, as UBS' Country Head, needed to know what was occurring as there could be significant reputational impact to the UBS' brand as a result of these matters. This conversation is not a breach of section 912A of the Corporations Act.

- (ii) *Did Mr Grounds suggest that the Deloitte Access Economics report be included in the revised report?*

No.

- (iii) *Did Mr Grounds make any other suggestions about what should be included in the revised report?*

No.

- (iv) *Who brought the copy of the Deloitte Access Economics report to Mr Williams' office?*

It was Mr Fowler.

7. *Mr Williams said that Mr Fowler was present in his office "by coincidence" during the second conversation with analysts about further revisions to the report.*

At other investment banks in Australia, the Head of Investment Banking (or indeed any banker) cannot just wander into the Head of Research's desk or onto the dealing floor – their passes and access areas do not allow it, unless someone from equities has personally walked them in. Does UBS have a similar system?

At UBS, the Head of Investment Banking and other investment banking staff cannot enter the area in which research analysts work. There are physical pass card arrangements that ensure this arrangement. The Head of Research sits outside that area. No investment banking staff entered the area in which research analysts work in connection with the events of 17 March 2015 that are the subject of the Committee's inquiry. I am not aware of other major investment banks having any different arrangements regarding access to their research areas.

To Mr Guy Fowler

8. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

I was individually interviewed by legal counsel, and by ASIC, after 17 March 2015. The matters discussed at interviews with legal counsel are the subject of legal professional privilege. I have been advised by ASIC that I should not disclose the questions asked or answers given during my interview with them.

Subsequent to these individual interviews, I attended meetings convened by UBS' legal counsel together with other UBS representatives, including those witnesses who were invited to jointly give evidence before this Committee. The matters discussed at those meetings are the subject of legal professional privilege.

To Mr Chris Williams

9. *In your evidence at pages 81 and 82 of the transcript, you stated that the original UBS report issued on 17 March 2015 had a "headline that did not reflect the substance of the report." (p81) and you disagreed with the proposition that the original headline does accurately reflected the original document (p82). The original report states clearly in a number of places that the State Budget will be negatively impacted by the proposed electricity transaction. How do you reconcile your view with the clear and express analysis included in the original report, in the highlighted passages?*

The report indicates (including in some of the highlighted passages) that the lease of poles and wires may improve the state's fiscal position in the short term but that the use of the proceeds of the lease for investment in new infrastructure may adversely affect the state's fiscal position in the long term. The latter proposition is dependent on the qualification that "[t]he only way this would not be true would be if the associated boost to the State's GDP was sufficient to raise revenue by enough to offset the lost income" (see page 4) and the authors of the report had not determined whether the associated boost to the State's GDP would in fact be sufficient to raise revenue by enough to offset the lost income. These matters were not reflected in the subheading "Bad for the budget, good for the state" and so that subheading did not accurately reflect the original report.

10. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

Following the events of 17 March 2015, I attended individual interviews with both lawyers and ASIC. My meeting with ASIC is the subject of a non-disclosure direction. My meetings with lawyers are the subject of legal professional privilege.

Subsequent to these individual interviews, a panel of UBS staff were invited to give evidence before this Committee. As this evidence was to be given by a number of people appearing together, I attended meetings with UBS' lawyers together with other UBS staff. Those meetings are the subject of legal professional privilege.

11. *Mr Williams in evidence said that Guy Fowler was present while he was talking to analysts Mr Leitch and Mr Williams.*

- (i) *As Mr Williams was discussing the revision of a report on the electricity privatisation for which Mr Fowler is advising the Baird government, is that not a breach of the bank's "Chinese Wall", which is supposed to separate its research and advisory arms?*

No.

- (ii) *Did Mr Fowler look at the report or any drafts or documents that were used to produce it?*

I am not aware that Mr Fowler looked at the revised report (or a draft of it) before its publication. Mr Fowler brought a copy of the Deloitte Access Economics report to me following a request I had made through Mr Grounds: see transcript pages 95 and 97.

- (iii) *Did Mr Fowler discuss the report or its subsequent drafts?*

Yes, he expressed views about the original report after its publication and acknowledged that he had already been informed that the report was going to be amended.

- (iv) *Did Mr Fowler make any suggestions about changes to the report?*

No. While Mr Fowler queried why the original report did not consider any potential productivity benefits, he did not suggest how that should be addressed in a revised report.

- (v) *Is it appropriate that the head of investment, Mr Fowler, was able to drop into the office of head of research, Mr Williams, while Mr Williams was discussing a research note that was highly sensitive to Mr Fowler's client?*

Yes, in the circumstances described in the evidence before the Committee.

- (vi) *How is this not a breach of section 912A of the Corporations Act which says an Australian Financial Services licensee must "have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business"?*

See 11(v) above. The conversations did not constitute a breach of section 912A of the Corporations Act.

12. *At what times did Mr Williams meet with Mr Leitch and Mr Lilley to discuss the revision of the report? Mr Williams said there were two meetings.*

Following my initial interactions with Mr Leitch and Mr Lilley immediately following the release of the original report, I met with Mr Leitch and Mr Lilley at approximately 2pm and again at approximately 3.15pm on 17 March 2015.

