

## Draft rule determination

# National Electricity Amendment (Accommodating financeability in the regulatory framework) Rule 2024

### Proponents

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Energy Networks Australia

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## About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

## Acknowledgement of Country

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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## Summary

- 1 The Australian Energy Market Commission (the AEMC or Commission) has decided to make a more preferable draft 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 the consolidated rule change request from the Honourable Chris Bowen MP, Commonwealth Minister for Climate Change and Energy (Minister) and Energy Networks Australia (ENA).
- 2 There is broad consensus that transmission is a critical enabler for the transition to net zero, both in the National Electricity Market (NEM) and the economy more broadly. 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.
- 3 The scale of transmission investment required, coupled with the speed of the energy transition, presents unique opportunities and challenges for the existing regulatory framework. This 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 Australian Energy Market Operator's (AEMO) ISP.
- 4 In addition, as part of the building block framework, depreciation revenue is reduced by the forecast indexation of capital. This feature contributes to financeability challenges because it can reduce cash flow early in the life of significant ISP projects. Providing flexibility to alter the rate of depreciation can address such cash flow issues without increasing the cost to customers over the life of the investment.
- 5 Given that transmission is a critical enabler for the transition to net zero, the Commission considers that improving the ability of TNSPs to efficiently access finance, where needed, to deliver actionable ISP projects in a timely and efficient way is in the long term interest of consumers. Delayed investment in transmission infrastructure would come at a cost to consumers. With transmission investment occurring in line with the timetable outlined in the ISP, cheaper renewable energy sources such as wind and solar can be unlocked for consumers, reducing emissions and wholesale prices. This will benefit consumers today and in the future.
- 6 We are seeking feedback on our draft determination and rule by **8 February 2024**.

## Our draft rule would support timely investment in and delivery of actionable ISP projects by addressing challenges faced by TNSPs in raising finance

- 7 The Minister, ENA and the AEMC's Transmission Planning and Investment Review (TPIR) raised concerns that there is a risk that financeability challenges could arise for actionable ISP projects, which may impact the timely and efficient investment in these major transmission projects. This is because:
  - TNSPs may face challenges in raising finance to proceed with ISP projects, and
  - the existing revenue-setting framework is not sufficiently flexible to address financeability challenges.
- 8 The draft determination would address financeability challenges by preventing a TNSP's financeability position from worsening as a result of the ISP project, based on a TNSP's regulated business and determined using the benchmark gearing ratio in the applicable rate of return instrument (RORI). To achieve this, the draft rule would introduce greater flexibility in the revenue-setting framework in the National Electricity Rules (NER) by allowing the Australian Energy

Regulator (AER) to vary the depreciation profile of assets that form part of an actionable ISP project. Varying depreciation would bring forward a TNSP's cashflows. This, in turn, would improve a TNSP's financial metrics and consequently, its ability to efficiently raise finance, facilitating timely investment in and delivery of actionable ISP projects.

## Stakeholder support for transparency and timely investment shaped our draft rule

- 9 Stakeholders supported an approach to improving TNSP financeability that is transparent and would support timely investment in ISP projects. Stakeholders were divided on how best to balance providing the AER with sufficient flexibility to adapt its financeability assessment to suit specific and changing circumstances, while also providing TNSPs and their investors with sufficient certainty to secure investment in a timely way. We consider the draft rule strikes an appropriate balance between these two objectives.
- 10 Some stakeholders proposed alternative approaches for delivering actionable ISP projects, such as funding ISP projects through a beneficiary pays model or allowing contestable provision of ISP projects. For reasons discussed in this draft determination, the Commission considers these approaches are not appropriate alternative solutions to financing actionable ISP projects.

## The Commission considers the draft rule is in the long term interests of consumers

- 11 The Commission considers its more preferable draft rule that would allow depreciation to be advanced for actionable ISP projects will better contribute to the achievement of the National Electricity Objective (NEO)<sup>1</sup> than the proposed rules by:
  - **Improving outcomes for consumers** – the draft rule would deliver benefits to consumers in the short and long term by facilitating timely investment in transmission infrastructure that the ISP has determined as necessary to support emissions reductions, security and reliability. Delayed investment in transmission infrastructure would come at a cost to consumers. With transmission investment occurring on time, cheaper renewable energy sources (wind and solar) can be unlocked for consumers, reducing emissions and prices. Without transmission, consumers need to pay for more expensive capacity.
  - **Providing a stable and predictable framework** – consistent with principles of good regulatory practice – the draft rule would provide TNSPs and their investors with certainty about how the AER would assess whether a TNSP has a financeability issue by requiring the AER (if requested by a TNSP) to apply a financeability test set out in the NER, supported by further details in AER guidelines about how the AER will determine a TNSP's financeability position.
  - **Supporting emissions reduction** – the draft rule would facilitate the shift to net zero by enabling timely investment in actionable ISP projects that are required to support renewable generation and storage infrastructure.
  - **Supporting reliability and security** – the draft rule would facilitate the timely investment in and delivery of necessary transmission infrastructure by improving the ability of TNSPs to efficiently obtain finance where required, enabling the reliable and secure provision of energy to consumers over the long term.

<sup>1</sup> Section 7 of the National Electricity Law (NEL).

- **Supporting efficient market arrangements** – the draft rule would support incentives for TNSPs to deliver actionable ISP projects by reducing the risk that a TNSP’s ability to efficiently obtain finance could deteriorate as a result of delivering an ISP project.

## How the draft rule would work

### TNSPs would be able to request a financeability test

- 12 The draft rule would allow a TNSP to submit a financeability request at the same time as submitting a request for an amendment to its revenue determination for an actionable ISP project to the AER.<sup>2</sup> A TNSP would not be able to request a financeability test as part of a CPA stage 1 - early works. In its request for a financeability test, the TNSP can propose adjustments to depreciation of the asset to address any financeability issue which can be considered by the AER.
- 13 The AER would be required to apply the financeability test, in accordance with the draft rule. The AER must bring forward cashflows for actionable ISP projects if the financeability test demonstrates there is a financeability issue. The AER may achieve this by using a combination of one or more of the following methods outlined below.
  - Using a new method under the draft rule, advance a TNSP’s cashflows by depreciating the assets of an ISP project by using a profile that it considers appropriate (e.g. a profile other than straight-line depreciation or shorter asset lives).
  - Under existing mechanisms under the current NER:
    - as incurred recovery of depreciation prior to commissioning;
    - revenue smoothing within the regulatory control period, if available.
- 14 A determination to bring forward cashflows through adjusting depreciation may apply to the current and the subsequent regulatory control period. If it applies to the subsequent regulatory control period, the AER’s determination would be binding.

### The AER would assess whether a TNSP has a financeability issue by applying a financeability test

- 15 If requested by a TNSP, the AER would be required to apply the financeability test set out in the NER. The financeability test requires the AER to determine the TNSP’s financeability position before and after investing in the ISP project to identify the project’s incremental impact on financeability. The AER must determine the TNSP to have 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
  - below the financeability threshold and its financeability position deteriorates at all with the ISP project.
- 16 The TNSP’s financeability position would be calculated using the Maximum Allowable Revenue derived from the prevailing Post Tax Revenue Model. That is, the assessment would be based on a TNSP’s regulated business only and would use the benchmark gearing ratio set out in the applicable RORI. The financeability threshold would be equivalent to the benchmark credit rating in the applicable RORI. The AER would not be required to assess a TNSP’s actual credit rating that is determined by credit rating agencies.

<sup>2</sup> That is, the Contingent Project Application (CPA) stage 2 for construction under NER clause 6A.8.2(a).

### The AER would be required to adjust a TNSP's cashflows if a TNSP has a financeability issue

- 17 If the AER determines the TNSP has a financeability issue, the AER would be required to adjust the TNSP's cashflows to prevent the TNSP's financeability position from worsening as a result of the actionable ISP project, where "worsening" depends on the TNSP's starting financeability position as noted below. The draft rule would introduce the ability for the AER to advance a TNSP's cashflows by depreciating the assets of an ISP project by using a profile that it considers appropriate (e.g. a profile other than straight-line depreciation or a shorter asset lives). The AER could also advance cashflows using existing tools, such as as incurred depreciation or smoothing revenue within the current regulatory control period.
- 18 The AER would be required to adjust cashflows 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, or
  - 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 would be required to make Financeability Guidelines

- 19 The AER would 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 AER would be required to explain the basis for its selection of financial metrics and weightings for financial metrics.
- 20 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 would allow the Guidelines to include other matters such as how the AER would treat depreciation for biodiversity offsets.

### Additional rules would apply to TNSPs that have received concessional finance, in some circumstances

- 21 TNSPs that have received concessional finance from a Government funding body (GFB) after 14 December 2023 would be treated differently under the draft rule depending on how the benefits of the concessional finance have been treated, as follows:
- If all the benefits of the concessional finance have been passed through to consumers, the TNSP is eligible to apply for a financeability test. Under this scenario there remains a risk that a TNSP could face financeability issues and so should be able to have its financeability assessed and, if required, addressed through a cashflow adjustment. In this case the TNSP itself has not received any financial support, so the AER would not have any concessional finance to take into account in the financeability assessment.
  - If some or all of the benefits of the concessional finance are retained by the TNSP, the TNSP is eligible to apply for a financeability test only if:
    - the government funding body providing concessional finance for the actionable ISP project to which the request relates agrees to the TNSP requesting a financeability test, and
    - the concessional finance agreements for all actionable ISP projects entered into after 14 December 2023 each set out how the benefits of the concessional finance that are retained by the TNSP are to be taken into account by the AER in applying the financeability test.

This approach prevents a TNSP from benefiting from both concessional finance and a cashflow adjustment for an actionable ISP project unless agreed to by the relevant government funding body and will allow the cashflow benefits from earlier concessional finance agreements to be captured in the test, minimising the impact on consumers.

## The draft rule is a more preferable rule

22 The draft rule differs from the proposed rule set out in each of the rule change requests in the following ways:

- A TNSP is to request a financeability test at the same time as it applies for an amendment to its revenue determination for an actionable ISP project (i.e. CPA stage 2), but a TNSP would not be able to request a financeability assessment as part of a CPA stage 1.
- There is no ability for a TNSP to submit an initial, earlier request, or requirement for the AER to publish an issues paper. The Commission considers that these steps proposed in the Minister's rule change request would not be required since the draft rule would provide a more prescriptive approach to assessing financeability.
- The AER would be required to undertake a financeability assessment by applying a prescriptive financeability test set out in the NER, rather than using principles as proposed by the Minister and previously by the Commission in TPIR. While this does not go as far as embedding a formula in the NER as proposed by ENA, the Commission considers the draft rule provides greater certainty to TNSPs and their investors than a purely principles-based approach.
- The draft rule does not include a requirement for the AER to consider inter-generational equity since the draft rule applies a prescriptive test rather than a principles-based approach to guide discretion. However, the Commission considers that the draft rule would benefit both near term and future consumers by supporting efficient delivery of transmission in accordance with the timeframes set out in the ISP. Many benefits will be realised early in ISP project lives, unlocking cheaper renewable energy sources that will reduce emissions and prices. The purpose of the ISP is to provide a 20-year plan for the optimal development of the transmission system that is in the long term interests of consumers, and the Optimal development path (ODP), including actionable ISP projects, must have a positive net benefit in the most likely scenario. We also note that:
  - revenue profiles are somewhat arbitrary under the current economic regulatory framework where the costs and benefits of network expenditure does not always align at the same time for consumers; and
  - advancement of depreciation would only occur in narrow circumstances where a TNSP has a demonstrable financeability challenge and it will only apply to the relevant actionable ISP project.
- The draft rule would require the AER to make a Financeability Guideline and sets out the minimum requirements for the Guideline, rather than providing the AER with the option to make a guideline as suggested in the Minister's rule change request and previously by the Commission in TPIR. As above, the Commission considers this approach improves certainty for TNSPs and investors by providing greater clarity on how the AER would determine a TNSP's financeability position.
- The Commission considers that the NER already allows for TNSPs to commence recovery of depreciation for biodiversity offset costs on an as incurred basis during construction of an ISP project. As such, the draft rule does not explicitly allow for this, as proposed by the Minister.

