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14 July 2023

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
SYDNEY NSW 2001

Dear Ms Collyer

Re: Submission to the Concessional Finance for Transmission Network Service Providers consultation paper

The Australian Energy Regulator (AER) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) consultation paper on Concessional Finance for Transmission Network Service Providers (TNSP).

We support the rule change proposal from the Minister to lower prices for consumers from concessional finance where this is the intent of the concessional funding body.

The rule change proposal highlights that the current arrangements in the rules do not explicitly recognise the treatment of concessional finance. We support introducing the requirement for TNSPs to provide the AER with information about the value of the benefit that should be passed on to consumers. We also support introducing a mechanism to distribute a proportion of that benefit to consumers. Where these benefits are to be passed on to consumers, we consider the two proposed mechanisms of a reduction in the regulatory asset base or a reduction in the maximum allowed revenue are appropriate and should be left to the parties to agree on how to determine.

The rules must also be clear that in the event of a dispute between the TNSP and the government funding body that the AER can rely on the advice of the government funding body.

The AEMC should also consider how the concessional finance rule change will interact with other parts of the rules, such as the financeability rule change currently being considered. The concessional finance rule should be sufficiently flexible to support other actions by a government funding body. Furthermore, the AEMC should consider how concessional finance will be treated in assessments for RIT-Ts for actionable ISP projects and the ISP.

These and other matters are discussed in further detail along with our responses to the AEMC's consultation questions in the attachment.

The AER looks forward to continued engagement on this rule change. To discuss any matter raised in this submission please contact Esmond Smith (03) 9290 1956.

Yours sincerely

A handwritten signature in black ink, appearing to read "K. Funston". The signature is written in a cursive style with a large initial 'K'.

Dr Kris Funston
Executive General Manager
Network Regulation

Sent by email on: 14.07.2023

Concessional Finance for Transmission Network Service Providers

STAKEHOLDER FEEDBACK TEMPLATE

The template below has been developed to enable stakeholders to provide their feedback on the questions posed in the consultation paper and any other issues that they would like to provide feedback on. The AEMC encourages stakeholders to use this template to assist it to consider the views expressed by stakeholders on each issue. Stakeholders should not feel obliged to answer each question, but rather address those issues of particular interest or concern. Further context for the questions can be found in the consultation paper.

SUBMITTER DETAILS

ORGANISATION: Australian Energy Regulator

CONTACT NAME: Kris Funston

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DATE 14 July 2023

PROJECT DETAILS

NAME OF RULE CHANGE Concessional finance for transmission network service providers

PROJECT CODE: ERC0349

PROPONENT The Honourable Chris Bowen MP, Commonwealth Minister for Climate Change and Energy

SUBMISSION DUE DATE: 14 July 2023

The Australian Energy Regulator (**AER**) welcomes the opportunity to comment on the proposed legislative changes to allow for the benefits of concessional financing to be shared with consumers.

1. WHY ARE THE RULE CHANGES NECESSARY?

We recognise that a key feature of Australia's shift to net zero is the replacement of centralised thermal generation with decentralised renewable generation, requiring additional investment in transmission infrastructure. There may be circumstances where it may be appropriate for some form of concessional financing by government funding bodies (**GFBs**) to ensure the delivery of

important transmission infrastructure projects. Therefore, concessional finance may play an important role in both facilitating investment and lowering its cost for energy consumers.

The Commonwealth Government's Rewiring the Nation Fund commits \$20 billion in finance, some of which will be provided at concessional rates. In providing this finance, some concessional financing benefits may be intended to be shared with consumers. However, the current Rules do not provide any mechanism to allow sharing of concessional finance benefits with consumers. We support changes to the Rules to ensure that any agreed benefit to be passed on to consumers—determined through negotiation by the transmission network service provider (**TNSP**) and GFB—is able to be reflected in the revenue setting framework.

The AER is supportive of the regulatory framework providing lower prices for consumers from concessional finance where this is the intent of the GFB.