13. *Did both meetings take place in his office? Did anybody other than Mr Fowler drop by at any point during these meetings? If so, who were they?*

Both meetings took place in my office. No, no one else was present when Mr Leitch, Mr Lilley and I were discussing the content of the addendum report.

To Mr David Leitch

14. *Why did you include in the original UBS report issued under your name and the name of Mr Lilley on 17 March 2015 the comments highlighted in the attached copy of that report?*

Those comments reflected my views, taking into account the qualification that appears on page 4 of the report that those views would not be correct if "the associated boost to the State's GDP was sufficient to raise revenue by enough to offset the lost income".

15. *Were you incorrect in the analysis highlighted?*

No, the highlighted analysis was subject to the qualification indicated in the answer to question 14 above.

16. *Why did you remove those specific passages?*

On page 1, I removed the words "Bad for the budget" because the subheading better conveys the content of the report without those words: see transcript page 88. The original subheading was sensational and was diverting attention from the content of the report. The balance of the first page was redrafted for the same reason. Specifically, to draw appropriate attention to the qualification on page 4 of the report and quoted above, and to indicate that there was third party research regarding productivity benefits that was not considered in the original report.

On page 2, I removed the highlighted words "but would worsen it over the long run" for the same reason.

I did not remove any of the highlighted text on page 4. That text remained in the revised report and is qualified by the words quoted in my response to question 14 above.

Again, on page 7, I removed the highlighted words "We believe the combined asset recycling plan will be negative for the state's fiscal position in the long run" and the last two highlighted lines (as well as the two unhighlighted passages preceding them) for the reasons identified above. On page 8, I removed the first four highlighted lines and Figure 7. The rest of the highlighted text on pages 7 and 8 were not removed. As Mr Lilley explained to the Committee (see transcript page 83), he asked Mr Williams whether it would be better to remove Figure 7, as productivity benefits had been identified more clearly and the analysis and the figures had not included them, and Mr Williams (and I) agreed.

17. *At page 89 of the transcript you said, "We did not write a report... that this was bad for the budget." How do you reconcile this view with highlighted passages in your original report?*

The report indicates (including in some of the highlighted passages) that the lease of poles and wires may improve the state's fiscal position in the short term but that the use of the proceeds of

the lease for investment in new infrastructure may adversely affect the state's fiscal position in the long term unless "the associated boost to the State's GDP was sufficient to raise revenue by enough to offset the lost income" (see page 4). That is a question that may be answered one way or another in 18 years' time and we had not performed any quantitative analysis in that regard. Accordingly, the words "bad for the budget" in the subheading did not accurately reflect the substance of the report. The report considered the lease and subsequent re-investment as a joint decision and did not separately analyse the lease in isolation. There is analysis in both reports that reflects that the lease in isolation would strengthen the budget (see page 1 "We expect the semi market would take the sale in a positive light...The improved fiscal position...").

18. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

Following the publication of the research reports on 17 March 2015, I attended interviews with lawyers. The matters discussed at those interviews are the subject of legal professional privilege. I subsequently attended an interview with ASIC. That interview relates to an ongoing investigation by ASIC and is the subject of non-disclosure direction.

Subsequent to these individual interviews, I learned that the Legislative Council had referred matters the subject of this inquiry to the Committee and that the Committee wished to invite representatives of UBS to give evidence before it. As I understood that this evidence would be given by a panel of UBS representatives appearing together, and not UBS representatives appearing individually, I attended meetings with UBS' lawyers together with the other UBS representatives, including those witnesses who were to jointly give evidence before this Committee. The matters discussed at those meetings are the subject of legal professional privilege.

19. *Which materials were added to your report? What materials were deleted from your report?*

The addendum removed the erroneous subheading, provided explanation of why that was necessary and, in doing so, referenced third party research on productivity benefits. It otherwise deleted Figure 7 and other text which we regarded as inappropriate in light of the issues that had led to the need to issue the addendum.

To Mr Jarrod Key

20. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

After the Legislative Council had referred matters the subject of this inquiry to the Committee and I learned that the Committee wished to invite representatives of UBS to give evidence before it together, I attended meetings with UBS' legal advisors together with the other UBS staff, including those who were invited to give evidence jointly before the Committee. The matters discussed at those meetings are the subject of legal professional privilege.

To Mr Andrew Lilley

21. *Prior to appearing before the NSW Legislative Council Select Committee on the Leasing of Electricity Infrastructure did you discuss the evidence that you would give before with any other person? If so, please provide with whom, when and what was discussed?*

Following 17 March 2015, I was individually interviewed by my and UBS' lawyers, and by ASIC. The matters discussed at those interviews are, respectively, the subject of legal professional privilege and a non-disclosure direction from ASIC.

Subsequent to these individual interviews, I attended meetings convened with UBS' lawyers together with other UBS representatives, including those witnesses who were invited to jointly give evidence before this Committee. The matters discussed at those meetings are the subject of legal professional privilege.