However, we suggest the AER clarify its approach to depreciating biodiversity offsets in the Guidelines.

## TNSPs would be able to apply for a financeability assessment from 29 March 2024

- 23 If made as a final rule, we propose the final rule commence on 29 March 2024. The AER would be required to finalise its Guidelines within approximately 9 months (by 31 December 2024).
- 24 TNSPs would be able to apply for a financeability test from the commencement date of the rule. However, the Guidelines would not be finalised until 31 December 2024. While ideally the Guidelines would be made first, the Commission is conscious that the need for TNSPs to secure finance to deliver actionable ISP projects is pressing. We consider uncertainty for TNSPs in how the AER will apply the financeability test in the absence of Guidelines will be minimised by implementing a rule that includes a clear test for assessing financeability.

## Related rule change process

- 25 The Commission is separately considering a rule change request from the Minister on *Sharing concessional finance benefits with consumers*.
- 26 That rule change request relates to amending the NER to enable the AER to take into account how any financial benefits that may arise from concessional financing of transmission infrastructure are shared between consumers and TNSPs.
- 27 The Commission also published a draft rule determination on *Sharing concessional finance benefits with consumers* on 14 December 2023.



## How to make a submission

### We encourage you to make a submission

Stakeholders can help shape the solution by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and contributes to well-informed, high quality rule changes.

### How to make a written submission

**Due date:** Written submissions responding to this draft determination and rule must be lodged with Commission by 8 February 2024.

**How to make a submission:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0348.<sup>3</sup>

Tips for making submissions on rule change requests are available on our website.<sup>4</sup>

**Publication:** The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).<sup>5</sup>

### Next steps and opportunities for engagement

There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions.

The AEMC will be holding a joint public forum on Friday 15 December 2023 to discuss the draft rule determinations for this rule change on *Accommodating financeability in the regulatory framework (ERC0348)* and the separate rule change on *Sharing concessional finance benefits with consumers (ERC0349)*.

You can also request the Commission to hold a public hearing in relation to this draft rule determination.<sup>6</sup>

**Due date:** Requests for a hearing must be lodged with the Commission by 21 December 2023.

**How to request a hearing:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0348. Specify in the comment field that you are requesting a hearing rather than making a submission.<sup>7</sup>

### For more information, you can contact us

Please contact the project leader with questions or feedback at any stage.

Project leader: Andrew Pirie  
Email: [andrew.pirie@aemc.gov.au](mailto:andrew.pirie@aemc.gov.au)

3 If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission

4 See: <https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3>

5 Further information about publication of submissions and our privacy policy can be found here: <https://www.aemc.gov.au/contact-us/lodge-submission>

6 Section 101(1a) of the NEL.

7 If you are not able to lodge a request online, please contact us and we will provide instructions for alternative methods to lodge the request.

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# 1 The Commission has made a draft rule determination

The Commission's draft decision is to make a draft rule that is a more preferable rule in response to a consolidated rule change request from the Minister and ENA that seeks to address challenges that TNSPs may have in raising finance to proceed with actionable ISP projects. We are seeking feedback on this draft rule.

For more detailed information on:

- why we made the rule, refer to Chapter 2
- how the rule works, refer to Chapter 3
- the rule change requests and background context, refer to Appendix A.

## 1.1 Our draft rule would support timely and efficient delivery of actionable ISP projects by addressing challenges faced by TNSPs in raising finance

The Minister, ENA and the AEMC in its TPIR raised concerns that there is a risk that financeability challenges could arise for actionable ISP projects, which may impact the timely and efficient investment in, and delivery of, these major transmission projects. This is because:

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

The scale of transmission investment required, coupled with the speed of the energy transition, presents challenges for the existing regulatory framework. This 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 addition, as part of the building block framework, depreciation revenue is reduced by the forecast indexation of capital. This feature contributes to financeability challenges because it can reduce cash flow early in the life of significant ISP projects. Providing flexibility to alter the rate of depreciation can address such cash flow issues without increasing the cost to customers over the life of the investment.

The draft rule would address financeability challenges by introducing greater flexibility in the revenue-setting framework in the NER by allowing the AER to vary the depreciation profile of assets that form part of an actionable ISP project. Varying depreciation would bring forward a TNSPs' cashflows. This, in turn, would improve a TNSP's financial metrics and consequently, its ability to efficiently raise finance, facilitating timely investment in and delivery of actionable ISP projects.

## 1.2 Stakeholder support for transparency and timely investment shaped our draft rule

Stakeholders supported an approach to improving TNSP financeability that is transparent and would support timely investment in ISP projects. Stakeholders were divided on how best to balance providing the AER with sufficient flexibility to adapt its financeability assessment to suit specific and changing circumstances, while also providing TNSPs and their investors with sufficient certainty to secure investment in a timely way. We consider the draft rule strikes an appropriate balance between these two objectives.

Some stakeholders proposed alternative approaches for delivering actionable ISP projects, such as funding ISP projects through a beneficiary pays model or allowing contestable provision of ISP projects. For reasons discussed in this draft determination, the Commission considers these approaches are not appropriate alternative solutions to financing actionable ISP projects.

For more detailed information on stakeholder feedback refer to chapters 2 and 3 and Appendix D.

### 1.3 Our draft rule would support the energy transition by ensuring TNSPs can scale up transmission services

There is broad consensus that transmission is a critical enabler for the transition to net zero, both in the NEM and the economy more broadly. 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 Commission considers that improving the ability of TNSPs to access finance, where needed, to deliver actionable ISP projects in a timely and efficient way is in the long-term interests of consumers. Avoiding delays would support access to cheaper renewable energy sources, supporting power system security and reliability and enabling emissions reductions to occur sooner, benefiting customers today and in the future.

Our draft rule would improve the ability of TNSPs to access finance and scale up transmission services by providing TNSPs and their investors with certainty about how the AER would conduct a financeability test. The draft rule would:

- allow a TNSP to submit a financeability request to the AER to address a financeability issue relating to their ability to finance their existing RAB and a specific ISP project. If a TNSP thinks it has a financeability issue, it will seek a cashflow adjustment, which may be addressed by the AER through any combination of one or more of the following tools:
  - as incurred recovery of depreciation prior to commissioning,
  - advancing depreciation after the asset has been commissioned, for example through a profile other than straight-line depreciation or shorter asset lives; and/or
  - revenue smoothing within a regulatory control period.
- require the AER to assess whether a TNSP has a financeability issue using a financeability test set out in the NER
- where a TNSP is assessed as having an overall financeability position, without the ISP project, that is:
  - at or above the financeability threshold (equivalent of the benchmark credit rating in the applicable RORI), the TNSP's financeability position would not be permitted to fall below the lower bound of the financeability threshold; or
  - below the financeability threshold, the TNSP's financeability position would not be permitted to deteriorate at all.
- require the AER to develop Financeability Guidelines to set out further details of how it would determine a TNSP's financeability position, including the financial metrics and weightings for these financial metrics, that it will apply.

## 2 The rule will contribute to the national electricity objective

### 2.1 The Commission must act in the long-term interests of energy consumers

The Commission can only make a rule if it is satisfied that the rule will or is likely to contribute to the achievement of the relevant energy objectives.<sup>8</sup>

For this rule change, the relevant energy objective(s) is the NEO:<sup>9</sup>

The NEO is:<sup>10</sup>

to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system; and
- (c) the achievement of targets set by a participating jurisdiction—
  - (i) for reducing Australia’s greenhouse gas emissions; or
  - (ii) that are likely to contribute to reducing Australia’s greenhouse gas emissions.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.<sup>11</sup>

The draft rule would, or would be likely to, contribute to the achievement of the NEO by addressing challenges that TNSPs may have in efficiently raising finance to proceed with actionable ISP projects. This would improve outcomes for consumers by facilitating timely investment in and delivery of transmission that the ISP has determined as necessary to support emissions reductions and security and reliability. In supporting timely investment in transmission infrastructure, the draft rule would also benefit both near-term and future customers by unlocking low-cost renewable generation.

### 2.2 We must also take these factors into account

#### 2.2.1 We consider a more draft preferable rule would better achieve the NEO

The Commission may make a rule that is different, including materially different, to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule is likely to better contribute to the achievement of the NEO.<sup>12</sup>

For this rule change, the Commission has made a more preferable draft rule. The reasons are set out in section 2.3 below.

<sup>8</sup> Section 88(1) of the NEL.

<sup>9</sup> The NEO was updated on 21 September 2023 with the introduction of the Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023. We have applied the updated NEO in this draft determination in line with that Act. This is a change from the consultation paper which referenced the old NEO.

<sup>10</sup> Section 7 of the NEL.

<sup>11</sup> Section 32A(5) of the NEL.

<sup>12</sup> Section 91A of the NEL.

### 2.2.2 We have considered the revenue and pricing principles for this rule change

We take the revenue and pricing principles into account when making rules with respect to the determination by the AER of allowances for depreciation for the purpose of making a transmission determination.<sup>13</sup>

Relevantly, the revenue and pricing principles provide that:

- A regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in—(a) providing direct control network services; and (b) complying with a regulatory obligation or requirement or making a regulatory payment.
- A regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to direct control network services the operator provides. The economic efficiency that should be promoted includes efficient investment in a distribution system or transmission system with which the operator provides direct control network services.
- A price or charge for the provision of a direct control network service should allow for a return commensurate with the regulatory and commercial risks involved in providing the direct control network service to which that price or charge relates.
- Regard should be had to the economic costs and risks of the potential for under and over investment by a regulated network service provider in, as the case requires, a distribution system or transmission system with which the operator provides direct control network services.<sup>14</sup>

Our draft rule is consistent with the revenue and pricing principles in the NEL. Our draft rule provides TNSPs with the opportunity to recover at least the efficient costs they incur in providing regulated services by ensuring the TNSP's opportunity to recover at least its efficient cost is not impacted by efficiently financing an ISP project. The draft rule does not require a TNSP to achieve the equivalent of the benchmark credit rating in the applicable RORI, and instead uses a "no worse off" approach<sup>15</sup>. However, we do not consider this to be inconsistent with the revenue and pricing principles and we consider it highly unlikely that a TNSP's initial financeability position, based on benchmark gearing, would be equivalent to a sub-investment grade credit rating.

We also note that a TNSP's Maximum allowed revenue (MAR) is not required to achieve financeability metrics that are consistent with the benchmark credit rating in the applicable RORI. Rather, the benchmark credit rating is used as an input to determining the rate of return in the applicable RORI.

Our draft rule would also provide effective incentives to promote economic efficiency by promoting efficient investment in actionable ISP projects. By supporting TNSPs' financeability, the draft rule would support timely investment in ISP projects according to the timetable outlined in AEMO's ISP. The ISP has been developed to provide an optimal transmission development path. The draft rule would also support the ability of TNSPs to obtain finance at efficient cost.

Similarly, our draft rule would reduce the risk for under-investment by TNSPs in actionable ISP projects. By supporting improved financeability, the draft rule would remove a disincentive the TNSP may have to invest in actionable ISP projects, noting that TNSPs have an exclusive right, but no obligation, to deliver actionable ISP projects.

<sup>13</sup> NEL Schedule 1 item 22.

<sup>14</sup> Section 7A of the NEL.

<sup>15</sup> For further information, see section 1.3

### 2.2.3 The draft rule would not apply in the Northern Territory

The proposed rule would not apply in the Northern Territory, as it amends provisions in NER Chapter 6A which does not apply in the Northern Territory.<sup>16</sup>

See Appendix C for more detail on the legal requirements for our decision.

## 2.3 How we have applied the legal framework to our decision

The Commission must consider how to address the financeability challenges that could arise for actionable ISP projects against the legal framework.

We identified the following criteria to assess whether the proposed rule change, no change to the rules (business-as-usual), or other viable, rule-based options are likely to better contribute to achieving the NEO:

- **Improving outcomes for consumers, today and in the future:** there should be a consideration of the benefits and costs borne by near-term and future consumers.
- **Principles of good regulatory practice:** the regulatory framework should be stable, predictable and transparent for TNSPs, investors, consumers and the AER
- **Emissions reduction:** the rule should support timely investment in the transmission infrastructure needed to enable new renewable generation and energy storage to deliver power to consumers more quickly.
- **Reliability and security:** the regulatory framework should contribute to a reliable and secure electricity system.
- **Principles of market efficiency:** the regulatory framework should support incentives for TNSPs to deliver actionable ISP projects.

