2 August 2023

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

Project reference code: ERC0348.

Dear Anna,

Accommodating Financeability - Consultation

Energy Networks Australia (**ENA**) welcomes the opportunity to make this submission in response to the Commission's consultation paper on accommodating financeability[1]. ENA welcomes the Commission's decision to consolidate the Commonwealth's proposal with ENA's own Rule change request to address the financeability risks associated with actionable ISP projects.

ENA represents Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia. ENA's submission is not supported by AusNet, one of our members. AusNet owns and operates the primary electricity transmission system in Victoria, as well as electricity distribution and gas distribution networks. AusNet's position was reflected too in ENA's Rule change request in relation to financeability.

Our electricity transmission members are focused on delivering the timely and efficient investment that is needed as Australia transitions to a lower carbon economy. Specifically, AEMO has identified actionable ISP projects totalling $12.8 billion[2] which are required to ensure that the needs of electricity consumers are met at the lowest overall cost.

ENA's primary objective is to deliver value for consumers by ensuring that the regulatory framework is capable of financing actionable ISP projects to benefit customers. ISP projects facilitate increased competition in wholesale markets and support Australia's transition to net zero. In this regard, ENA's position is fully aligned with the Commonwealth's objectives.

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1 AEMC, Consultation Paper, National Electricity Amendment (Accommodating Financeability in the Regulatory Framework) Rule, 8 June 2023.

2 AEMO, 2022 Integrated System Plan, June 2022, page 15.

ENA's concern is that the Commonwealth's proposed solution would not provide either customers or investors with sufficient confidence that financeability risks will be identified, and resolved satisfactorily, before investors would have to commit financially and reputationally to actionable ISP projects.

ENA's key messages are:

- ENA's focus is on the timely delivery of actionable ISP projects for the benefit of electricity consumers. This objective should be supported by allowing the depreciation and annual revenue to be adjusted where required by the minimum amount necessary to ensure that actionable ISP projects can be financed, without consumers paying higher network charges in present value terms over the life of the asset.

- A transparent and objectively replicable mechanism needs to be specified in the Rules to provide greater certainty for stakeholders and so that investors can understand, in advance of committing to actionable ISP projects, how future financeability problems will be identified and addressed.

- ENA supports the Commonwealth's proposal that biodiversity offset costs should be depreciated on an 'as incurred' basis, noting that the Rules drafting should be generalised to refer to 'biodiversity and environmental offset costs'. An 'as incurred' approach is consistent with the timing of the benefits of this expenditure and, therefore, is a more appropriate method for cost recovery.

  ENA agrees with the Commonwealth that this adjustment will help reduce financeability risks. However, this aspect of the Commonwealth's Rule change request does not obviate the need for a transparent and objectively replicable mechanism to address the broader financeability risks that arise in relation to actionable ISP projects.

ENA looks forward to working with the Commission as it progresses this Rule change request. In the meantime, if you would like to discuss this submission, please contact Verity Watson in the first instance at the following email address. vwatson@energynetworks.com.au.

Yours sincerely,

Dominique van den Berg,
Chief Executive Officer

Submission: Accommodating financeability in the regulatory framework Rule

In this submission, ENA sets out its views on the following matters that are discussed in the consultation paper:

- There is a material issue to be addressed for the benefit of customers;
- A discretionary approach, guided by principles, will not resolve financeability risk;
- A formulaic approach removes the need for a financeability assessment process;
- A project-based financeability assessment will deliver more consistent and acceptable outcomes for customers, although entity level assessments such as a 'no worse off' approach should also be considered; and
- Biodiversity and environmental offset or remediation costs should be depreciated on an as incurred basis.

We discuss each of these points in turn below. ENA's answers to each of the Commission's questions is also provided at the end of this submission.

1. There is a material issue to be addressed for the benefit of customers

The Commonwealth's Rule change request explains that 'financeability' refers to the ability of TNSPs to efficiently raise capital to finance their activities. In relation to actionable ISP projects, the Commonwealth's concerns are aligned with the conclusions of the Commission's Transmission Planning and Investment Review, which also found that financeability risk is material for large ISP projects.[3] The focus of concern is that financeability risks, if not resolved, could jeopardise the substantial customer benefits that the actionable ISP projects are expected to deliver.