Where a GFB provides a discount/concessional loan to a TNSP, the TNSP will keep the full benefit of this loan under the Rules absent a mechanism in a private agreement. The only way we are aware of, that currently facilitates the benefit from concessional finance flowing through to consumers, is for the private funding agreement to require the TNSP to not report its full capital expenditure to the AER. This would thereby reduce the regulatory asset base and future cost to consumers. This mechanism is not ideal because it is non-transparent and not enforceable under the Rules by the AER, only being enforceable by the funder via private contract.

The proposed Rule change will facilitate concessional finance partially or fully flowing through to consumers under the Rules in two ways via:

- a reduction in the regulatory asset base (the mechanism that currently might be facilitated outside the Rules under a private funding agreement)
- a reduction in the maximum allowed revenue.

We support both of these mechanisms being options under the Rules.

There are a number of reasons the GFB may provide concessional finance and a given concession funding agreement may have multiple purposes. These include:

- To incentivise a TNSP to undertake a project, or to undertake a project more quickly than they otherwise would.
- To offset the financial impact on a TNSP of providing other government funding that is perceived to be more expensive for the TNSP than funding from the market (e.g. the provision of hybrid subordinated securities to assist financeability metrics that have a higher yield than senior debt securities).
- To resolve financeability issues where bringing forward depreciation is not considered sufficient or the preferred method.
- To offset the impact on consumers of bringing forward depreciation for financeability reasons.
- To get a project over the line from a cost benefit perspective for the purposes of the Regulatory investment test for transmission (**RIT-T**) or Integrated System Plan (**ISP**) assessment. In this situation the concession might flow to either consumers or the TNSP as the RIT-T is a market benefits test, although exactly how this Rule change interacts with the RIT-T and ISP process needs to be considered.
- To lower the price of energy for consumers.

We consider the purpose of a concessional funding agreement, where funding is provided at a cost below that obtained in capital markets, is for the funder to decide. It is for the funder to decide why it undertakes a particular action and who is to benefit from the action. Therefore, we consider the Rules should provide the GFB this flexibility.

2. INTERACTIONS WITH OTHER PARTS OF THE NER

The AEMC should consider how the concessional finance Rule change will interact with other parts of the Rules. Several interactions we are aware of that should be considered are:

- In relation to the financeability Rule change being considered by the AEMC, the concessional finance Rule change should be sufficiently flexible to support other potential financeability driven actions by a GFB. We consider the current proposal is sufficiently flexible both because it allows the funder to determine how much of the benefit from concessional financing will flow through to consumers, and because it provides flexibility to have the concession benefit flow to consumers either as a regulatory asset base reduction or a reduction in the maximum allowed revenue.
- In relation to the RIT-T for an actionable ISP project and the ISP, how concessional finance will be treated in these assessments should be considered. As concessional finance will lower the cost of projects to market participants, irrespective of where the concession flows, it may make projects that would not have passed the RIT-T cost benefit positive or change the preferred option. Concessional finance may also change the ISP development path and speed when projects are undertaken.

3. OTHER ISSUES

A key issue we would highlight, also covered in our response to questions below, is the need for certainty for the TNSP, consumers and the AER in relation to the regulatory process.

We consider it critical that the AER is not involved in a contractual dispute between a GFB and a TNSP. This is because the contracting parties to a concessional financing transaction—the TNSP and the GFB—should agree on how any concession is to be shared (and under what circumstances) and enter into contracts that give effect to their agreement and protect their interests. There seems little reason for the AER to be involved in a dispute in relation to this type of private contractual agreement between large, sophisticated parties that can be dealt with under the law of contract or in equity. Therefore, the Rules should be clear on what the AER must do where there is a dispute around the sharing of benefits.

Our preference is to follow the direction of the GFB in the event of a dispute, although there would need to be a date after which the GFB could not provide us a nomination for a given determination. We consider the TNSP can protect its interest via the concessional financing contractual agreement. We also note in relation to any concessional finance, the GFB is providing below market finance rates and therefore we consider it appropriate that the GFB decides where the benefit of any concession flows.