These assessment criteria reflect the key potential impacts – costs and benefits – of the rule change request, for impacts within the scope of the NEO. There is one change from the assessment criteria proposed in the consultation paper. Emissions reduction has replaced the criterion of decarbonisation. This is in line with the changes to the NEO on 21 September 2023.

The Commission has undertaken regulatory impact analysis to evaluate the impacts of the various policy options against the assessment criteria. Appendix B outlines the methodology of the regulatory impact analysis.

The rest of this section explains why the draft rule best promotes the long-term interest of consumers when compared to other options and assessed against the criteria.

### 2.3.1 Improving outcomes for consumers, today and in the future

The draft rule would deliver benefits to consumers in the short and long term by facilitating timely investment in and delivery of transmission that has been determined to be necessary in the ISP to support emissions reduction and security and reliability.

Delayed investment in transmission infrastructure would come at a cost to consumers. With transmission investment occurring in line with the timetable outlined in the ISP, cheaper renewable energy sources such as wind and solar can be unlocked for consumers, reducing emissions and wholesale prices. Delivering major transmission projects on time requires minimising any potential barriers to TNSPs obtaining the necessary finance at efficient cost and avoiding potential delays associated with negotiating funding agreements with government funding bodies.

<sup>16</sup> Under the NT Act and its regulations, only certain parts of the NER have been adopted in the Northern Territory. The version of the NER that applies in the Northern Territory is available on the AEMC website at: <https://energy-rules.aemc.gov.au/ntner>.



Some stakeholders raised concerns about costs being brought forward for near-term consumers, at a time when bills have been escalating. These stakeholders were also concerned that even though a change in depreciation profile would be revenue neutral for a TNSP, consumers today would face a higher cost burden than future consumers, yet the benefits would accrue to future consumers.

The Commission acknowledges the cost burden that consumers are facing to support the delivery of a decarbonised grid. However, to maintain a secure and reliable electricity supply inevitably requires significant investment in new infrastructure, including transmission. The ISP provides a twenty-year plan for the optimal development of the transmission system that is in the long term interests of consumers. The ODP, including actionable ISP projects, must have a positive net benefit in the most likely scenario.

Delivering those projects in line with the timeframe set out in the ISP will minimise costs to consumers and support emissions reduction and security and reliability, all of which will benefit current as well as future consumers. The Commission considers that the benefits of timely delivery outweigh consideration of whether revenues are exactly aligned with benefit realisation. Further, many benefits will be realised early in the project lives, particularly where projects relate to replacement generation and storage that will support lower wholesale prices and reduced emissions.

In addition, it is not clear whether the current economic regulatory framework is delivering an optimal allocation of costs and benefits between current and future consumers, and therefore whether it represents an appropriate starting point on which to base future allocations. Revenue profiles are somewhat arbitrary as the economic regulatory framework was not designed to assess inter-generational allocations. Rather, the regulatory framework is intended to deliver outcomes that are in the long term interests of all consumers by delivering efficient operational and investment decisions.

Nonetheless, we have taken into account the cost burden on today's customers in the design of the financeability test. The draft rule would limit any adjustment to depreciation to circumstances where a TNSP has a demonstrable financeability problem as assessed by the AER using a prescriptive financeability test. Depreciation would only be adjusted for the ISP project, not for the wider asset base, and it would only be adjusted to the extent necessary to prevent a TNSP's overall financeability position from becoming worse off or to minimise any deterioration.<sup>17</sup> This mechanism will minimise the impacts on today's consumers.

The Commission considers the draft rule represents a more preferable approach to ENA's proposed approach whereby financeability assessments would be based on individual projects, rather than the TNSP's regulated business, and cashflows would be required to support the benchmark credit rating (currently BBB+). Basing the assessment on individual projects and the benchmark credit rating would be inconsistent with the holistic approach to determining revenue under the regulatory framework. Further, it could result in more cash being brought forward than necessary. Our approach supports a TNSP being no worse off as a result of delivering an ISP project, and ensures that no more cash than necessary is brought forward.

The ENA proposed an alternative option whereby the assessment would be based on the TNSP's regulated business, rather than individual projects, and cashflows would again be set to support the benchmark credit rating. Our draft rule is more preferable than ENA's alternative option. While

<sup>17</sup> Where a TNSP is assessed as having an overall financeability position that is at or above the financeability threshold, the TNSP's financeability position would not be permitted to fall below the financeability threshold. Where a TNSP's overall financeability position is below the financeability threshold, the TNSP's financeability position would not be permitted to deteriorate at all.

our draft rule and ENA's alternative option both involve a prescriptive financeability test, our draft rule provides clear direction for this test in the NER, while allowing the AER to select the appropriate financial metrics and weightings for these metrics for the financeability test. In addition, our draft rule enables the AER to update the financial metrics and weightings over time through their guidelines, avoiding the need for another rule change, which may be required under ENA's alternative option where financial metrics and weightings are locked into the NER.

### 2.3.2 Providing a stable and predictable framework, consistent with good regulatory practice

The draft rule would provide TNSPs and their investors with certainty about how the AER would conduct a financeability test and predictability in the outcomes of the test, consistent with good regulatory practice. It would do this by including a financeability test in the NER that the AER must use to determine whether a TNSP has a financeability issue and, if so, by how much depreciation would need to be adjusted. In addition, the AER would be required to set out in its Financeability Guidelines the financial metrics, and weightings to apply for each financial metric, that it would use to conduct its assessment. Therefore, while the NER would not include a prescriptive formula as proposed by the ENA, the metrics and weightings that the AER would apply would nevertheless be locked in via the AER's Guidelines.

Where the AER determines that a TNSP has a financeability issue as a result of investing in an ISP project, the AER would be required to adjust the TNSP's cashflows to prevent the overall financeability position of the TNSP from deteriorating or reduce any deterioration.

The Commission considers the draft rule is more preferable to the approach proposed in the Minister's rule change request whereby the AER would conduct a financeability assessment based on principles set out in the NER. A principles-based approach provides flexibility to assess the specific context and circumstances of a TNSP on a case-by-case basis. However, in this instance we consider the benefits of providing confidence to TNSPs and their investors via a stable and predictable framework outweigh the need for the AER to have greater flexibility in the way they conduct a financeability assessment. This is because investor confidence is critical for supporting timely investment in actionable ISP projects which, in turn, support emissions reduction, reliability and security, and efficient market arrangements, as discussed below.

On the other hand, we do not consider that locking a formula into the NER to determine whether a TNSP is financeable is required to promote investment certainty. As noted above, we consider the combination of a financeability test set out in the NER and a methodology set out in guidelines together would provide sufficient investment certainty of the likely outcome of a financeability assessment. We also note that credit rating agencies update their methodologies for determining companies' credit ratings from time to time. Similarly, we consider that the AER should have the ability to update their methodology, noting that any changes to the Guidelines would be subject to the Transmission Consultation Procedures.

The draft rule is also more likely to promote an administratively simpler and less costly framework than either the Minister's or ENA's proposed solutions, for the following reasons:

- It would remove additional requirements proposed in the Minister's rule change request for the TNSP to submit an initial request to vary depreciation and the AER to publish an issues paper prior to making a determination. We consider that these steps would no longer be required due to the prescriptive approach to the financeability test.
- It would require a TNSP to request a financeability test, rather than requiring the AER to apply the financeability test every time the AER makes a revenue determination for an actionable ISP

project, as proposed by ENA. We consider our draft approach is administratively less costly for the AER.

### 2.3.3 Contribution to achieving government targets for reducing greenhouse gas emissions

Our draft rule would help achieve Commonwealth and state government greenhouse gas emissions reduction targets, for example, the Commonwealth's 2030 target of 43% below 2005 levels. It also helps achieve Commonwealth and state government renewable energy targets, for example the Commonwealth's commitment to a national renewable target of 82% by 2030. It does this by supporting the timely delivery of the transmission infrastructure required to facilitate the transition to a net zero energy system.

The ISP sets out the optimal path for transmission development to deliver on, among other things, current environmental policies including net zero targets. As such, by supporting timely investment in actionable ISP projects, the draft rule would support emissions reduction targets.

The draft rule would support investment in actionable ISP projects in three ways, as explained below.

**First, it would reduce barriers to obtaining financing at efficient cost** through existing market mechanisms by ensuring a TNSP's overall financeability position, based on benchmark gearing, is supported when investing in an ISP project. This means that, where a TNSP is assessed as having an overall financeability position, without the ISP project, that is:

- at or above the financeability threshold, the TNSP's financeability position would not be permitted to fall below the financeability threshold; or
- below the financeability threshold, the TNSP's financeability position would not be permitted to deteriorate at all.

As such, TNSPs would be expected to be able to continue to raise finance as they could without the ISP project.

**Second, the draft rule would support timely investment** by supporting the financeability position of TNSPs seeking to invest in ISP projects.

**Thirdly, by supporting a TNSP's financeability, the draft rule would remove a disincentive a TNSP may have to invest in actionable ISP projects.** TNSPs have an exclusive right, but no obligation to deliver actionable ISP projects. Without the draft rule, there is a risk that TNSPs may choose not to invest to avoid a deterioration in their ability to obtain finance at efficient cost.

### 2.3.4 Supporting reliability and security

As noted above, the ISP sets out the optimal path for transmission development. The identified projects are required not just to deliver on emissions reduction targets, but also to enable the delivery of necessary transmission infrastructure to support the reliable and secure provision of energy to consumers over the long term. The draft rule would support this outcome for the same reasons it would support emissions reduction. That is, it would reduce barriers to TNSPs obtaining efficient finance, it would support timely investment in ISP projects and would remove a disincentive the TNSP may have to invest in actionable ISP projects.

### 2.3.5 Supporting efficient market arrangements

The draft rule would support efficient market arrangements in three ways, as explained below.

- **First, the draft rule would support the ability of TNSPs to finance their investments at efficient cost.** In the absence of the draft rule, there is a risk that investment in actionable ISP

projects could lead to a material deterioration of a TNSP's financial metrics. This could reduce the ability of TNSPs to efficiently (that is, without unnecessary costs) raise finance in the context of the framework used to determine regulated revenue. The draft rule would mitigate this risk by supporting the financeability of TNSPs that are investing in ISP projects, as explained in section 3.3.3 above.

- **Second, as noted above, TNSPs are not obligated to invest in and deliver actionable ISP projects.** Where a TNSP's financeability could deteriorate as a result of investing in an ISP project, it may have a disincentive to deliver the project. Allowing the depreciation profile of the ISP project to be adjusted to bring forward cashflows where necessary to support financeability would seek to mitigate this risk.
- **Finally, the draft rule would only allow a TNSP's cashflows to be brought forward in order to maintain its overall financeability position, and only for the actionable ISP project.** The depreciation profile for assets in the TNSP's existing Regulatory Asset Base (RAB) would remain unchanged. We consider this approach is more preferable to two of the solutions proposed in the ENA's rule change request<sup>18</sup>, as discussed further in chapter 3.

<sup>18</sup> The options raised by ENA are explained in Appendix A.

### 3 How our rule would operate

#### Box 1: SUMMARY OF DRAFT DETERMINATION

Our draft determination would allow a TNSP to submit a request for a financeability test, which is described in the draft rule as a ‘financeability request’. If such a request is submitted, the AER must apply the financeability test, which assesses the ability of the TNSP to efficiently raise finance to fund its RAB and a specific actionable ISP project, based on the benchmark gearing ratio value in the applicable RORI.

The draft rule is limited to actionable ISP projects and the AER would only adjust cashflows if a TNSP has a demonstrable financeability issue. In determining whether a TNSP has a financeability issue, the AER must apply a financeability test, set out in the NER. The financeability test requires the AER to determine the financeability position of the TNSP with and without the actionable ISP project. The test must be based on a TNSP’s regulated revenues and uses the benchmark gearing ratio value in the applicable RORI, and financial metrics and weightings set out in the AER’s Financeability Guidelines.