ENA strongly supports the Commonwealth's view that there is a material financeability issue to be addressed for the benefit of customers. To date, government support has been used to finance actionable ISP projects outside the regulatory framework. However, this funding source is unlikely to be sustainable or preferable and alternative arrangements are required. As these urgently needed projects are expected to provide significant benefits to customers, there is a strong case for making a Rule change to promote the interests of customers and avoid the need for government support to finance actionable ISP projects.

As explained in the remainder of this submission, however, the discretionary and uncertain nature of the Commonwealth's proposed solution will not provide sufficient

3 Australian Government, Department of Climate Change, Energy, the Environment and Water - Treatment of financeability for Transmission Network Service Providers, Rule change proposal, March 2023 page 2.

certainty for stakeholders or promote investor confidence to commit to actionable ISP projects and undertake the investments needed to deliver benefits to customers.

2. A discretionary approach, guided by principles, will not resolve financeability risk

The Rules proposed in the Commonwealth's Rule change request specify that the AER must have regard to the following matters when exercising its discretion:

- the relative consumer benefits from the provision of network services over time;
- the capacity of the network service provider to efficiently finance its overall regulatory asset base, including efficient capital expenditure; and
- any other factors the AER considers relevant.

From a stakeholder and investor perspective, the Commonwealth's principles-based approach would leave significant uncertainty for all concerned regarding:

- the method that would be used to assess whether there is a financeability issue; and
- the method for adjusting the cashflow timing to resolve the financeability issue.

For these reasons, the Commonwealth's principles-based approach – even if it were supported by AER guidance – would not provide sufficient certainty for stakeholders or promote investor confidence to commit to actionable ISP projects. In addition to the unavoidable uncertainty that arises from the exercise of discretion, a further issue arises in relation to the timing of the AER's decision.

In relation to timing, actionable ISP projects require significant resource commitments during the 'early works' phase, which may be several years prior to the AER's decision on the Contingent Project Application relating to project construction ('CPA-2'). An effective remedy to the financeability issue requires a clear pathway for resolving any financeability issues prior to the TNSP making resource and reputational commitments to the project. The Commonwealth's proposal, however, would not achieve this objective because the proposed remedy will only be known in the AER's final decision for CPA-2, which may be several years too late.

3. A formulaic approach removes the need for a financeability assessment process

In order for investors to commit to financing actionable ISP projects, they need to be able to understand:

- how a regulatory assessment of financeability of actionable ISP projects will be undertaken; and
- how any financeability problem identified by such a process would be remedied through regulatory action.

To achieve these objectives, a transparent mechanism is required that can be applied objectively in a repeatable and predictable manner. ENA's Rule change would achieve this by requiring the AER to apply a *financeability formula* each time it makes a revenue determination for an actionable ISP project.

The financeability formula would ensure that the depreciation allowance for the project enables it to be financeable in each year of the relevant regulatory period. It is important to apply the financeability formula in subsequent revenue determinations to ensure that financeability problems that may arise throughout the early period of a project's life, including after the first regulatory period, are identified and addressed.

The financeability formula would be specified in the Rules. The AER's application of the formula would require that allowed revenues are just sufficient to support the AER's benchmark financing parameters set out in the Rate of Return Instrument (**RORI**). By bringing forward depreciation by the minimum amount required to satisfy the financeability formula, the revenue profile would be as closely aligned as possible with the profile obtained through the standard application of the PTRM. Furthermore, the Rules requirement that assets are only depreciated once ensures that the total revenue recovered from customers will be NPV neutral.

This objective nature of the formula would produce predictable financeability assessments and regulatory action to address financeability problems, thereby providing stakeholders with greater certainty and investors with the confidence they need to commit to actionable ISP projects. ENA's Rule change request explains how a formulaic approach, based on the methodologies employed by credit ratings agencies, can be implemented.

