Accommodating financeability in the regulatory framework

The Commission has made a final determination and final rule to support the financeability of TNSPs investing in actionable ISP projects

The Commission has decided to make a more preferable final rule to address challenges that Transmission Network Service Providers (TNSPs) may have in raising finance to proceed with actionable Integrated System Plan (ISP) projects. This is in response to rule change requests received from the Honourable Chris Bowen MP, Commonwealth Minister for Climate Change and Energy (Minister) and Energy Networks Australia.

The final rule allows the Australian Energy Regulator (AER) to bring forward a TNSP's cash flows through a combination of as incurred depreciation, accelerated depreciation, and revenue smoothing. The final rule will prevent a TNSP's financeability position from falling below a threshold, or from falling at all if the TNSP is already below the threshold, to support the ability of a TNSP to efficiently raise finance.

The final rule seeks to promote the long term interests of consumers by supporting timely investment in and delivery of transmission, a critical enabler for the transition to net zero. This will unlock cheaper energy sources, as well as reducing emissions and wholesale prices to the benefit of current and future consumers.

The final rule addresses the risk to delivery of necessary transmission investment

Our final rule is made in the context of the broad consensus that transmission is a critical enabler for the transition to net zero. This transition will require an unprecedented level of investment in, and build of, transmission infrastructure to deliver power from renewable generation and energy storage to consumers, and to deliver infrastructure quickly. The scale of transmission investment required, coupled with the speed of the energy transition, presents challenges for the existing regulatory framework because:

- TNSPs may face challenges in raising finance to proceed with ISP projects, and
- the existing revenue-setting framework may not be sufficiently flexible to address financeability challenges.

The final rule will address this risk by:

- allowing a TNSP to submit a financeability request to the AER as part of a Contingent Project Application stage 2 for construction or as part of a revenue determination process
- allowing a TNSP to propose any method available (adjustments to depreciation or revenue smoothing within a regulatory control period) to the AER to address a financeability issue
- requiring the AER to assess whether the TNSP has a financeability issue by applying a financeability test set out in the NER
- requiring the AER to adjust a TNSP's cash flows if a TNSP has a financeability issue
- requiring the AER to set out further details of how it would determine the TNSP's financeability position in Financeability Guidelines
- applying additional rules to TNSPs that have received concessional finance to prevent a TNSP from benefiting from both concessional finance and a cash flow adjustment for an ISP project.

TNSPs will be able to apply for a financeability assessment from the commencement date of the final rule on 29 March 2024.

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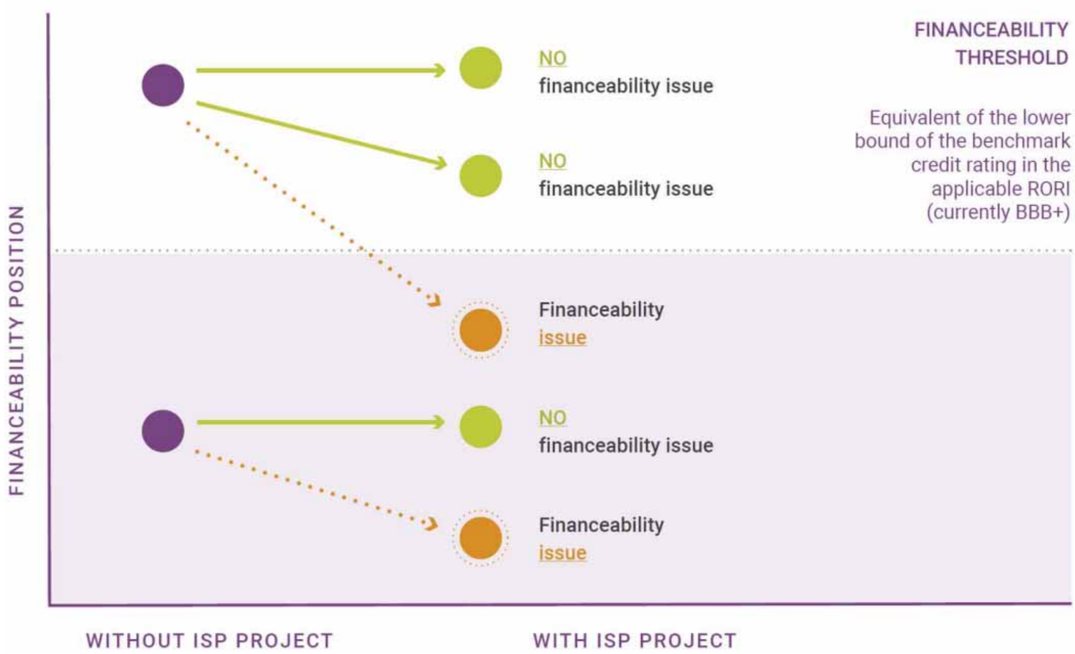
The financeability test will assess whether a TNSP's financeability position is worse off as a result of investing in an ISP project

