3 August 2023

Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Submitted via: https://www.aemc.gov.au/contact-us/lodge-submission (ERC0348)

Dear Ms Collyer,

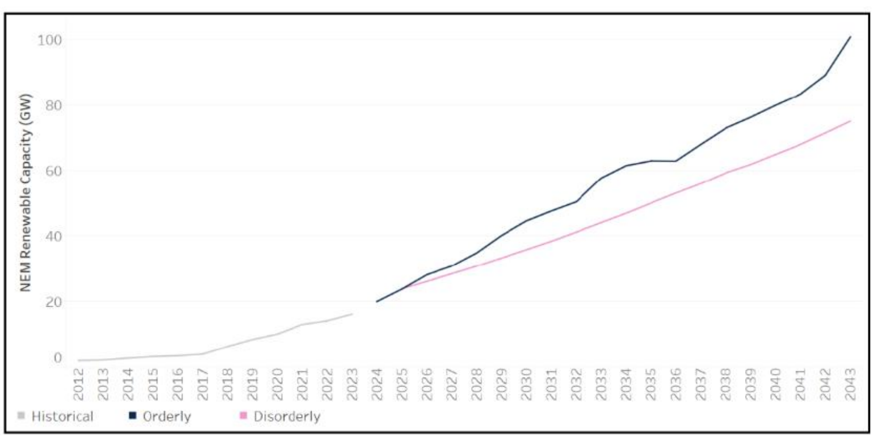
Accommodating Financeability in the Regulatory Framework: Consultation Paper

Nexa Advisory welcomes the opportunity to provide a submission to the AEMC Accommodating Financeability in the Regulatory Framework: Consultation Paper (ERC0348). Our submission will address:

- The rule change proposal from the Honourable Chris Bowen MP Minister for Climate Change and Energy covering financeability and biodiversity costs (ERC0348).
- The rule change proposal from Energy Networks Australia (ENA): Ensuring the financeability of actionable ISP projects (ERC0365) that proposes a much more prescriptive approach to assessing and addressing financeability.

Context

Australia's electricity system is transitioning rapidly away from high carbon generation to clean renewable generation and storage. However, that transition is not occurring rapidly enough, with the regulatory framework acting as a serious blocker to delivering new transmission and new generation and storage. If we continue on our current slow pathway there will be a 26 GW shortfall in required renewable generation and storage capacity by the early 2040s[1], resulting in higher emissions and costs for customers.



Required renewable generation (dark blue) in the NEM as recommended in the 2022 ISP Step Change scenario versus projected future delivery of renewable generation (pink) based on past delivery rates (grey) showing the significant and escalating shortfall in delivering renewable generation required.

[1] https://nexaadvisory.com.au/site/wp-content/uploads/2023/07/Nexa-Advisory-Eraring-can-be-closed-on-schedule-Report-24072023.pdf

Earlier work by Nexa Advisory identified the key blockers[2] to new transmission and further work identified that even short delays on commissioning had significant bill costs for consumers[3]. Further, trying to deliver new transmission under the current regulatory framework, with a dependence on the regulated monopoly Transmission Network Service Providers (TNSPs), would result in significantly higher costs overall, of up to $13 billion[4].

While the AEMC has extensively explored the issues with the current regulatory framework that slow down the delivery of new transmission lines through the Transmission Planning and Investment Review (TPIR)[5], the myriad of incremental "tweaks" to the framework proposed by the AEMC will not result in any acceleration of the construction of transmission and if the clean energy transition is to be advanced, then bolder initiatives need to be explored.