In terms of the regulatory process, ENA's formulaic approach removes the need for the AER to conduct a financeability assessment as envisaged in the Commonwealth's Rule change request. The need for this process falls away because all stakeholders would understand upfront how financeability risks will be assessed and resolved under this formulaic approach which will promote investor certainty and confidence. Similar to other aspects of the regulatory framework, specifying the formula in the Rules also avoids repeated debate and consultation each time the AER assesses financeability risks in relation to an actionable ISP project.

4. A project-based approach will deliver more consistent and acceptable outcomes for customers, although entity level approaches such as a 'no worse off' approach should also be considered

The Commonwealth's second guiding principle in its Rule change request requires the AER to consider financeability risks from the perspective of the regulated TNSP, rather than on a project-specific basis. The Commission also recommended a 'whole of business' approach in its Final Report on Stage 2 of the Transmission Planning and Investment Review. ENA considers that the question of whether the approach should be project-based or entity-based should be addressed from a customer perspective.

ENA's preference is that the Rule change should be limited to ensuring that efficient costs (including return on capital) can be recovered for the particular ISP project, not for the entire network business. From the perspective of customers, this approach has the following benefits:

- it is transparent and easily applied because it does not depend on information regarding the financial performance of the regulated business; and

- it ensures that similar actionable ISP projects result in similar revenue profiles, and do not vary depending on which TNSP is undertaking the project.

ENA also considered a version of the financeability test in which the formula is used to ensure that the ISP project makes the proponent firm 'no worse off.' This approach differs from the options described above in that it would seek to support the credit metrics implied for the benchmark entity in the proponent's prevailing PTRM, rather than the AER's benchmark BBB+ rating in every case. This test would ensure that a credit rating downgrade cannot occur as a consequence of an ISP project.

While we do not prefer a 'no worse off' approach, we consider there could be value in the Commission further considering this option to determine if it may better promote the long-term interests of consumers.

5. Biodiversity and environmental offset or remediation costs should be depreciated on an as incurred basis.

ENA supports the Commonwealth's proposal that biodiversity offset costs should be depreciated on an 'as incurred' basis. In particular, ENA agrees with the Commonwealth's view that the benefits of biodiversity offsets will be obtained before project commissioning[4], which means that network charges are aligned with customer benefits under the Commonwealth's proposed approach. The alignment of costs and benefits is consistent with principles of economic efficiency.

In relation to terminology, ENA notes that some states use language that differs from 'biodiversity offset costs'. It is therefore appropriate to use more generic language such as 'biodiversity and environmental offset or remediation costs'.

The consultation paper asks whether the Commonwealth's proposal would re-allocate ISP project completion risk from TNSPs to consumers and, if so, why this reallocation of this risk is appropriate. ENA does not consider project completion risk to be a significant concern for the following reasons:

- Where biodiversity and environmental offset or remediation costs arise *after* the TNSP has committed to delivering the project, there is no project completion risk; and
- In contrast to other construction-related costs, the consumer benefits from the biodiversity and environmental offset or remediation expenditure commence as the expenditure is incurred (rather than when the transmission project is commissioned).

Given the above observations, ENA does not consider the project completion risk to be a material concern.

While ENA supports the Commonwealth's proposal to depreciate biodiversity and environmental offset or remediation costs on an as incurred basis, this does not

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4 Australian Government, Department of Climate Change, Energy, the Environment and Water - Treatment of financeability for Transmission Network Service Providers, Rule change proposal, March 2023 pages 4 and 5.

obviate the need for a formulaic resolution of financeability risks. While some ISP projects will involve biodiversity and environmental offset or remediation costs that, if depreciated on an as incurred basis could materially vary cashflows for the whole project, other ISP projects will not. For the reasons outlined in this submission, a formulaic approach to resolving financeability risks is required to promote efficient investment for the long-term interests of consumers in accordance with the National Electricity Objective.

Answers to the Commission's questions

Question 1: Identifying the problem

Do stakeholders have any new information or views on the problem raised in this rule change request, having regard to what has already been consulted on and established in TPIR?