Under the draft rule, a TNSP has a financeability issue if its financeability position is worse off as a result of investing in the actionable ISP project. Whether or not a TNSP is “worse off” depends on whether the TNSP’s initial financeability position is at or above the financeability threshold (the equivalent of the benchmark credit rating in the applicable RORI explanatory statement), or below the financeability threshold. If the AER assesses the TNSP as having a financeability issue, the AER must adjust cashflows such that the TNSP’s financeability position avoids dropping below the financeability threshold or is no worse off as a result of investing in the ISP project.

If a TNSP has a financeability issue, the AER must address this issue by bringing forward cashflows through one or more of the following tools:

- The draft rule would allow the AER to vary the depreciation of assets that form part of an actionable ISP project, so that they are depreciated using a profile that the AER considers appropriate (e.g. a profile other than straight-line depreciation or using shorter asset lives).
- Existing mechanisms available under the current arrangements:
  - allow as incurred recovery of depreciation for assets that form part of the actionable ISP project; and/or
  - smooth revenue within a regulatory control period, if this is available.

The draft rule diverges from the rule change requests. It provides the AER with less discretion than under the principles-based approach proposed in the Minister’s rule change request. However, it does not go as far as ENA’s proposed rule that would embed a financeability formula in the NER. The draft rule adopts a “no worse off” test rather than requiring the TNSP to achieve a BBB+ credit rating with the ISP project as proposed by the ENA. Finally, the draft rule would not make amendments to the NER to allow biodiversity offsets to be depreciated on an as incurred basis because this is permitted under the NER.

### 3.1 Greater flexibility in the regulatory framework will allow cashflows to be brought forward, improving financeability of ISP projects

The AER must depreciate assets using a profile that reflects the nature (or category) of the assets over the economic life of that asset (or category of assets).<sup>19</sup> This feature contributes to financeability challenges because it can reduce cash flow early in the life of significant ISP projects.

The explanation of the financeability problem in the rule change requests from the Minister and ENA are consistent with the Commission's assessment in TPIR.<sup>20</sup> The Minister and ENA consider that there is a material risk that successive ISPs result in a large amount of new investment for TNSPs, relative to their existing RABs.<sup>21</sup> The Minister suggests that this could place pressure on TNSPs' cash flows and by extension their credit metrics, in the absence of alternative methods to address financeability challenges, such as sourcing financing from the Commonwealth, including through the Rewiring the Nation (RTN) program.<sup>22</sup>

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 NEM.

The Commission notes that not all stakeholders agree there is a need to address financeability of TNSPs to enable them to invest in actionable ISP projects. Some stakeholders considered further justification was required to support the need for a rule change.<sup>23</sup> Other stakeholders proposed alternative solutions, such as transferring the ISP project to another party,<sup>24</sup> adopting a beneficiary pays approach to allow cost recovery from generators as well as consumers<sup>25</sup> and introducing contestability for actionable ISP projects and/or ownership of transmission assets.<sup>26</sup> The EUAA suggested government support through Rewiring The Nation may be a more appropriate approach.<sup>27</sup>

The Commission consulted extensively with stakeholders on whether there is a problem to be addressed in TPIR. As noted above, we continue to hold the view that there is a risk that TNSPs will face financeability issues. As such, we consider that the regulatory framework should be more flexible to allow the AER to address financeability issues through adjusting the depreciation profile for actionable ISP projects. Further, we note that the draft rule is limited to actionable ISP projects and the AER may only adjust cashflows if a TNSP has a demonstrable financeability issue, limiting the application of the approach to where it is needed.

Allowing contestability in the development of actionable ISP projects was considered as part of TPIR. The Stage 3 Directions Paper concluded that the value of contestability is limited due to the jurisdictional regimes in place or being developed and decided not to progress this matter further. We continue to hold this view, and consider that the same issues arise for transferring an ISP project to another party. We do not consider that a beneficiary pays approach would address a

<sup>19</sup> The framework for the return of capital through depreciation is set out in clause 6A.6.3 of the NER.

<sup>20</sup> For more information, refer to Chapter 2 of the Consultation paper.

<sup>21</sup> Rule change request, p. 2.

<sup>22</sup> Rule change request, p. 1.

<sup>23</sup> Submissions to the Consultation Paper: Australian Energy Council, p. 1; Business NSW, p. 1; Energy Users Association of Australia (EUAA), p. 4; Public Interest Advisory Centre, p. 1.

<sup>24</sup> CEFC, submission, p. 8.

<sup>25</sup> PIAC submission, p. 4.

<sup>26</sup> Submissions to the Consultation Paper: AEC, p. 1; Business NSW, p. 4; EnergyAustralia, p.1; Iberdrola, p. 4; Nexa Advisory, p. 2; PIAC, pp. 2-3.

<sup>27</sup> EUAA submission, p. 10.

financeability issue in and of itself, since this would simply reallocate costs between consumers and generators. Finally, government support for ISP projects is a matter for governments to consider and is out of scope of this rule change.

The draft rule addresses the regulatory barrier identified above by explicitly allowing the AER to adjust depreciation for actionable ISP projects using a profile that the AER considers appropriate (e.g. a profile other than straight-line depreciation or shorter asset lives).<sup>28</sup> This would allow the AER to vary depreciation for actionable ISP projects and to bring forward cashflows, improving a TNSP's financial metrics and therefore its ability to obtain finance at efficient cost, based on benchmark gearing in the applicable RORI. The remainder of this chapter provides further detail on how the draft rule would operate to address this problem.

## 3.2 TNSPs may request a financeability test

### Box 2: DRAFT DETERMINATION - ALLOW A TNSP TO REQUEST A FINANCEABILITY TEST

Our draft determination would allow a TNSP to submit a request for a financeability test, which is described in the draft rule as a 'financeability request'. The request would seek to address a financeability issue by bringing forward cashflows through one or more of the tools described in Box 1 above.

If such a request is submitted, the AER must apply the financeability test, which assesses the ability of the TNSP to efficiently raise finance to fund its RAB and a specific actionable ISP project, based on benchmark gearing ratio in the applicable RORI.

The draft rule sets out the information that the request must include, when the request could be submitted, eligibility requirements and additional information requirements where the TNSP has received concessional finance for an actionable ISP project. The TNSP can propose adjustments to depreciation of the asset to address any financeability issue which can be considered by the AER.

The Commission considers that the draft rule would promote a simpler and less costly approach to administering requests for a financeability assessment than those proposed in the Minister and ENA's rule change requests.

### 3.2.1 TNSPs may request a financeability test

The draft rule would allow a TNSP to submit a financeability request to the AER to have the depreciation profile varied for an actionable ISP project.<sup>29</sup>

The financeability test would not be automatically triggered for every actionable ISP project. Rather, the TNSP must request the AER to apply the test. The AER supported an approach, whereby a TNSP submit a request<sup>30</sup> however the ENA considered that having to request a test would not promote investor certainty.<sup>31</sup> The Commission considers that the draft rule would

28 Draft rule, clause 6A.6.3A(o)(1)

29 For ease of discussion, this draft determination refers to depreciation of an actionable ISP project. However, the draft rule clarifies that a TNSP may apply to have an asset (or group of assets) that forms part of an actionable ISP project depreciated using an alternative profile. For example this may involve a depreciation profile other than a straight-line bases or shorter asset lives.

30 AER submission, pp. 14-15.

31 ENA submission, p. 8.



promote sufficient investor certainty through a prescriptive approach to the financeability test (see section 3.3). Requiring the TNSP to request a test, rather than having it apply automatically, will reduce the administrative burden on the AER. Further, not all TNSPs will be eligible to request a financeability test, depending on whether they have received concessional finance and, if so, the purpose of the finance (see section 3.5). As such, requiring TNSPs to apply for the financeability test is consistent with this approach.

In requesting a financeability test, the TNSP would be required to provide the AER with their proposed adjustments to the depreciation of the asset(s) associated with the actionable ISP project, any applicable information about any concessional finance received (see section 3.5) and any information required by the AER under the Financeability Guidelines (see section 3.4). The TNSP would also be required to provide the AER with additional information that is reasonably requested by the AER for the purpose of applying the financeability test or addressing the financeability issue.

### 3.2.2 TNSPs would be able to apply for a financeability test when submitting a CPA 2

A TNSP would be able to submit a request for a financeability test at the same time as submitting a request for an amendment to its revenue determination for an actionable ISP project. That is, at the Contingent Project Application (CPA) stage 2 for construction.<sup>32</sup>

TNSPs would not be able to request a financeability test as part of any early works in respect of the actionable ISP project i.e. when submitting an early works CPA.<sup>33</sup> There are two reasons for this draft decision:

- First, we consider that the quantum of an early works CPA is unlikely to be significant enough to result in a financeability issue and therefore does not warrant the AER conducting a financeability test. In this instance, we consider the costs of requiring the AER to conduct a financeability test would outweigh the benefits.
- Second, at the early works stage it is likely to be too early to accurately forecast construction capital expenditure that occurs later at the CPA stage 2. Requiring the TNSP to apply for a financeability test at CPA stage 2 would allow more accurate forecasts to be used, resulting in a more accurate assessment of whether a TNSP has a financeability issue.

The Minister's rule change request included requirements for:<sup>34</sup>

- the TNSP to submit an initial request to vary depreciation, and
- the AER to publish an issue paper in response to the TNSP's initial request for a financeability test.

Some stakeholders considered that it is important to have early visibility regarding cashflows for a project to provide investors with certainty and confidence that financeability risks will be addressed, and that this would be required in advance of the CPA stage 2.<sup>35</sup>

The Commission acknowledges the need for early certainty, but we consider that adopting a prescriptive approach to the financeability test provides the necessary level of certainty about the likely outcomes of a financeability test while balancing the possibility that capital expenditure

<sup>32</sup> Under NER clause 6A.8.2(a).

<sup>33</sup> The draft rule introduces the concept of an *early works contingent project application*, drawing on the drafting proposed under stage 3 of the Transmission Planning and Investment Review. The draft rule for this *Accommodating financeability in the regulatory framework* rule change introduces the minimum drafting required to distinguish early works. Future rule changes may expand on this drafting.

<sup>34</sup> Minister's rule change request, p. 4.

<sup>35</sup> Submissions to Consultation Paper: ENA, p.4; Transgrid, p. 1.



estimates shift substantially prior to the CPA stage 2. The draft rule would minimise the administrative burden on the AER by streamlining the decision-making process by removing:

- the need for the TNSP to submit an initial request to vary depreciation; and
- the need for the AER to publish an issues paper.

In doing so, the Commission considers this approach supports a stable and predictable framework, consistent with good regulatory practice.

### 3.3 The AER would be required to apply a prescriptive financeability test and adjust cashflows if the TNSP has a financeability issue

#### **Box 3: DRAFT DETERMINATION - THE AER MUST APPLY A FINANCEABILITY TEST AND ADJUST CASHFLOWS IF THERE IS A FINANCEABILITY ISSUE**

Our draft rule would require the AER to apply a financeability test, if requested by a TNSP, to determine whether the TNSP has a financeability issue. The test is to be applied with and without the ISP project. The draft rule specifies how the AER would apply the test and under what circumstances the AER must determine that the TNSP has a financeability issue.

The draft rule also sets out how the AER must address the financeability issue, if required, and permits the AER to depreciate an asset (or group of assets) for an actionable ISP project using a profile that the AER considers appropriate (e.g. a profile other than straight-line depreciation or using shorter asset lives). It would also allow the determination to be binding in the subsequent regulatory control period, if relevant.

Adapting the regulatory framework to be more flexible would support the ability of TNSPs to access finance at efficient cost. In doing so, the draft rule would promote the NEO by supporting timely delivery of transmission investment that will unlock cheaper renewable energy sources, reducing emissions and wholesale prices and promote reliability and security.

#### 3.3.1 The purpose of the financeability test is to determine whether there is a financeability issue

In determining whether a TNSP has a financeability issue, the draft rule would require the AER to derive financeability positions for the TNSP without the actionable ISP project ("initial financeability position") and with the ISP project, then compare the two. The AER must use the Post tax revenue model (PTRM) to determine the TNSP's cashflows (i.e. maximum allowed revenue, MAR), on which to base its financeability test.