The final rule will allow a TNSP to submit a financeability request. If requested by a TNSP, the AER will be required to apply a financeability test in accordance with the final rule and the AER's Financeability Guidelines. The AER must determine that a TNSP has a financeability issue if the TNSP's financeability position without an ISP project is:

- at or above the financeability threshold and its financeability position drops below the financeability threshold with the ISP project, or
- below the financeability threshold and its financeability position deteriorates at all with the ISP project.

The financeability test is illustrated below in Figure 1. The financeability threshold will be equivalent to the benchmark credit rating in the applicable Rate of Return Instrument (RORI).

Figure 1 - How to determine whether a TNSP has a financeability issue after an actionable ISP project



The AER will be required to set out further details of how it would determine the TNSP's financeability position in Financeability Guidelines. This includes the selection of financial metrics to apply and the weightings to apply to each financial metric. The Guidelines would need to set out how the financeability position would relate to the financeability threshold (the equivalent of the benchmark credit rating in the applicable RORI), and may include other matters such as how the AER would treat depreciation for biodiversity offsets.

The AER will be required to adjust a TNSP's cash flows if a TNSP has a financeability issue

If the AER determines the TNSP has a financeability issue, the AER will be required to adjust the TNSP's cash flows such that:

- if the TNSP's financeability position without the ISP project is at or above the financeability threshold, the TNSP's financeability position with the ISP project does not fall below the financeability threshold
- if the TNSP's financeability position without the ISP project is below the financeability threshold, the TNSP's financeability position with the ISP project does not worsen.

The AER could achieve this by using a combination of one or more of the methods outlined below.

- The AER may vary the depreciation of assets that form part of an actionable ISP project after the asset has been commissioned, so that they are depreciated using a profile that the

AER considers appropriate. For example, based on a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation.

- The AER may depreciate actionable ISP project assets using a profile that the AER considers appropriate, prior to the asset being commissioned. The AER may allow as incurred recovery of depreciation (which may apply for all assets that form part of the actionable ISP project in addressing a financeability issue).
- The AER may smooth revenue within a regulatory control period, if there are sufficient remaining years in the regulatory control period.

We have made changes from our draft rule

Following stakeholder feedback on our draft determination, we have made changes to better reflect the policy intent. This includes, but is not limited to, the amendments outlined below.

- Requires the AER to carry out a financeability test using the benchmark gearing ratio adjusted for the increased equity component in that ratio in accordance with concessional finance agreements.
- Clarifies that a TNSP can only submit a financeability request once for each actionable ISP project or construction stage of an actionable ISP project
- Clarifies that, when applying the financeability test, the AER must:
  - apply the Financeability Guidelines (after they have been published)
  - have regard to the information provided in the financeability request; and
  - have regard to any relevant concessional finance agreement.
- Clarifies that the process and timing for the AER's application of the financeability test is aligned with the CPA2 or revenue determination process, as appropriate.

Related rule change process: *Sharing concessional finance benefits with consumers*

The Commission separately considered a rule change request from the Minister on *Sharing concessional finance benefits with consumers*.

That rule change request sought to clarify the regulatory treatment of concessional finance under the NER where a government funding body has agreed with a network service provider to share any of the benefits of concessional finance with consumers. A final determination and final rule was published on 21 March 2024.

Background

The existing regulatory framework was developed and has evolved over a period of incremental growth of the grid, rather than the current required pace of step-change growth set out in the AEMO ISP.

In our Transmission Planning and Investment Review Stage 2 final report, we concluded that there was currently no clear evidence of financeability issues with specific projects or TNSPs. However, we recognised that successive ISP iterations could see the timing of major transmission projects moved forward or bunched in a way that creates a risk of financeability issues arising in the future.

The Commission continues to hold the view that there is a material risk that TNSPs face financeability issues if successive ISP projects result in a large amount of new investment, relative to the TNSP's existing RAB. This could impact timely and efficient investment in transmission infrastructure that is required to support the transition of the National Electricity Market (NEM).

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