ENA considers that the Commonwealth has correctly identified the financeability risk and focused appropriately on the significant value to customers in taking action to support the timely delivery of actionable ISP projects. ENA shares the Commonwealth's objectives.

However, the Commonwealth has not considered the importance of providing investor confidence and certainty to all stakeholders to unlock customer benefits and the conditions that must be met to address financeability risks effectively. Please refer to section 2 of this submission for further information.

Question 2: How to assess financeability applications

(a) Should TNSPs have to submit an application to the AER to vary the depreciation profile of actionable ISP projects? If so, what information should this include?

No. For the reasons set out in section 2 of this submission, the proposed process for a TNSP to submit an application to the AER will not promote investment certainty, as intended by the Commonwealth. Instead a formulaic approach is required as explained in section 3 of this submission.

(b) Should the AER vary the depreciation profile of actionable ISP projects using principles or a prescriptive approach?

For the reasons set out in sections 2 and 3 of this submission, the principles-based approach will not provide the level of certainty that stakeholders should expect, or confidence that investors require, to deliver ISP projects for the benefit of consumers.

(c) What level of AER discretion is appropriate?

The AER should be able to determine the capital and operating expenditure requirements of the actionable ISP project in accordance with the Rules provisions relating to contingent projects. A formula should be prescribed in the Rules which would be applied by the AER in identifying and addressing financeability risks, as explained in section 3 of this submission.

(d) Do you consider that the proposed principles are appropriate? Should any other assessment factors be taken into account?

No, for the reasons set out in section 2 of this submission.

Question 3: Level of financeability assessment

Should the financeability assessment be at the TNSP RAB level or the ISP project level?

For the reasons set out in section 4 of this submission, ENA prefers that the financeability assessment should be applied at the project level.

Question 4: Financeability assessment process and timing

Is the proposed process and timing to assess requests to vary depreciation for actionable ISP projects practical and efficient? If not, what alternative processes and timings do you suggest being specified in the NER?

As explained in section 2 of this submission, the proposed process and timing will not facilitate investment and stakeholder certainty as intended by the Commonwealth. This is because the process culminates in the AER publishing an issues paper which only sets out the AER's indicative position and a range of depreciation profiles. Only a formulaic approach as explained in section 3 of this submission will resolve the financeability risks.

Question 5: Will the proposal resolve the problem?

(a) Will the proposed solution to vary depreciation profiles resolve the problem raised in the rule change request? Would it reduce or eliminate the need for concessional finance from governments for ISP projects?

ENA supports the proposal to vary depreciation. As explained in section 3 of this submission, a formulaic approach is required for identifying the annual depreciation that is required to address the financeability risks.

ENA considers the proposed solution would reduce the need for government funding by amending the regulatory framework to address the financeability risks. We consider the proposed concessional finance Rule change would also provide a mechanism to enable governments to reduce the price impact on consumers to achieve broader policy objectives.

(b) Are there any alternative solutions that would resolve the problem and be more preferable and aligned with the long-term interests of consumers?

No. ENA is not aware of any alternative approaches that would promote the long-term interests of consumers as effectively as the formulaic approach described in section 3 of this submission. In particular, the proposal provides just sufficient revenue to achieve the AER's benchmark credit ratings in the RORI.

Question 6: AER Guidance

Should the AER be required to publish guidance on how it may vary the depreciation profile for assets that forms part of an actionable ISP project

No. As explained in sections 2 and 3 of this submission, a formulaic approach would remove the need for AER guidelines and provide an approach that is predictable and transparent.

Question 7: Transitional Arrangements

(a) If the proposed rule is made, should the AER be required to develop any guidance, or amend any AER models, before or after the commencement of the rule? If so, what level of prescription should be included in the NER?

For the reasons set out in this submission, ENA supports a prescriptive approach. The details of ENA's preferred formula are provided in the Rule change request that ENA submitted on 9 June 2023. ENA considers that its proposed formula should be prescribed in the Rules. ENA's Rule change request explains that the proposed formula only requires information that is already available from the AER's Post-Tax Revenue Model (**PTRM**). The AER would not be required to amend any models or publish guidelines.