Requiring the AER to use the PTRM means that the financeability test is based on the TNSP's regulated revenue and uses the benchmark gearing ratio from the applicable RORI (i.e. currently 60% geared). That is, the financeability position will be hypothetical, rather than using a TNSP's actual credit rating. We consider this approach avoids incentive issues where a TNSP may seek to amend its actual financial position (e.g. capital structure) in a way that would downgrade its financial metrics, so that it fails the financeability test, and cashflows are brought forward unnecessarily.

The draft rule would require the AER to determine that there is no financeability issue where the financeability position including the actionable ISP project is equivalent to or above the financeability threshold (i.e. is equivalent to, or higher than, the benchmark credit rating in the

applicable RORI)<sup>36</sup> Under the current 2022 RORI this means that cashflows would, and would not, need to be adjusted, as outlined below.

- **Cashflows don't need to be adjusted:**
  - if a TNSP's regulated revenue has cashflows that support a financeability position equivalent to or higher than the financeability threshold (currently a credit rating of BBB+), even with the ISP project, there is no financeability issue and so no requirement to bring forward cashflows.
  - if a TNSP's regulated revenue has cashflows that support a financeability position below the equivalent to the financeability threshold (currently a credit rating of BBB+), and there is no deterioration in this financeability position after the ISP project, there is no financeability issue and so no requirement to bring forward cashflows.
- **Cashflows need to be adjusted:**
  - If the initial financeability position of the TNSP is equivalent to or above the financeability threshold and the financeability position falls below the financeability threshold as a result of the ISP project, the AER must determine the TNSP to have a financeability issue.
  - If the initial financeability position of the TNSP is below the financeability threshold and the overall financeability position worsens as a result of the ISP project, the AER must determine the TNSP to have a financeability issue.

The AER must set out the following information in its Financeability Guidelines relating to the application of the financeability test:

- **Financial metrics** - the AER must select one or more financial metrics that would apply for the financeability test. For example, this may include financial metrics such as funds from operations (FFO)/net debt, FFO interest coverage and/or other financial metrics.
- **Weighting to apply to each financial metric** - the AER must set out the weighting that would apply for each of the financial metrics that the AER selects for the financeability test.

In the Consultation Paper we asked stakeholders for feedback on whether the financeability test should apply at the RAB level or the project level. We consider that because under the draft rule the AER would be required to apply a test that considers financeability with and without the ISP project, the test would necessarily occur at the RAB level. The draft rule specifies that the AER must apply the financeability test using the TNSP's regulated revenue.

### 3.3.2 If there is a financeability issue, the AER must adjust cashflows to prevent the TNSP from being worse off

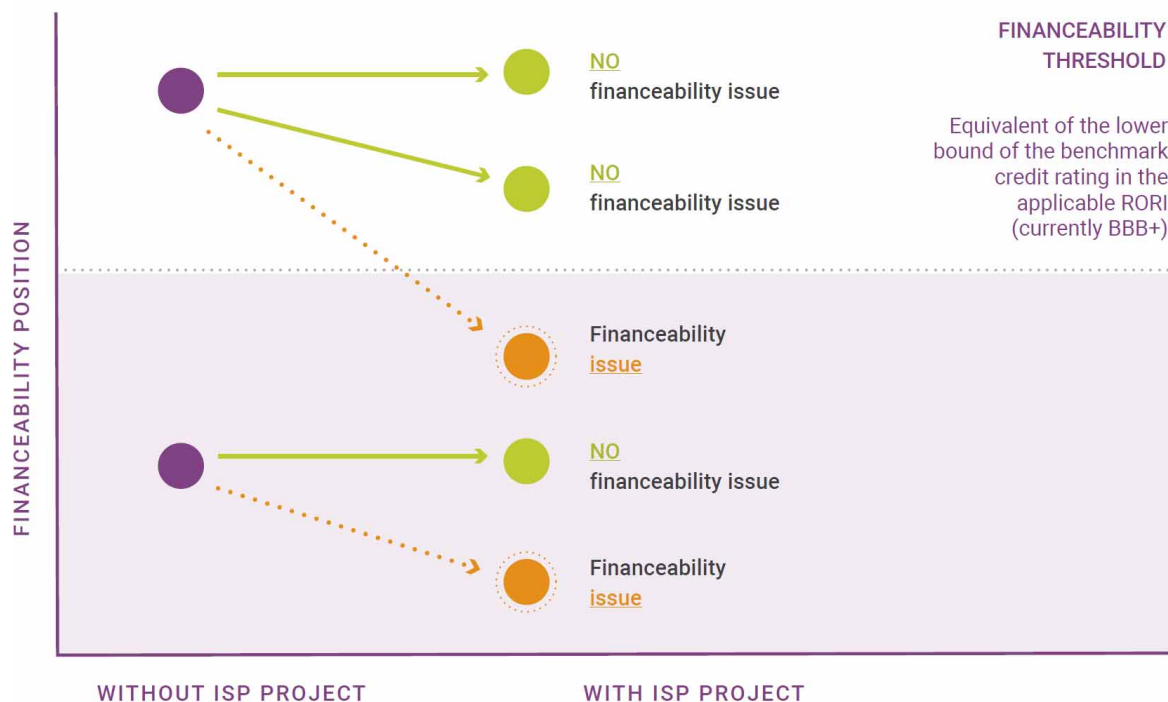
The draft rule would require that if the AER determines there is a financeability issue, as defined above, the AER must address the financeability issue by adjusting cashflows for the actionable ISP project. The AER must make adjustments to cashflows such that:

- If the initial financeability position of the TNSP is equivalent to or above the financeability threshold, the AER must prevent the TNSP's financeability position from deteriorating below the lower bound of the financeability threshold when the actionable ISP project is included.
- If the initial financeability position of the TNSP is below the financeability threshold, the AER must prevent the TNSP's financeability position from deteriorating at all when the actionable ISP project is included.

<sup>36</sup> In the draft rule, "financeability threshold" is defined as the benchmark credit rating used to estimate the return on debt component of the applicable rate of return instrument.

This approach would permit some deterioration above the financeability threshold (within the equivalent of the benchmark credit rating band or higher in the applicable RORI), but does not allow a TNSP's financeability position to worsen at all if its initial position is below the financeability threshold.

**Figure 3.1: How to determine whether a TNSP has a financeability issue after an actionable ISP project**



Source: AEMC

The draft rule also recognises that it may not always be mathematically possible for the AER to adjust cashflows in a way that prevents a TNSP's financeability position from worsening. This is most likely to occur in the first year of a project because as incurred depreciation is not actually recovered until the year after capital expenditure is incurred. To address this situation, the draft rule would require the AER to adjust cashflows "to the extent possible" to achieve the above outcomes.<sup>37</sup>

### 3.3.3 The draft rule provides the AER with another tool to help TNSPs manage cashflows for actionable ISP projects

The AER can already seek to address a TNSP's financeability issues by smoothing its revenue within a regulatory control period and allowing depreciation to be recovered as it is incurred.<sup>38</sup> However, these existing tools may not always be sufficient to prevent a financeability problem from occurring. For example:

- where the capital expenditure required for the actionable ISP project is high compared to the existing regulatory asset base or where existing assets are reaching the end of their economic lives, there may not be sufficient revenue available within the regulatory period to support financeability

<sup>37</sup> Draft rule, clause 6A.6.3A(n).

<sup>38</sup> In practice, "as-incurred" depreciation is not recovered until the year after capital expenditure is incurred.

- where the capital expenditure occurs towards the end of a regulatory period, there may be limited or no ability to smooth revenue.

The draft rule would add another tool to the AER's toolbox for managing TNSPs' cashflows. It would enable the AER to vary the depreciation profile of an actionable ISP project using a profile that it considers appropriate, and so advancing the recovery of depreciation to support financeability where the above measures alone are insufficient to maintain a TNSP's financeability position. The adjustment would be net present value (NPV) neutral, meaning TNSPs would not recover any additional revenue over the life of the ISP project assets.

The AER may use the combination of tools that it considers best supports financeability.

The AER may determine that depreciation adjustments should apply in both the regulatory period in which the request for a financeability test was made and the subsequent regulatory control period. If applying to the subsequent regulatory control period, that determination would be binding on the AER and the TNSP. This approach provides certainty for TNSPs and their investors.

### 3.3.4 The draft rule would not require the AER to ensure that a TNSP maintains the benchmark credit rating, as proposed by ENA

The Commission considered ENA's proposal to require the AER to bring forward cashflows to support a financeability position that is equivalent to the benchmark credit rating in the applicable RORI (currently BBB+) with the ISP project. However, we decided a "no worse off" approach was more preferable.

The Commission considers that ENA's proposed approach potentially merges a broader set of issues outside the scope of this rule change, such as whether cashflows should be set to support a specific credit rating. The purpose of this rule change is to ensure that the regulatory framework supports the delivery of ISP projects, not to amend the way cashflows are determined for transmission investments more generally. Our approach targets the issue at hand. That is, the potential for the combination of the timing of cash flows and recovery of depreciation to increase the estimated cost of delivering an ISP project above the forecast efficient cost. Our approach does not change the process for setting cashflows for transmission investment, other than for actionable ISP projects. No more revenue is recovered by TNSPs and no more cashflow is brought forward than necessary to address a financeability issue.

### 3.3.5 Some stakeholders supported consideration of a no worse off approach

The approach set out in the draft rule is similar to the "no worse off" approach raised (but not proposed) by ENA in its rule change request,<sup>39</sup> a variation of which was supported by the CEFC.<sup>40</sup> ENA noted that a key advantage of a no worse off approach is that it is consistent with the way TNSPs make investment and financing decisions in practice. That is, they consider the incremental impact of a project. However, they also noted that the test depends on the TNSP's current financeability position, based on benchmark gearing in the applicable RORI, and therefore different levels of cashflows could be brought forward for the same ISP project depending on the circumstances of the TNSP at the time of the test. Further, ENA was concerned that this could create uncertainty since the TNSP's future credit rating may be uncertain at the time that investors commit to a project.

In response, the AEMC notes that basing the assessment on the financeability position of a TNSP (based on the benchmark gearing ratio in the applicable RORI) at a point in time, does mean that

39 ENA, *Ensuring the Financeability of Actionable ISP projects, Proposal to change the National Electricity Rules*, 9 June 2023, pp. 8-9.

40 CEFC, submission, pp. 6-7.

outcomes will differ for the same project depending on the timing. However, we do not consider this to be problematic. The purpose of the rule change is to remove regulatory barriers to support financeability, which this approach achieves. In addition, while the magnitude of any uplift in cashflows could differ, the overall impact is NPV neutral and so will not result in any differences in the overall revenue received. Combined with a prescriptive financeability test, we consider that a TNSP's future financeability position will be relatively straight forward to forecast with a reasonable degree of accuracy, particularly since TNSPs will only be able to apply for a financeability test at the CPA 2 stage when estimated ISP costs are expected to be more accurate than at CPA 1 stage.

ENA was also concerned that only preventing a TNSP's financeability position from becoming worse off implies that their financeability position could materially diverge from the benchmark credit rating in the applicable RORI.<sup>41</sup> The Commission acknowledged that it is possible that a TNSP's financeability position could diverge from the benchmark credit rating. However, as discussed above, this is not inconsistent with the way the regulatory framework is currently applied, whereby there is no obligation on the AER to ensure that a TNSP's cashflows are sufficient to support a specific credit rating.

Finally, the ENA was concerned that the "no worse off" approach would not resolve a financeability issue where the TNSP's initial financeability position was equivalent to a sub-investment grade credit rating.<sup>42</sup> Our proposed rule is more targeted. It aims to ensure that a TNSP is no worse off from delivering an ISP project compared to not delivering an ISP project by applying a with and without test based on cash flow from the PTRM. This way, there is no need to form a view on the financeability position of the broader business.

### 3.3.6 The draft rule limits the AER's discretion in conducting a financeability test

As discussed above, the draft rule would require the AER to, on request of a TNSP, apply a financeability test to determine whether a TNSP has a financeability issue and, if so, by how much cashflows must be brought forward to address the issue. In addition, as discussed further in section 3.4, the AER must set out in Financeability Guidelines how it will determine a TNSP's financeability position. This would limit the AER's discretion in determining whether a TNSP has a financeability issue.