The Rules should also be clear on what happens if neither the TNSP nor the GFB indicates where concessional financing should flow. In this unlikely situation we suggest the full value of the concession should flow to consumers.

Finally, we note that a given amount of concessional finance may flow across multiple regulatory periods/determinations. Consideration should be given to what happens at subsequent regulatory determination where a given amount of concessional finance still exists, and if the direction of where any remaining concession should flow can change, or if the original nomination cannot be changed.

4. RESPONSES TO SPECIFIC QUESTIONS – CONCESSIONAL FINANCE

CHAPTER 2 – THE PROBLEM RAISED IN THE RULE CHANGE REQUEST

1. The regulatory treatment of concessional finance	
Do you agree that the Rules need to recognise concessional finance to share benefits with consumers?	We agree that concessional finance should be recognised under the framework. This will allow the framework to support the benefit of concessional financing flowing to consumers where the funding body wishes this.

CHAPTER 3 – THE PROPOSED SOLUTION AND IMPLEMENTATION

2. Responsibility to inform the AER about the existence of a concessional financing arrangement	
Do you agree that the TNSP should notify the AER about the existence of a concessional finance arrangement?	We agree that the TNSP is the appropriate party to inform the AER of any concessional finance arrangements, and this should be a requirement on the TNSP once such an arrangement is agreed. We also note the Rules cannot compel the GFB to notify the AER of funding arrangements.
3. What types of information about the concessional finance arrangement should be provided to the AER and by whom?	
Do you agree with the types of information that should be provided to the AER, as detailed in the rule change request, and that the TNSP be required to provide the information?	We agree with the proposed Rule change, although the description should include the present value of the concession provided, the basis of this calculation, and the amount to be shared with consumers and how it is to be shared (whether via a RAB reduction or via a MAR reduction, or a combination of these, and how this is to be split).
4. How the AER confirms the intent of the concessional finance and the method(s) through which the AER can treat the concessional finance benefits	
1. Do you agree that the AER should confirm the amount to be treated as a benefit to consumers and/or TNSPs with the TNSP and the GFB?	We agree the AER should be able to confirm the specific amount and timing of any benefit agreed to be shared with consumers. In the event a dispute arises between the TNSP and the GFB the AER should be required to follow the written direction of the GFB in allocating any concession. In the event the GFB does not provide information on where a concession is to flow, the AER should be required to follow the direction of the TNSP set out in its proposal. Where there is no direction by either the TNSP or GFB on where the concessional financing benefit is to flow, we consider the entire concession should flow via a MAR reduction to consumers.
2. Do you agree that this amount should be treated as either a capital contribution and deducted from the RAB or as a MAR adjustment? Do you prefer one method over another? Why?	We agree that these would appear the most appropriate adjustments and consider it should be left to the parties to agree on how to determine it is to be treated. We note an adjustment to the MAR would appear to be the most straightforward and transparent adjustment and there may be different regulatory tax implications under the different approaches. For example, if the amount was directly funded as a capital contribution to reduce the TNSP's RAB it may give rise to a tax payment which would require consumers to fund.
3. Do you see any issues with treating some or all of the benefits as either a capital contribution or as a revenue	The current regulatory models for TNSPs do not include any consideration of capital contributions. Unlike distribution where customer contributions and gifted assets are more common, transmission assets have not generally been funded