(b) If the proposed rule is made, should it provide a transitional period to enable market participants to prepare? If so, how long should such a transitional period be?

As already noted, while ENA strongly supports the Commonwealth's stated objective as set out in the Rule change request, we do not support the Rule as drafted. The need for a transition period arises because the AER's guidelines will not be published until nine months after the Rule commences. Evidently, this will exacerbate uncertainty and fail to promote efficient investment in accordance with the long-term interests of consumers. A prescriptive approach would resolve the financeability issue without the need for guidelines or a transitional period.

(c) Is there a need for any transitional arrangements to assist in managing interactions with other NER amendments or other market reforms? If so, what?

No. Please refer to the answer above.

Question 8: Biodiversity offset arrangements across NEM jurisdictions

Are the costs of meeting biodiversity obligations material? Are they likely to impact financeability of actionable ISP projects?

Yes, the costs of meeting biodiversity offset obligations can be material. As explained in section 5 of this submission, while the ENA supports the proposed depreciation of biodiversity offset costs (and other environmental remediation costs) on an as incurred basis, this does not obviate the need for a formulaic resolution of financeability risks.

Question 9: Recognising and managing biodiversity offset costs

(a) Does the AER already have discretion to do what the rule change request is proposing (i.e. applying depreciation as incurred for transmission assets)?

ENA's preference is that the regulatory treatment of biodiversity offset costs and other environmental remediation costs should be clarified in the Rules and AER guidelines.

(b) Should land purchased specifically for the purpose of meeting biodiversity offset obligations be depreciable? Should other costs of meeting biodiversity offset obligations be depreciable?

Yes, it would be appropriate to depreciate land where the expectation is that it has no alternative use value (and therefore no future market value) because it is required for biodiversity purposes. Land procured for biodiversity purposes contrasts with land used by a transmission project, which is not depreciated. In the latter case, the land is likely to have an alternative use (and therefore market value) when it is no longer required by the network company.

(c) Do you agree or disagree that recovering depreciation of biodiversity offset costs as incurred (as opposed to as commissioned), would be an appropriate solution to the financeability problem? Does this re-allocate completion risk from TNSPs to consumers?

Yes, ENA supports the proposal. Please refer to section 5 of this submission for our comments on the transfer of completion risk.

(d) Are the nature of biodiversity offsets different from other assets that comprise a specific actionable ISP project, such that biodiversity offsets should be depreciated on a different basis to other assets?

Yes. As explained in the Commonwealth's Rule change request, the benefits obtained from biodiversity offset costs arise prior to the commissioning of the transmission project. Accordingly, it is appropriate to depreciate these costs (and other environmental remediation costs) on an as incurred basis.

Question 10: Application of proposed solution to Intending TNSPs

If TNSPs are able to recover depreciation of biodiversity offsets on an as incurred basis, should this be extended to intending TNSPs?

ENA considers that this should be a matter for each intending TNSP, having regard to their particular circumstances.

Question 11: Clarifying depreciation treatment of asset classes

(a) Do you agree with the proposal to require the AER to explicitly outline how depreciation would apply to all asset classes in actionable ISP projects? Should this include biodiversity assets?

ENA does not oppose this proposal, although it is unclear why additional guidance is required for asset classes other than biodiversity or environmental offsets.

(b) If you agree that the deprecation treatment of asset classes should be documented, how should it be implemented — through the NER, AER guidelines and/or other methods?

Please refer to the previous answer.

Question 12: Assessment framework

Do you agree with the proposed assessment framework? Are there additional principles that the Commission should take into account or are there principles that are not relevant?

ENA broadly supports the AEMC's assessment framework. We note however that, in the current environment, actionable ISP projects are needed urgently to unlock net benefits for energy customers. In addition to the first criteria relating to the inter-generational equity implications of energy costs, we consider the costs and benefits for customers of timely investment in ISP projects should be considered over the long term.