The draft rule differs from the Minister's rule change request,<sup>43</sup> which proposed a principles-based approach to the financeability test. Under the Minister's proposed rule, the AER would have discretion to consider a TNSP's ability to obtain finance, guided by three principles:<sup>44</sup>

- The relative consumer benefits (having regard to the reliability and price risk associated with transmission delivery delays) from the provision of network services over time (the inter-generational equity principle).
- The capacity of the TNSP to efficiently finance its overall RAB, including efficient capital expenditure (which focuses on the capacity to finance a project at the network business level, rather than the project level).
- Any other factors the AER considers relevant, having regard to the first two principles.

41 ENA, *Ensuring the Financeability of Actionable ISP projects, Proposal to change the National Electricity Rules*, 9 June 2023, pp. 9.

42 Ibid p. 9.

43 The principles in the Minister's rule change request were based on, but slightly different from, the principles proposed by the AEMC in the TPIR Stage 2 Final Report.

44 Minister's rule change request, p. 5.

Further, while the Minister's proposed rule permitted the AER to publish a Financeability Guidelines, it did not require the AER to indicate how it would conduct the assessment process. However, the Minister also noted the Commission should consider the use of principles vs a prescriptive test for assessing whether to vary the depreciation profile for an actionable ISP project.<sup>45</sup>

Most stakeholders, except for the ENA and TNSPs (excluding AusNet), supported a principles-based approach to financeability tests because it would:

- allow the AER to conduct financeability tests on a case by case basis<sup>46</sup>
- be adaptable to changing circumstances over time<sup>47</sup>
- provide more flexibility than set financial metrics with set weightings,<sup>48</sup> and
- allow the AER to take into account a range of qualitative and quantitative factors.<sup>49</sup>

In contrast, the ENA and TNSPs (except for AusNet)<sup>50</sup> supported a prescriptive test. ENA's rule change request proposed a formula be set out in the NER which would include the financial metrics that the AER must use and how the metrics must be weighted to determine a TNSP's overall financeability position and by how much cashflows must be brought forward.<sup>51</sup>

The Commission's views on the appropriate balance between a principles-based approach and a prescriptive approach have evolved since this issue was considered in the TPIR review. We consider a more prescriptive approach to the financeability test is appropriate to provide TNSPs and their investors with certainty and predictability and therefore confidence to invest in actionable ISP projects. We consider this approach is more likely to achieve the purpose of this rule change, to support a TNSP's ability to obtain finance, than a principles-based approach. Given that we decided to apply a more prescriptive approach, our draft rule does not include any principles for how the AER is to assess requests from TNSPs to address financeability issues.

The draft rule does not go so far as to include a financeability formula in the NER. We consider this would be unnecessarily restrictive and inflexible. The weightings of financial metrics and the selection of financial metrics themselves could reasonably be expected to change over time, noting that credit ratings agencies update their methodologies from time to time. As such, we consider the financial metrics and weightings should be specified in the AER's Financeability Guidelines, which are administratively simpler to amend than the rules.

Further detail on why we consider the approach to assessing financeability set out in the draft rule is more likely to promote achievement of the NEO than either of the proposed rule change requests is set out in chapter 2.

45 Minister's rule change request, pp. 6.

46 Submissions to the Consultation Paper: AER, p. 16; EUAA, p. 13; Iberdrola, pp. 2-3; Origin, p. 1; Public Interest Advocacy Centre (PIAC), p. 1.

47 Submissions to the Consultation Paper: AER, p. 12; Iberdrola, p. 3; EnergyAustralia, p. 10; Nexa, p. 3.

48 AER submission, p. 13.

49 Submissions to the Consultation Paper: AER, p. 16; CEFC, p. 3.

50 Submissions to the Consultation Paper: ElectraNet, p. 2; Powerlink, pp. 1-2; TasNetworks, pp. 2-3; and Transgrid, p. 1.

51 ENA rule change request, p. 17.



### 3.4 The AER would be required to develop Financeability Guidelines

#### **Box 4: DRAFT DETERMINATION - THE AER MUST DEVELOP GUIDELINES TO EXPLAIN HOW IT WOULD DETERMINE THE FINANCEABILITY POSITION**

Our draft rule would require the AER to develop and publish Financeability Guidelines that provide further detail on how the AER would assess a TNSP's financeability position. This includes the financial metrics and weightings for those metrics. The AER must also define how the financeability position relates to the financeability threshold.

While not a requirement of the rule, the AER may also include in its Financeability Guidelines its approach to depreciating different asset classes, including biodiversity offsets.

The Commission considers that these requirements appropriately balance the need for certainty with the flexibility to update the method for determining a TNSP's financeability position from time to time.

#### **3.4.1 The Financeability Guidelines must explain how the AER would determine the financeability position**

The draft rule would require the AER to develop Financeability Guidelines that explain how the AER would determine the financeability position of a TNSP, based on a set of financial metrics and weightings for these financial metrics.

The Financeability Guidelines would be required to set out the financial metrics that the AER would use to determine a TNSP's financeability position and the weightings that would apply to the financial metrics. The AER would also be required to explain the basis for its approach. The Commission expects that the AER would adopt a set of financial metrics and weightings that are similar to the approaches used by credit rating agencies. However, we note that there is no single accepted set of metrics and weightings used to determine credit ratings. As such, the AER would have some discretion in determining the financial metrics and weightings it would adopt.

The AER's methodology for determining a TNSP's financeability position would also differ from credit rating agencies in that it would not be able to adjust the financeability position based on qualitative factors. Rather, the AER must only apply its chosen selection of financial metrics. This means that the financeability test would be replicable and predictable, providing certainty for TNSPs and their investors. While this approach diverges from that used by credit rating agencies, we note that the AER would not need to replicate a credit rating for the TNSP. The AER's approach would differ from that applied by credit rating agencies in a number of ways, including that:

- the AER would determine the financeability position for a TNSP's regulated business given the framework only covers regulated TNSPs, while credit rating agencies determine the credit rating for a transmission business more broadly, which can include both regulated and unregulated business activities;
- the AER's financeability test is based on the benchmark gearing ratio in the applicable RORI, while credit rating agencies use a transmission business' actual gearing ratio.

The Financeability Guidelines would also be required to set out how the financeability position for a TNSP relates to the financeability threshold. That is, whether it is above or below the equivalent of the benchmark credit rating in the applicable RORI..<sup>52</sup> This is necessary to determine whether a

52 Draft rule clause 6A.6.3A(r)(3)

TNSP has a financeability issue and, if so, to determine how much cashflows must be brought forward.

Finally, the AER would be permitted to set out any other matters it considers appropriate in the Financeability Guidelines. This could include, for example, further details of the information that a TNSP must provide in submitting a request for a financeability test. It may also include an explanation of the AER's approach to depreciating different asset classes, as discussed in section 3.4.2 below.

The Financeability Guidelines would be required to be developed in accordance with the *Transmission Consultation Procedures*, meaning TNSPs and other stakeholders would be consulted on the development of the Guidelines. The AER would be required to publish the Financeability Guidelines by 31 December 2024, which is approximately nine months after the proposed commencement date of the final rule, if made. The AER would be able to update the Financeability Guidelines from time to time in accordance with the *Transmission Consultation Procedures*. For example, the AER may wish to update the Financeability Guidelines at the same time that it updates the RORI given the relationship between the two documents. The Commission considers it appropriate that the AER be able to update the Financeability Guidelines, noting that credit rating agencies update their methodologies from time to time.

#### 3.4.2 The Financeability Guidelines may also explain the AER's approach to depreciating different asset classes, including biodiversity offsets

The Commission's draft position is that no amendment to the rules is required to allow the AER to depreciate biodiversity offsets on an as incurred basis. The AER is already able to do this under the current NER. Further, the draft rule would not require the AER to clarify its treatment of depreciation for different asset classes, including biodiversity offsets. This is because asset classes and their associated lives currently vary between TNSPs, as they are based on historic categories that predate the NEM.

However, we consider it would be beneficial for the AER to clarify its approach to depreciating different asset classes, including biodiversity offsets, in the Financeability Guidelines. This could cover matters such as:

- the application of depreciation 'as incurred' to different types of biodiversity offsets; and
- depreciation of land purchased for biodiversity offset purposes.

Appendix D provides further detail on these issues.

### 3.5 TNSPs that have received concessional finance would have additional eligibility requirements to apply for a financeability test

#### **Box 5: DRAFT DETERMINATION - TNSPs THAT HAVE RECEIVED CONCESSIONAL FINANCE WOULD HAVE ADDITIONAL ELIGIBILITY REQUIREMENTS TO APPLY FOR A FINANCEABILITY TEST**

Under our draft rule, if a TNSP has received concessional finance in relation to the ISP project that is the subject of the request for a financeability test, and for any previous ISP project(s), where the concessional finance agreement(s) is/are entered into after 14 December 2023, the TNSP is eligible to submit a request to bring forward cashflows to address a financeability issue where:



- **all of the benefits of concessional finance flow through to consumers;** or
- **only some or none of the benefits of concessional finance flow through to consumers,** the GFB providing concessional finance for the relevant ISP project agrees that the TNSP can make such a request, and the concessional finance agreements for the relevant and earlier ISP projects set out how the AER should take into account that earlier concessional finance.

The Commission considers this approach would prevent TNSPs from benefiting from both concessional finance and a cashflow adjustment unless agreed to by the GFB and will allow the cashflow benefits from earlier concessional finance agreements to be captured in the test, minimising the impact on consumers.

If a TNSP has received concessional finance it would only be eligible to submit a request for a financeability test if:<sup>53</sup>

- all of the benefits from any concessional finance agreement entered into after 14 December 2023 are passed through to consumers, such that the TNSP has not received any concessional finance itself, or
- not all of the benefits from any concessional finance agreement entered into after 14 December 2023 are passed through to consumers, but:
  - the GFB providing concessional finance for the actionable ISP project to which the request relates agrees to the TNSP submitting a financeability request, and
  - the current and earlier concessional finance agreements each set out how the benefits of the concessional finance that are retained by the TNSP are to be taken into account by the AER in applying the financeability test.

If this information is not provided to the AER, the TNSP would not be eligible to submit the request. A key principle of this approach is to provide an incentive for an adjustment under the regulatory framework to occur where required to minimise the need to utilise concessional finance.

The purpose of this approach is to prevent a TNSP from benefiting from both concessional finance and a cashflow adjustment where the concessional finance is intended to achieve the same purpose as the cashflow adjustment. Whether a TNSP is benefiting twice depends on the purpose of the concessional finance and the extent to which it benefits the TNSP itself, or whether the benefits flow through to consumers.

Where a TNSP receives concessional finance and the full benefits of that concessional finance are passed through to consumers, the TNSP should be eligible to request a financeability test. In this case the purpose of the concessional finance is to benefit consumers, not to improve a TNSP's financeability. In this scenario we would not expect the AER to make any further adjustments to the PTRM in conducting the financeability test to reflect the impacts of the concessional finance, noting that adjustments may already have been made in accordance with the concessional finance rule change.

Where a TNSP receives concessional finance for the actionable ISP project to which the request for a financeability test relates and some or none of the benefits are passed through to consumers, we do not consider a TNSP should be prohibited from having its cashflows adjusted to address a financeability issue. This is because the concessional finance may have been

<sup>53</sup> Draft rule, clause 6A.6.3A(e).

provided for a specific purpose that was not intended to resolve any financeability issue. As such, the TNSP could still have a financeability issue despite having benefited from concessional finance.

However, we consider the GFB should have visibility over, and consent to, any request by the TNSP to have its cashflows adjusted in addition to receiving concessional finance. This approach will prevent TNSPs from benefiting from concessional finance and mechanisms under the NER to address financeability, unless agreed to by the GFB.

