



# INFORMATION

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## Draft determination on TransGrid's financeability participant derogation

The Australian Energy Market Commission (AEMC or Commission) calls for public submissions on its draft determination to not make TransGrid's rule change request which would bring forward cashflows for its share of current and future actionable Integrated System Plan (ISP) projects.

Based on current information and market evidence, the Commission does not consider there is a barrier in the regulatory framework to TransGrid financing its share of these projects. The Commission therefore does not consider that a change to the National Electricity Rules (NER) in the form of a participant derogation is warranted.

Submissions are due by 18 March 2021.

### The Commission's draft determination

In accordance with section 99 of the National Electricity Law (NEL), the Commission has made this draft rule determination in relation to TransGrid's proposed participant derogation.

The Commission recognises the importance of delivering ISP projects in an efficient and timely manner, consistent with meeting the National Electricity Objective (NEO). However, based on the AEMC's consultant's analysis and stakeholder feedback to the consultation paper and public forum, the Commission considers the regulatory framework does not create a barrier to financing TransGrid's share of actionable ISP projects (including Project EnergyConnect (PEC)).

The Commission has therefore determined not to make the proposed participant derogation.

### Reasons for the Commission's draft determination

In assessing the rule change request, the AEMC engaged Cambridge Economic Policy Associates (CEPA) to provide advice on the financeability of ISP projects. CEPA's advice and analysis, published with this draft determination, helped inform the Commission's view on whether the current economic regulatory framework set out in the NEL and NER and applied by the Australian Energy Regulator (AER) is creating a barrier to TransGrid being able to secure finance for its share of current actionable ISP projects, including Project EnergyConnect. In summary, the Commission has concluded the following:

- TransGrid has adopted a narrow financeability test to support its case for change. CEPA found that when using the full credit scoring methodology used by credit rating agencies, a notional transmission network businesses with an investment profile consistent with TransGrid's share of Project EnergyConnect, financed at 60 per cent gearing and receiving the benchmark rate of return, would likely be able to retain an investment grade rating. This contrasts with the claim made by TransGrid in its rule change request.
- The extent of improvement resulting from the proposed rule, if made, would be relatively marginal and could be achieved by TransGrid itself by making a small change to its gearing. CEPA's analysis shows that a change in gearing from the benchmark level of 60 per cent to within the range of 55-58 per cent would achieve the same FFO/Net Debt ratio as in the rule change case. This also supports the case that TransGrid's current investment profile is financeable within the current framework.
- Contrary to TransGrid's claims, there is no expectation that a transmission network business, such as TransGrid, will adopt the benchmark efficient entity's capital structure.

The concept of a 'benchmark efficient entity' is used by the AER to derive the rate of return (or WACC) for an efficient service provider. Once set, network businesses are free to set their own capital structures and to use a range of tools to manage any financeability issues should any arise.

- Finally, CEPA observed market evidence of significant funding options available in the market. This was supported by observations that networks in Australia had gained substantial debt and equity financing in 2020, fully anticipating the ISP investments would be made without a rule change.

More broadly, the Commission is not satisfied that the proposed participant derogation will, or is likely to, contribute to the achievement of the NEO. Making the rule proposed by TransGrid would likely substantially increase costs to consumers in the near to medium term, creating an inter generation wealth transfer. Stakeholder consultation evidenced significant concern regarding the impact on households and businesses paying for services years before they receive the benefit of them.

### **TransGrid's proposed rule**

On 1 October 2020, the AEMC received a rule change request from TransGrid in the form of a participant derogation (that is, an exception to applicability of the rules to it) in relation to the financeability of its share of actionable ISP projects.

TransGrid asserts that, during its assessment of PEC, it identified that there are features of the regulatory framework that have significant implications for the financeability of large-scale projects with long asset lives, such as PEC. Specifically, it considers that the deferral of revenue recovery under the current rules results in a long period early in a large asset life where the revenue allowance will fall short of covering the efficient costs of financing the project during that period. This creates a barrier to securing the capital necessary to finance the project, undermines the incentive to invest and risks denying consumers the benefits of the projects concerned.

To address this issue, TransGrid has proposed the removal of regulatory asset base indexation and a move to as incurred depreciation for its current, and future, share of actionable ISP projects. It considers these changes could, with prudent capital management, achieve an investment grade rating sufficiently early to overcome the barrier to securing the capital necessary to proceed with these projects.

### **Future considerations on timely and efficient delivery of transmission projects**

In the course of assessing the rule change request, a number of significant issues were raised in respect of the ISP framework, in particular in relation to the timely and efficient delivery of large transmission projects (including current and future ISP projects) in the national electricity market (NEM).

The Commission notes that currently, transmission network service providers have a monopoly right to build and own ISP projects but not an obligation. There is also no option for an alternative provider nor any consequence if the asset isn't built or is delivered late. This creates an environment of uncertainty around the timely delivery of future ISP projects.

The Commission therefore intends to commence a broader review, together with the other market bodies, to consider options to support the timely and efficient delivery of large transmission projects that are in the long-term interests of consumers, recognising that the nature of transmission investment is invariably changing. The scope of the review will include matters such as financing, regulatory and governance issues.

### **Consultation**

Stakeholders are invited to make submissions in response to the draft rule determination by Thursday 18 March 2021.

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