Key Points

- It is not clear that there is a problem with financeability for large new transmission projects, however, given the urgent need for new transmission the Minister's rule change represents a prudent response to mitigate financeability concerns.
- In progressing the rule change, any financeability assessment should be at the discretion of the AER, with the ability to determine:
  - whether there is a demonstrated financeability problem for a particular TNSP on the basis of the performance of the entire business, not just related to a given project;
  - whether bringing forward depreciation is the appropriate response to address any identified problem, while ensuring that the risks of any investment are not disproportionately placed on consumers.
- The ENA rule change should not be adopted in part or in whole.
- If we genuinely want to progress the delivery of transmission at pace and at least cost, then we must seriously explore the role of contestable transmission provision.
- We note that these rule changes interact with the Concessional finance for Transmission Network Service Providers (ERC0349)[6] and a TNSP should not be able to receive both concessional finance and a financeability assessment.

A prudent response in the face of limited evidence

While the AEMC extensively explored the issue of TNSPs securing investment for the large new transmission interconnector projects detailed in the Integrated System Pan (ISP) in the TPIR, it is still not clear what has changed from April 2021 when the derogations sought by Transgrid and Electranet for Project EnergyConnect (ERC0320 and ERC0322) were rejected:

> *"… the Commission considers the regulatory framework does not create a barrier to financing Transgrid's share of current actionable ISP projects. … and it does not consider that the rule proposed by the proponent would address the issues identified[7]." (page v)*

[2] https://nexaadvisory.com.au/site/wp-content/uploads/2022/04/Removing-transmission-roadblocks-discussion-paper-080422.pdf
[3] https://nexaadvisory.com.au/site/wp-content/uploads/2022/06/Report-Modelling-Electricity-bill-impact-due-to-transmission-delay_2022-06-07.pdf
[4] https://nexaadvisory.com.au/site/wp-content/uploads/2023/06/Nexa-Advisory_Transmission-Contestability-in-Australia-Research-Report-June-2023.pdf
[5] https://www.aemc.gov.au/market-reviews-advice/transmission-planning-and-investment-review
[6] https://www.aemc.gov.au/rule-changes/concessional-finance-transmission-network-service-providers
[7] https://www.aemc.gov.au/sites/default/files/documents/erc0320_-_final_determination_-_transgrid_-_final.pdf

Neither the AEMC, as part of the TPIR, nor ENA in its rule change, have clearly demonstrated that there is a problem with financeability for ISP projects, but the AEMC is now pursuing a rule change to make essentially the same rule that was rejected 18 months ago[8].

It is our view that the current regulatory framework does allow TNSPs the flexibility to finance ISP projects and that any perceived issues with financeability are related to unwillingness of the TNSPs and their investors to bear the risk, as investors normally would during a time of expansion, and to place that risk on consumers while ensuring that the TNSP and their investors see no reduction in returns.

However, we accept that should a financeability risk arise in the future, then progressing this rule change is a prudent approach to expediting new transmission projects. By giving the AER the discretion to consider a proposal from a regulated monopoly TNSP to vary the recovery of costs, and allowing the AER to make a determination that, in its opinion, balances the need to progress the investment against the appropriate risk to be borne by consumers, any future issues with financeability can be mitigated.

We do support the Minister's proposal to allow TNSPs to recover depreciation of biodiversity offset costs on an as incurred basis. The environmental permitting requirements for new transmission lines are a significant part of any project and also contribute to project delays. By allowing the depreciation of biodiversity offsets on an "as incurred" basis, we hope this will expedite the environmental permitting and support the social licence for transmission projects.

The Financeability rule change interacts with the Concessional Finance rule change (ERC0349), with the Minister clearly stating that the goal of the Financeability rule change is to reduce the reliance on Concessional Finance. We strongly support the Concessional Finance rule change proposal that would ensure any concessional finance benefits consumers and not the TNSPs or their shareholders.

Additionally, given the stated intent of the Financeability rule change is to reduce the need for concessional finance, it should not be possible for a TNSP to seek a financeability assessment if concessional finance has already been received for the same transmission line project. Nor should concessional finance be subsequently granted to a TNSP for a project that has previously been assessed by the AER for a financeability determination. This is regardless of whether the determination the AER makes either supports or does not support a TNSP as having a financeability issue, but particularly in the case where the AER decides there is no issue, a TNSP should not then be able to seek concessional finance as a "back up".