In addition, we consider that the GFB should agree with the TNSP as part of the concessional finance agreement how the concessional finance will be taken into account by the AER in applying a financeability test. This includes both the way in which the PTRM is adjusted to reflect the benefit of the concessional finance to the TNSP and the value of the adjustments. This step is required in order for a TNSP to be eligible to submit a request for a financeability test because we consider the TNSP and GFB are best placed to determine the appropriate approach to account for concessional finance for the following reasons:

- otherwise the quantum of the benefit that flows to the TNSP will not necessarily be clear from the concessional finance agreement, particularly where some of the benefits flow to consumers and/or the concessional finance was received by a related entity of the TNSP, and
- concessional finance agreements can involve complex financing arrangements meaning the value of the benefit, and how it is best taken into account, may be difficult for the AER to determine, whereas the GFB will likely have examined, and may intend to achieve, particular impacts on specific metrics.

As such, we consider it appropriate for the GFB, rather than the AER, to state the way in which the PTRM is to be adjusted to reflect the benefit of the concessional finance to the TNSP, and to do so within its agreement with the TNSP. Requiring the TNSP to ensure that this information is contained within the agreement, and requiring the TNSP to provide these details to the AER, is also consistent with the Concessional Finance rule change.<sup>54</sup>

The requirement for concessional finance agreements to set out how the benefits of the concessional finance are to be taken into account by the AER in applying the financeability test would apply to *all* concessional finance agreements for actionable ISP projects entered into after 14 December 2023, i.e. the draft rule publication date.

The Commission considered limiting the requirement for concessional finance agreements to set out how the AER must take into account the concessional finance to only the relevant actionable ISP project for which the depreciation adjustment is sought. However, we consider that where a TNSP's financeability position is expected to be better as a result of concessional finance received for an earlier actionable ISP project, this should be factored into the financeability test to reduce the cashflows that need to be brought forward and so reduce the impact on today's consumers. We are interested in stakeholder views on this draft decision.

<sup>54</sup> NER clause 6A.3.3(b) of the draft rule for the *Sharing concessional finance benefits with consumers* rule change, 14 December 2023.

### Question 1: Scope of concessional finance agreements that are to be taken into account in a financeability test

When applying the financeability test, should the AER be required to consider:

- all concessional finance agreements entered into after 14 December 2023 between the TNSP and any GFBs in relation to actionable ISP projects; or
- only a concessional finance agreement that is entered into after 14 December 2023 between the TNSP and a GFB in relation to the specific ISP project to which the request relates?

If a TNSP has received concessional finance and the concessional finance agreement includes details on how the AER should take into account concessional finance in applying a financeability test, it must provide the following information to the AER at the same time as submitting its request for a financeability test:<sup>55</sup>

- a copy of every concessional finance agreement relating to any actionable ISP project it, or a related entity of it, has entered into since 14 December 2023
- if applicable, the written approval of the GFB to which the financeability request relates
- if the concessional finance agreement was entered into by a related entity of the TNSP, the name, ACN and contact details of the related entity that is party to the agreement and an explanation of the benefit of the concessional finance to the TNSP;
- a description of the capital expenditure in relation to which the concessional finance is being provided; and
- a description of the benefits of the concessional finance that are retained by the TNSP and an explanation of how the benefits are to be taken into account by the AER in applying the financeability test, in accordance with the concessional finance agreement.

The draft rule would allow the AER to consult with the relevant GFB in respect of the financeability request. It also allows the AER to request information from the GFB and disclose any information received from the TNSP in the financeability request in consulting with the GFB.<sup>56</sup>

If the AER receives confidential information from a GFB in relation to a concessional finance agreement, the AER must treat that information as confidential information.

Several stakeholders raised concerns about the ability of TNSPs to access both concessional finance and a depreciation adjustment.

- The AER, CEFC and EUAA considered that any concessional finance should be considered as part of the financeability test.<sup>57</sup> We agree with this view and have taken it into account in developing the draft rule.
- The CEFC and Business NSW considered a transparency requirement should be imposed on a TNSP requesting a financeability assessment to assure consumers that the amount they are being asked to pay is necessary.<sup>58</sup> We have addressed this issue by requiring the AER to apply a prescriptive test to determine whether a TNSP has a financeability issue. Since the test is based on a TNSP's PTRM and the benchmark gearing ratio, it cannot be influenced by, and will not influence, a TNSP's actual financing decisions.

<sup>55</sup> Draft rule, clause 6A.6.3A(f).

<sup>56</sup> Draft rule, clause 6A.6.3A(g).

<sup>57</sup> AER submission p. 8 and CEFC submission p. 3.

<sup>58</sup> CEFC submission, p. 3; and Business NSW submission, p. 4.

#### **Box 6: How concessional finance arrangements are incorporated into the draft rules on Financeability and Concessional finance**

On 14 December 2023, the Commission published draft rule determinations for this rule change on *Accommodating financeability in the regulatory framework (ERC0348)* and a separate rule change on *Sharing concessional finance benefits with consumers (ERC0349)*. These rule changes cover different elements relating to the treatment of concessional finance, that has been provided by GFBs to Network Service Providers (NSPs), to support investment in network infrastructure.

This draft rule for Financeability (ERC0348) is concerned with taking into account any financial benefits of concessional finance that flow to a TNSP in a financeability test applied by the AER. This relates to scenarios where:

- all of the benefits of concessional finance flow to consumers, so that none of the benefits flow to the TNSP; and
- only some or none of the benefits of concessional finance flow to consumers, so that some or all of the benefits flow to the TNSP.

The draft rule for Concessional finance (ERC0349) is concerned with concessional finance provided to TNSPs and Distribution Network Service Providers (DNSPs) where benefits have been agreed to flow to consumers. It enables the AER to allow an agreed-upon quantum of benefits of concessional finance to flow to consumers via a RAB and/or MAR adjustment.

### **3.6 The draft rule includes transitional arrangements**

#### **Box 7: DRAFT DETERMINATION - TRANSITIONAL ARRANGEMENTS**

Transitional rules would require the AER to publish its Financeability Guidelines by 31 December 2024, approximately 9 months after the commencement of the final rule, if made. The proposed transitional arrangements would also allow TNSPs to request a depreciation adjustment from the commencement of the rule, and for the AER to apply the rule before the Financeability Guidelines are in place.

The Commission considers that early application of the final rule, if made, would support financeability of actionable ISP projects as soon as possible, noting that these projects are already being progressed.

The AER would be required to publish its Financeability Guidelines approximately 9 months after the commencement date of the final rule, if made.<sup>59</sup> However, the AER would be required to apply the rule once it commences, and before the Financeability Guidelines are in place.

Transitional rules would allow a TNSP to submit a request for a financeability test from the commencement date of the rule. Transitional provisions would allow for the AER's determination to approve or reject the request to be binding on both the AER and the TNSP.

While the AER would not have developed its Financeability Guidelines at this stage, and so the financial metrics and weightings would still need to be established, we consider that the final rule, if made, provides sufficient guidance to enable the AER to conduct a financeability test. The

<sup>59</sup> Draft rule, clause 11.[XXX].2.

transitional rules also require the AER to use its reasonable endeavours to give effect to the requirements set out in the draft rule, including using similar metrics and weightings to credit rating agencies in applying the financeability test and addressing a financeability issue.

The Commission considers that TNSPs should be able to submit a request for a financeability test as soon as possible, noting that actionable ISP projects are already being progressed. We consider the advantages of allowing TNSPs to apply sooner outweigh any disadvantages associated with uncertainty about the financeability metrics and weightings that the AER would use to determine the financeability position.

## A Rule making process

A standard rule change request includes the following stages:

- a proponent submits a rule change request
- the Commission initiates the rule change process by publishing a consultation paper and seeking stakeholder feedback
- stakeholders lodge submissions on the consultation paper and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a draft determination and draft rule (if relevant)
  - stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a final determination and final rule (if relevant).

You can find more information on the rule change process on our website.<sup>60</sup>

### A.1 The Minister and ENA proposed rules to address financeability issues for actionable ISP projects

The rule change request is the consolidation of rule change requests from the Minister and ENA that seek to address financeability issues for TNSPs relating to actionable ISP projects.

In the context of TPIR and this rule change process, the term ‘financeability’ refers to the ability of TNSPs to efficiently (that is, without unnecessary costs) raise finance to fund their activities in the context of the framework used to determine regulated revenue.

#### A.1.1 The Minister’s financeability rule change request

On 28 October 2022, Energy Ministers agreed that the Commonwealth Minister submit a rule change request to the AEMC seeking to mitigate the foreseeable risk that financeability challenges could arise in relation to actionable ISP projects.<sup>61</sup>

The Commonwealth Minister considered that there is a foreseeable risk that financeability challenges could arise in relation to actionable ISP projects.<sup>62</sup> To address this risk, the Minister’s rule change request proposed the following three solutions.

- **A proposal to introduce greater flexibility for the AER to vary depreciation profiles of ISP projects.** This reflects the AEMC’s recommendation on financeability in the TPIR Stage 2 Final report.<sup>63</sup>
- **A proposal to allow a TNSP to start recovering depreciation for biodiversity offset costs, as incurred, during construction of an ISP project.** This proposal was not considered by the AEMC in TPIR Stage 2.
- **A proposal that the AER must explicitly outline how depreciation is expected to be applied to different types of asset classes, including biodiversity offset.** This proposal was not considered by the AEMC in TPIR Stage 2.

<sup>60</sup> See our website for more information on the rule change process: <https://www.aemc.gov.au/our-work/changing-energy-rules>

<sup>61</sup> Commonwealth Minister for Climate change and Energy, *Treatment of financeability for Transmission Network Service Providers— Rule change request*, 11 April 2023, p. 1.

<sup>62</sup> Rule change request, pp. 1-2.

<sup>63</sup> AEMC, *Transmission Planning and Investment Review — Stage 2 Final report*, 27 October 2022.

### A.1.2 ENA's financeability rule change request

On 9 June 2023, ENA submitted a separate rule change request that sought to ensure the financeability of actionable ISP projects.<sup>64</sup>

On 30 June 2023, ENA submitted a letter to the Commission noting a correction to ENA's rule change request in relation to Figure 2 on p. 31.<sup>65</sup> The Commission considered the new version of Figure 2 as part of ENA's rule change request.

ENA's rule change request raised three solutions to address financeability issues, as explained below.

- **A prescriptive financeability test at ISP project level.** This was ENA's preferred solution. The proposal was to specify a financeability formula in the NER that the AER must use to assess whether a TNSP can finance a specific ISP project.<sup>66</sup>
- **A prescriptive financeability test at the TNSP RAB level.** This solution was not preferred by ENA, but was included as a counterfactual relative to ENA's preferred solution above. The proposal was to specify a financeability formula in the NER that the AER must use to assess whether a TNSP can finance its RAB and a specific ISP project.<sup>67</sup>

The ENA raised, but did not propose, a third option for the Commission's consideration: a "no worse off" prescriptive test at the TNSP RAB level. This option is a prescriptive test where the TNSP is made 'no worse off' after investing in the ISP project, based on the benchmark credit rating in the applicable RORI.<sup>68</sup>

## A.2 The proposals address inflexibility in the regulatory framework to support the financeability of ISP projects

The Minister's proposal considered that there is a foreseeable risk that TNSPs may face financeability challenges in relation to actionable ISP projects because:

- TNSPs may face challenges in raising capital to proceed with ISP projects
- the existing revenue framework is not sufficiently flexible to address financeability challenges that may arise in the future.

These issues reflect the conclusions from the TPIR Stage 2 Final report and are explained in section 2.1 of the Consultation paper for this rule change.<sup>69</sup>

ENA's proposal considered that:<sup>70</sup>

- the current arrangements do not support efficient financing of ISP projects as they do not ensure that regulated revenues provide TNSPs with a benchmark credit rating and benchmark rate of return, based on benchmark gearing in the applicable RORI.
- the Minister's proposed principles-based approach would not provide sufficient certainty for TNSPs and investors that the AER would assess the financeability of an ISP project, and if necessary adjust its depreciation profile.

64 ENA, *Ensuring the financeability of actionable ISP projects - Proposal to change the National Electricity Rules*, 9 June 2023

65 ENA, *Ensuring financeability of ISP projects rule change - Letter to the AEMC*, 30 June 2023

66 ENA, rule change proposal, p. 7.

67 ENA, rule change request, p. 7.

68 ENA, rule change request, pp. 8-9.

69 AEMC, *Accommodating financeability in the regulatory framework*, Consultation paper, 8 June 2023, pp. 4-6.

70 ENA, rule change request, p. 3.

### A.3 The proposals seek to support timely and efficient investment in actionable ISP projects

The proposals from the Minister and ENA seek to improve investor certainty. They support timely and efficient investment in actionable ISP projects by addressing challenges faced by TNSPs in raising finance.