<p>adjustment?</p>	<p>through contributions from users or non-users—as proposed under the Rule.</p> <p>For distribution, our regulatory models account for the value of capital (cash) contributions by excluding the value from the RAB—as they have not been funded by the network, and no depreciation or return is required. However, for tax purposes they are treated as a taxable revenue and a depreciable cost to expense. This is generally consistent with the tax treatment of capital contributions.</p> <p>As such, the regulatory models for TNSPs would need to be amended to allow for the RAB to be adjusted correctly for regulatory and tax purposes. The potential tax implications of treating the benefit as a directly funded capital contribution needs to be considered. Our preference for reflecting the benefit is to do so directly through an adjustment to the allowed revenues.</p>
<p>4. Do you agree the AER should be required to seek submissions from the government funding body:</p> <ul style="list-style-type: none"> • To ensure benefits are passed on to customers and/or TNSPs as intended, and • to determine whether they intended that some or all of the benefit of the concessional finance be treated as a capital contribution or a MAR adjustment, if required? <p>If not, how should the AER confirm intent and treatment of consumer benefits?</p>	<p>We agree that the AER should be required to confirm the value of benefits to be passed on to customers with the relevant funding body. In the event the GFB does not provide information on where a concession is to flow, the AER should be required to follow the direction of the TNSP set out in its proposal.</p>
<p>5. Proposed solution</p>	
<p>1. Do you think the proposed solution is the most appropriate way to share benefits of concessional finance with consumers, or is there another more effective solution that could be implemented (including non-rules based solutions)?</p>	<p>We consider that the proposed solutions are appropriate adjustments. An adjustment to the MAR would appear to be the most straight-forward and transparent adjustment.</p>
<p>2. Do you think the proposed solution:</p> <ol style="list-style-type: none"> a) is targeted, fit for purpose and proportionate to the issues it is intended to address? b) considers the broader direction of reforms in transmission infrastructure? c) provides for simplicity and transparency in regulatory arrangements? 	<p>Yes</p>
<p>6. Costs and benefits of the proposed solution</p>	

What do you think the direct and indirect costs and benefits of the proposed solution are likely to be? Are the costs likely to be proportionate to the problem they are intended to address?	The costs should be relatively low from a regulatory perspective given the AER is to receive a direction on where concessional finance is to flow.
7. Implementation considerations	
1. Do you have any suggestions regarding the commencement timeframe?	The AEMC should consider whether the mechanism is able to be applied to concessional finance arrangements entered into prior to the final Rule change. For example, if concessional arrangements that include some sharing are entered into in August 2023, and the final Rule is made in December 2023, can these sharing arrangements be reflected in decisions made by the AER in 2024?
2. Are there additional measures that should be considered that would support the effective implementation of the desired solution?	And if so, what is the process for notifying the AER of the existence of such an arrangement? We consider, if legally permissible the final Rule should apply immediately once made and should apply to all concessional finance sharing arrangements provided prior to and after the Rule change is made.
8. Compliance and enforcement	
Do you have any feedback on the compliance and enforcement role proposed for the AER?	We consider the AER should not be placed in the situation of choosing between different parties' submissions on where concessional financing is to flow. In the event a dispute arises between the TNSP and the GFB, the AER should be required to follow the written direction of the GFB in allocating any concession irrespective of any other information or submissions. In the event the GFB does not provide information on where a concession is to flow, the AER should be required to follow the direction of the TNSP as set out in its proposal. This will require the GFB and TNSP to agree on where concessional benefits are to flow and protect themselves via their contractual arrangements, something the AER should not be involved in (or have a role enforcing).
9. Are there alternative solutions that would be preferable?	
Can you share any alternative solutions that you think would be preferable and more aligned with the long-term interests of consumers?	Concessions to consumers can be provided by the Government giving money directly to consumers in cash (they can spend on anything), or in the form of energy discounts (they can spend only on energy bills). However, these methods can be used where appropriate irrespective of this proposed Rule change. The use of concessional finance under the Rules may be the most appropriate method and in the long-term interests of consumers in a given circumstance.

CHAPTER 4 – MAKING OUR DECISION

10. Assessment framework	
Do you agree with the proposed assessment framework?	Any final Rule may allocate risk to both TNSPs and the GFB that will require these parties to manage via contract. Therefore, the first principle should include the risks allocated to the GFB (as well as TNSPs) in its consideration.