Consumers are being asked to bear the risks

If the regulated monopoly TNSPs are unwilling or unable to invest in the new transmission lines detailed in the ISP, then the Australian transmission market should be opened up to competition to allow experienced entities to deliver the new transmission required.

The identification of a requirement to make specific financeability rules to support the monopoly regulated TNSPs to invest in new transmission strongly implies that these privately held

[8] https://www.aemc.gov.au/sites/default/files/documents/erc0320_-_final_determination_-_transgrid_-_final.pdf

companies are not financially capable of underpinning Australia's transition to a low carbon electricity system.

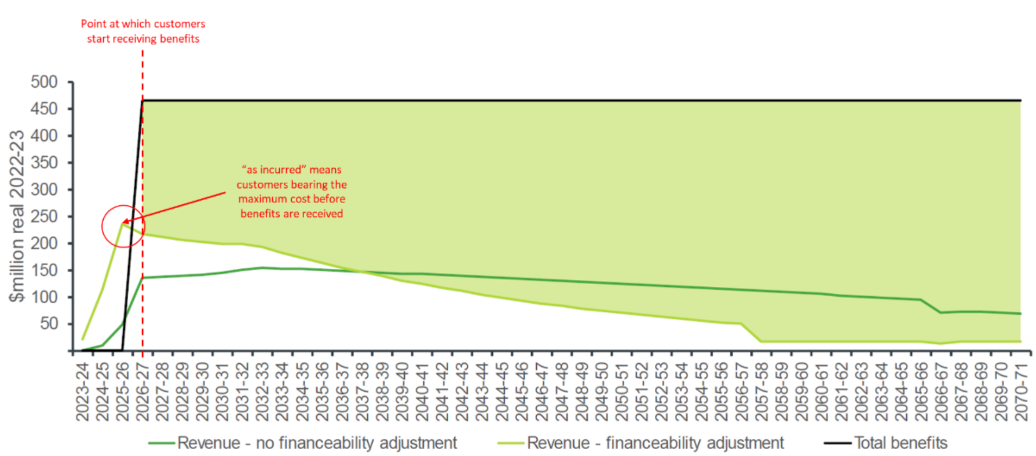
However, it appears more likely that the regulated monopoly TNSPs would prefer their customers carry any risks associated with new transmission investments, rather than their own investors, who are happy to take the guaranteed regulated return but not prepared to invest.

TNSPs Regulated Asset Bases (RABs) are expected to grow significantly, doubling from the current value of $22.8 billion[9]. As a TNSP expands its RAB it will result in an increase in returns for investors over the long +50-year life of transmission assets.

Key points in the earlier 2021 AEMC decision to not make the rule were on the basis that bringing forward depreciation on an "as incurred" basis, as opposed to the current "as commissioned" basis increased risks for consumers and also increased bills for consumers in the near-term[10].

Additionally, the "as incurred" approach means that consumers will be paying for an asset before any of the benefits of that asset being operational would flow to customers, while magnifying the intergenerational cost borne by customers (made clear in the figure from ENA below). The regulated monopoly TNSP are asking Australian's to "loan" them the finance for an ISP project, rather than the TNSP's own investors. This places a risk on customers that they are not able to manage and is a fundamental shift in the regulatory framework, placing an additional cost burden on consumers, particularly at a time when the costs of living are high.

