

3 August 2023

Ms Anna Collyer
Chair
Australian Energy Market AEMC
Sydney South NSW 1235

By online submission

Dear Ms. Collyer,

Accommodating financeability in the regulatory framework) (ERC0348)

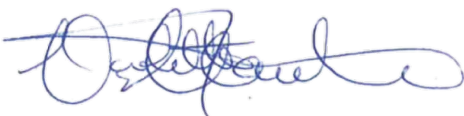
The Australian Energy Market Operator (AEMO) welcomes the opportunity to comment on the consolidated rule change request (which includes the Commonwealth Minister for Climate Change and Energy and the ENA's proposed rule changes) on accommodating financeability in the regulatory framework.

AEMO broadly agrees that it is prudent to ensure the regulatory framework is flexible and resilient enough to cope with the potential for financeability issues that may arise in the future, particularly given the need for material investment in infrastructure over a relatively short space of time by TNSPs from the ISP planning framework.

We have provided some perspectives on the questions asked in Appendix 1 below. We have also provided views on the ENA's proposed rule changes in Appendix 2. We look forward to working with the AEMC through the Rule Change process.

If you would like to discuss anything further, please contact Kevin Ly, AEMO Group Manager – Reform Development & Insights (kevin.ly@aemo.com.au).

Yours sincerely,



Violette Mouchaileh

Executive General Manager – Reform Delivery

APPENDIX 1: AEMO'S VIEWS AND INSIGHTS ON THE FINANCEABILITY CONSULTATION PAPER

This section discusses AEMO's views and insights related to specific questions posed in the Consultation Paper.

1. Financeability issues may arise in the future

AEMO has no additional information to provide and notes it is possible financeability issues may arise on transmission investments, particularly where there are concurrent investments.

Given this, AEMO agrees that it is prudent to ensure the regulatory framework is flexible and resilient enough to cope with the potential for financeability issues that may arise, particularly given the need for material investment in infrastructure over a relatively short space of time by TNSPs from the ISP planning framework.

2. Assessment of financeability applications

In our submission to the AEMC TPIR Stage 2 Draft Report, we suggested a proportionate approach to provide greater flexibility would be to give the AER the explicit ability to vary the depreciation profile for actionable ISP projects to address financeability challenges, where it considers this would better meet the National Electricity Objective (NEO).

AEMO notes that the Commonwealth's proposed rule change includes the recommendation in the TPIR to allow more flexibility to vary the depreciation profile, but also suggests that TNSPs should be allowed to recover the depreciation of biodiversity offset costs on an incurred basis, and to further clarify the treatment of depreciation for asset classes. The focus on biodiversity offset costs is based on the assertion that they will count for a material proportion of costs for ISP projects, and that there is a unique justification to commence depreciation of biodiversity offsets during construction, given this is the time when the natural environment is disturbed, as opposed to other asset classes.

In the context of a Victorian contestable project, a similar concept could be incorporated into transmission contracts. This would entail the TNSP paying out and recovering prior to the TNSP demonstrating Practical Completion or allowing a front-end loaded annuity profile (which bidders can do in any case, at the risk of their contract appearing less competitive on an NPV basis if they are too aggressive).

3. Level of financeability assessment

AEMO would urge the AEMC to work with the AER to better understand what the material impacts of both the TNSP RAB level and the ISP project level are likely to be. For example, there would be merit

in exploring which of the two options would lead to a larger impact on the depreciation profile relative to the current approach, and whether either of these options would ensure that the appropriate level of certainty is required for investors.

AEMO notes the outcomes of the ENA's modelling comparing the application of the proposed formula to each of the two options posed, namely that undertaking the assessment at project level "*would accelerate just enough regulated cashflows to ensure that the actionable ISP project is financeable and able to go ahead*", but we consider that further consideration should be required in addition to this exercise.

We further note the importance of predictability to support investments and encourage clear guidance be established regarding how the level of financability adjustment would be determined and applied.

4. Financeability assessment process and timing - application of the proposed solution in Victoria

Currently, there are two regulated TNSPs in Victoria; Murraylink and AusNet (Marinuslink is set to become a third). Murraylink only has one existing asset, and AusNet has a portfolio of assets with the authority to plan for the replacement of existing assets. Both are allowed to charge AEMO an AARR as determined by the AER based on their RAB. Only AEMO is permitted to plan and procure augmentation to the Victorian shared network.

Within Victoria, the vast majority of ISP projects are likely to be contestable, with only a very minor part of an ISP project likely to be non-contestable.

A TNSP (AusNet included) does not need to secure financing for an augmentation unless and until it is contracted to build, own and operate a contestable or non-contestable project.

A contestable augmentation is not bound by any regulatory requirements, such as applying a regulated WACC or efficient % split between debt and equity (currently 60/40).

In Victoria, a non-contestable augmentation does have the regulated WACC applied to it. It is initially contracted until the commencement of the next regulatory control period, at which point AusNet has to apply to roll it into its RAB. Service payments are made under the contract until the remaining non-depreciated value of the asset is rolled into the RAB at the next reset. However, the contract does set out the full recovery of capex/opex and margin for the whole term (usually 30 years) as a risk mitigation strategy in case AusNet does not or is unable to roll that asset into the RAB. (NB: the AER and AusNet have an established procedure whereby the value of these assets are permitted to be rolled-in every 5 years.)

APPENDIX 2: AEMO'S VIEWS AND INSIGHTS ON THE ENA RULE CHANGE REQUEST

The ENA rule change request indicates that network customers will be indifferent to a higher charge in early years, because they will be offset by lower charges at the back-end, therefore reaching equivalent outcomes on an NPV basis. Revisions to the depreciation profile will take into account the time value of money such that it is NPV neutral and customers should be no worse off over the longer term.

Notably, the AEMC had concerns with this notion of Transgrid's financeability rule change in the past, because it amounted to an inter-generational wealth transfer, and we are of the view that this consideration will be an important one that the AER will need to look at going forward.