To each UBS witness

22. *Did you send or receive any email, or any communication in written form, from any person in UBS, or from any person in government, relating to the two UBS reports dated 17 March 2015?*

Mr Leitch and Mr Lilley: No, we did not send or receive any written communication from or to any person in government or in the investment banking function at UBS AG or the research function at UBS Securities before publication of either of the reports dated 17 March 2015 relating to those reports, with the exception of:

- an 11.18am email from Mr Leitch to Peter McKerracher (UBS AG) forwarding the original report and stating "Fyi. Hope there aren't too many errors"; and
- an 11.23am email from James Druce (UBS Securities) to Mr Leitch in reply to an email that distributed the original report which stated "What about inter generational arguments...", to which Mr Leitch replied at 11.25am: "Thanks for that value add";
- written communications within UBS prior to the publication of the reports, relating to those reports, undertaken in the ordinary course of business within the research function (which did not concern the need or rationale for amendments to the original report); and
- communications regarding the logistics for the interviews we had with the media following 3.30pm.

Mr Williams: I did not send or receive any written communication from or to any person in government or in the investing banking function at UBS AG before publication of either of the reports dated 17 March 2015 relating to those reports, other than a text to Mr Fowler at 1.09pm stating "Just getting a bite. Back at my desk in 10". This was sent in anticipation of Mr Fowler delivering a copy of the Deloitte Access Economics report to me, as I had expected.

Otherwise, my only written communications within UBS prior to the publication of the reports, relating to those reports, were emails attaching the reports which were automatically delivered to my email inbox following their publication and emails regarding interaction with the media.

Mr Fowler: I did not send or receive any written communications from or to any person in government or UBS before publication of either of the reports dated 17 March 2015, which related to those reports, other than:

- the text which Mr Williams refers to above;
- an email from Victoria Hardie of UBS at 12.29pm to various persons on the deal team from NSW Treasury, Deutsche Bank, Aliens Linklaters and Newgate Communications and other members of the UBS AG deal team attaching a copy of the original report and stating "All, Please see attached a report released by UBS research analyst David Leitch today which discusses potential proceeds from the lease transactions and the impact on the State's fiscal position. Regards, Victoria";

- emails attaching the reports which were automatically delivered to my email inbox following their publication;
- a text message I received at 3.01pm on 17 March 2015 from Mr Crocker saying "Do you know which journalist from the AFR?" to which I responded at 3.04pm stating "Jemima White"; and
- emails regarding the logistics for the interviews we had with the media following 3.30pm.

Mr Grounds: Yes. At 3:21pm, I sent a text message to Mr Warburton of the Premier's department letting him know that UBS had a plan to proactively engage with the media, hopefully to distinguish the investment banking team's views from those of research and seek to avoid any confusion about that: "Yes I am on it also. We have a plan to address (hopefully)". That text message was in response to a text message from Mr Warburton that I had just read: "Hi Matthew, suspect you are aware of this, but a fair degree of angst about the UBS report released today. I am told Guy is working on it". At 3.24pm, Mr Warburton sent another text message to me saying "Just told the Premier, and told him I am sure you would be working on it. We don't want to have to distance ourselves from our expert advisors – not ideal". I then telephoned Mr Warburton at 3:26pm and had the conversation I described at p81 of the transcript regarding the steps that Guy and I were working on to engage with the Australian Financial Review to explain the investment banking team's views in relation to poles and wires (as distinct from any views the research department may have had). The meeting with the Australian Financial Review then took place at 3:30pm.

I otherwise did not send or receive any written communications from or to any person in government or UBS before publication of either of the reports dated 17 March 2015, which related to those reports (other than emails attaching the reports which were automatically delivered to my email inbox following their publication, and regarding the logistics for the interviews we had with the media following 3.30pm).

Mr Key: I had no written communications with the government or with UBS' research function before publication of either of the reports dated 17 March 2015 relating to those reports.

23. *If yes, what was the content of each communication?*

See answer to question 22 above.

24. *Would you please provide copies of each written communication to the Committee?*

The communications are described in the answer to question 22 above.

25. *If not, why not?*

See answer to question 24 above.

To UBS generally

26. *Who was the supervisory analyst on the note?*

Alexandra Champion.

27. *What is the compliance process for factually incorrect reports at UBS?*

In the event a factually incorrect report is published, a research analyst may request an amendment or replacement of the existing published report. Amended or replacement reports are subject to the usual approval processes for research reports, and existing published reports are retracted once an amended or replacement version is approved for distribution. Otherwise, the usual compliance escalation procedures apply.

28. *And what is the compliance process for non-factually based reports (such as political commentary) at UBS?*

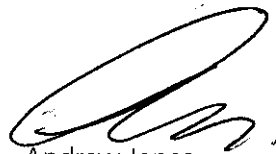
UBS does not produce non-factually based reports or political commentary.

Yours sincerely

UBS AG and UBS Securities Australia Limited



Annette Spencer
Managing Director
Head of Legal, Australasia



Andrew Jones
Managing Director
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