Figure 2: Consumer impact of the proposed financeability formula (real $2022)



Labelled version of the ENA plot provide in their rule change request[11]

The Energy Networks Australia rule change

We do not support the prescriptive approach proposed by ENA that would place a specific formulaic methodology in the Rules. At a time of transition "locking in" specific approaches in the Rules should be avoided. We recommend that the AER develop and consult on a guideline

[9] https://www.aer.gov.au/system/files/State%20of%20the%20energy%20market%202022%20-%20Full%20report.pdf
[10] https://www.aemc.gov.au/sites/default/files/documents/erc0320_-_final_determination_-_transgrid_-_final.pdf
[11] https://www.aemc.gov.au/sites/default/files/2023-07/ENA%20update%20to%20rule%20change%20request%20-%2030%20June%202023.pdf

to underpin the both the development of financeability requests by the TNSPs and the approach the AER will take to assessing those requests. This would provide transparency to stakeholders, particularly consumers, on how the AER will apply its discretion and any resulting determinations.

Any assessments of financeability should be made at the business level and not the project level. We support the AEMC's approach and do not agree with the per-project level proposed by ENA. This is because the TNSP is incentivised across the entire business to be efficient, which allows the TNSP to manage multiple projects and balance outcomes. By assessing financeability on a project-by-project basis, this would separate the project from the wider assessment of the performance of the business as a whole, while the specific project would contribute to the RAB as a whole.

We certainly do not support the "no worse off" methodology proposed by the ENA as an alternative to Options 1 and 2. If a TNSP has a rating less than the notional rating of BBB+, it is not the job of the regulatory framework or customers to fund the improvement of that rating through a financeability methodology. Poorly rated or performing regulated monopoly TNSP need to resolve operational and business issues rather than seeking financial support from consumers.

We note that the ENA rule change is specifically focused on Transgrid and while recognising the burden of ISP projects that fall within NSW we do not favour rule change proposals that are largely to the benefit of a single regulated monopoly TNSP. Good regulatory practice indicates that a rule change proposal should demonstrate that there is a broad issue in the regulated framework to be resolved. We further note that the rule change proposals would have increased impacts in NSW, where consumers are funding the additional investment in the Renewable Energy Zones (REZ) at a time when electricity bills are already high.

New approaches are needed

As noted earlier, the two proposed rule changes appear to identify that the regulated monopoly TNSPs are not in a sufficiently robust financial position to undertake the transformational investment needed in new transmission.

Additionally, the regulated monopoly TNSPs in the National Electricity Market (NEM) are small when compared to established transmission companies globally. There are international companies, already established and operational in Australia having tendered for the transmission projects in the NSW REZ, that have RABs of a similar value to the entire transmission RAB of the NEM[12].

If the regulated monopoly TNSPs are not willing or able to support the financing and delivery of the new transmission, then the market for the delivery of new transmission should be widened to other entities through contestability, as has been adopted in Victoria.

[12] https://nexaadvisory.com.au/site/wp-content/uploads/2023/06/Nexa-Advisory_Transmission-Contestability-in-Australia-Research-Report-June-2023.pdf

The companies already operating in Australia have access to established international supply chains and experienced, confident and willing investors who understand the scale of the investment needed in Australia and globally.

Contestability in transmission would ensure that projects are built on time and efficiently without the need for special financeability rules, ensuring that Australia can meet emission and renewable generation targets, while allowing the benefits of low cost, low carbon electricity to flow rapidly to customers.

Thank you for the opportunity to comment on the financeability of new transmission lines and we look forward to continuing to work with the AEMC on accelerating the transition to a clean power system. If you would like to discuss any of the issues raised in this submission, please contact me.

Yours Sincerely,

Stephanie Bashir
CEO and Principal
Nexa Advisory

About Nexa Advisory

Nexa is a full-service advisory firm. We work with public and private clients including renewable energy developers, investors and climate impact philanthropists to help accelerate efforts towards a clean energy transition. We've been shaping the energy industry for over 20 years. With a proven track record across policy creation, advocacy, political risk assessment and project delivery, we're holistic in our approach and deliver solutions with commercial intent.

The Nexa Advisory team is a collaboration of passionate energy specialists, all committed to the successful transformation of Australia's energy markets. The team is focused on helping clients grasp the unpredicted opportunities the energy transformation will bring with trusted and innovative thinking and advice.