- The Minister's proposal seeks to introduce greater flexibility in the revenue-setting framework in the NER to vary the depreciation profile of assets that form part of an actionable ISP project. The Minister expected that, if made, the proposal would be the primary mechanism that TNSPs use to address their financeability concerns. Up until recently, TNSPs have sought alternative methods to address their financeability concerns. These methods have included sourcing concessional finance from the Commonwealth Government, for example through the RTN program.
- ENA's proposal is to specify a financeability formula in the NER to ensure that regulated revenues for each ISP project<sup>71</sup> provide a benchmark credit rating and benchmark rate of return, based on benchmark gearing in the applicable RORI.

### A.4 The rule change process to date

On 8 June 2023, the Commission published a notice advising of the initiation of the rule-making process and consultation in respect of the rule change request.<sup>72</sup> A consultation paper identifying specific issues for consultation was also published. Submissions closed on 3 August 2023.

The Commission received 19 submissions as part of the first round of consultation. The Commission considered all issues raised by stakeholders in submissions. Issues raised in submissions are discussed and responded to throughout this draft rule determination. A summary of other issues raised in submissions and the Commission's response to each issue is contained in Appendix E.

#### A.4.1 Consolidation of rule change requests

On 6 July 2023, the Commission initiated the rule change request from the ENA and consolidated it with the Minister's rule change request under the name "*Accommodating financeability in the regulatory framework*" (ERC0348).

The Commission decided to consolidate the rule change requests from the Minister and ENA as it considered it necessary or desirable to deal with the requests together. Both rule changes relate to the financeability of actionable ISP projects.

#### A.4.2 Extending the time to publish the draft determination

The Commission twice extended the period of time for making a draft rule determination under section 107 of the National Electricity Law (NEL).<sup>73</sup> These extensions were due to the complexity of the rule change request, such that further time was required to finalise the draft rule determination.

Given the complexity of the issues covered by the rule change request, the current date to publish the final determination of 21 March 2023 may need to be extended.

<sup>71</sup> This is ENA's preferred solution, where the financeability test is for each ISP project.

<sup>72</sup> This notice was published under section 95 of the NEL.

<sup>73</sup> Section 107 statutory notices to extend the draft rule determination were published on 21 September 2023 and 9 November 2023.



## B Regulatory impact analysis

The Commission has undertaken regulatory impact analysis to make its draft determination.

### B.1 Our regulatory impact analysis methodology

#### **We considered a range of policy options**

The Commission compared a range of viable policy options that are within our statutory powers. The Commission analysed these options:

- the rule proposed in the Minister’s rule change request;
- the three solutions raised in ENA’s rule change request;
- a business-as-usual scenario where we do not make a rule; and
- a more preferable rule where the AER assesses a TNSP’s financeability, before and after an actionable ISP project, based on the TNSP’s financeability position.

These options are described in Appendix A.

#### **We identified who would be affected and assessed the benefits and costs of each policy option**

The Commission’s regulatory impact analysis for this rule change used qualitative methodologies. It involved identifying the stakeholders impacted and assessing the benefits and costs of policy options. The depth of analysis was commensurate with the potential impacts. The Commission focused on the types of impacts within the scope of the NEO.

Table B.1 summarises the regulatory impact analysis the Commission undertook for this rule change. Based on this regulatory impact analysis, the Commission evaluated the primary potential costs and benefits of policy options against the assessment criteria. The Commission’s determination considered the benefits of the options minus the costs.

Table B.1: Regulatory impact analysis methodology

Assessment criteria	Primary costs Low, medium or high –	Primary benefits Low, medium or high –	Stakeholders affected	Methodology  QT = quantitative, QL = qualitative
Improving outcomes for consumers	Increase transmission costs, with low impact on consumers' total electricity bills (Low costs).	Benefits in the short and long term by facilitating timely investment in transmission infrastructure. Delayed investment in transmission infrastructure would come at a cost to consumers. With transmission investment occurring earlier rather than later, cheaper renewable energy sources (wind and solar) can be unlocked for consumers, reducing emissions and prices. (Medium benefits)	All electricity consumers	QL: stakeholder feedback to assess all benefits and costs.
Principles of good regulatory practice	New requirements on the AER to develop Financeability guidelines and assess financeability requests from TNSPs (Low costs).	<b>Provide investor certainty about how the AER would conduct a financeability assessment by including clear direction in the NER on the financeability test, supported by prescription in AER guidelines about how the AER will assess financeability. (High</b>	<ul style="list-style-type: none"> <li>• TNSPs</li> <li>• Investors in the energy sector</li> <li>• AER</li> </ul>	QL: stakeholder feedback to assess all benefits and costs.

Assessment criteria	Primary costs Low, medium or high –	Primary benefits Low, medium or high – (benefits)	Stakeholders affected	Methodology QT = quantitative, QL = qualitative
Emissions reduction	Nil	Facilitate the shift to net zero by enabling timely investment in the actionable ISP projects that are required to support renewable generation and storage infrastructure. (Medium benefits)	<ul style="list-style-type: none"> <li>All Australians</li> </ul>	QL: stakeholder feedback to assess all benefits and costs.
Reliability and security	Nil	Facilitate timely investment in necessary transmission infrastructure by improving the ability of TNSPs to attract capital where required, enabling the reliable and secure provision of energy to consumers over the long term. (Medium benefits)	<ul style="list-style-type: none"> <li>AEMO</li> <li>TNSPs</li> <li>Generators</li> <li>Storage providers</li> <li>All electricity consumers</li> </ul>	QL: stakeholder feedback to assess all benefits and costs.
Principles of market efficiency	Nil	Support incentives for TNSPs to deliver actionable ISP projects by reducing the risk that a TNSP's ability to attract capital could deteriorate as a result of delivering an ISP project. (Medium benefits)	<ul style="list-style-type: none"> <li>TNSPs</li> <li>Investors in the energy sector</li> </ul>	QL: stakeholder feedback to assess all benefits and costs.

## C Legal requirements to make a rule

This appendix sets out the relevant legal requirements under the NEL for the Commission to make a draft rule determination.

### C.1 Draft rule determination and draft rule

In accordance with section 99 of the NEL, the Commission has made this draft rule determination for a more preferable draft rule in relation to the rule proposed by the proponents.

The Commission's reasons for making this draft rule determination are set out in chapter 2.

A copy of the more preferable draft rule is attached to and published with this draft determination. Its key features are described in chapter 3.

### C.2 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules.

The more preferable draft rule falls within section 34 of the NEL as it relates to the activities of persons (including Registered participants) participating in the national electricity market under section 34(1)(iii) of the NEL.

### C.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the draft rule<sup>74</sup>
- its powers to make a more preferable rule<sup>75</sup>
- the rule change request<sup>76</sup>
- submissions received during the first round consultation
- the Commission's analysis as to the ways in which the draft rule will or is likely to contribute to the achievement of the NEO
- the revenue and pricing principles<sup>77</sup>

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>78</sup>

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of AEMO's declared system functions.<sup>79</sup> The more preferable draft electricity rule is compatible with AEMO's declared system functions because it does not change AEMO's functions in any material respect.

<sup>74</sup> See Appendix C.2

<sup>75</sup> See Appendix C.2

<sup>76</sup> See Appendix A

<sup>77</sup> See section 2.1

<sup>78</sup> Under s. 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. In December 2013, it became known as the Council of Australian Government (COAG) Energy Council. In May 2020, the Energy National Cabinet Reform Committee and the Energy Ministers' Meeting were established to replace the former COAG Energy Council.

<sup>79</sup> Section 91(8) of the NEL.

## C.4 Making electricity rules in the Northern Territory

The more preferable draft rule does not relate to parts of the NER that apply in the Northern Territory. As such, the Commission has not considered Northern Territory application issues.

## C.5 Civil penalty provisions and conduct provisions

The Commission cannot create new civil penalty provisions or conduct provisions. However, it may recommend to the Energy Ministers' Meeting that new or existing provisions of the NER be classified as civil penalty provisions or conduct provisions.

The more preferable draft rule does not amend any clauses that are currently classified as civil penalty provisions or conduct provisions under the National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the Energy Ministers' Meeting that any of the proposed amendments made by the more preferable draft rule be classified as civil penalty provisions or conduct provisions.

## C.6 Review of operation of the rule

The more preferable draft rule does not require the Commission to conduct a formal review of the operation of the rule. The Commission may however self-initiate a review of the operation of the rule at any time if it considers such a review would be appropriate, pursuant to section 45 of the NEL.

## D Biodiversity related solutions proposed in the Minister's rule change request

The Commission considered biodiversity offset-related solutions proposed in the Minister's rule change request.

### D.1 Proposal to allow TNSPs to recover depreciation of biodiversity offset costs on an as incurred basis

The Commission does not consider any changes to the NER are required to allow for the recovery of depreciation on an as incurred basis for biodiversity offsets.

The Minister suggested that TNSPs' costs of meeting biodiversity conservation obligations for ISP projects are expected to:

- account for a material proportion of overall ISP project costs
- materially impact the financeability of ISP projects, in the absence of being depreciable.

For these reasons, the Minister suggested that:<sup>80</sup>

- TNSPs should be able to commence recovery of depreciation for biodiversity offset costs, on an as incurred basis, during construction of an ISP project; and
- the NER be amended so that the AER has discretion to begin depreciating biodiversity offset costs on an incurred basis.

Currently, biodiversity offset policy or legislation applies in each Australian jurisdiction, including the Commonwealth.<sup>81</sup> Between jurisdictions there is variation in the type of biodiversity impact considered, and the options available for TNSPs to meet their biodiversity offset obligations.

TNSPs have options to efficiently meet their biodiversity offset obligations and this varies depending on the relevant jurisdictional legislation. The biodiversity offset obligation can be met by purchasing land to establish a protected habitat or ecological community, purchasing equivalent offset credits from a third party, funding a biodiversity conservation action that benefits the impacted ecological community or paying into a biodiversity offset fund or scheme. For instance, South Australia's *Native Vegetation Act 1991* and its associated regulations establish a framework for preserving and enhancing native vegetation, while the *Biodiversity Conservation Act 2016* which establishes New South Wales' Biodiversity Offset Scheme considers both flora and fauna.

There is uncertainty around biodiversity offset costs, which can vary greatly between ISP projects. Some estimates of biodiversity offset costs for ISP projects are:

- **Humelink:** Transgrid's estimated environmental offset costs<sup>82</sup> of \$935m or around 28 per cent of the total estimated cost of \$3,317m for Humelink.<sup>83</sup>

<sup>80</sup> Minister's rule change request, p.5.

<sup>81</sup> The name for such offsets differs between jurisdictions. For example, in NSW they are referred to as biodiversity offset while in SA they are referred to as environmental offsets.

<sup>82</sup> In NSW, environmental offset costs relate to biodiversity offset costs

<sup>83</sup> Based on Option 3C. Transgrid's assessment in the Project Assessment Conclusions Report (PACR) was that Option 3C provides the greatest net benefits across all scenarios. These costs are estimated and are subject to change in the Humelink CPA stage 2 for construction, the process for which has not commenced. Transgrid, *Reinforcing the NSW Southern Shared Network to increase transfer capacity to demand centres (Hemelink)*, Project Assessment Conclusions Report, 29 July 2021, pp. 5 and 29.

- **Project EnergyConnect:**

- Transgrid: the AER approved environmental offset costs<sup>84</sup> of \$125m or around 7 per cent of the AER's total forecast expenditure of \$1,818m for Project EnergyConnect.<sup>85</sup>
- ElectraNet: the AER approved environmental offset costs<sup>86</sup> of \$3m or around 1 per cent of the AER's total forecast expenditure of \$457m for Project EnergyConnect.<sup>87</sup>

Some stakeholders support the recovery of depreciation of biodiversity offsets on an as incurred basis as the costs may be material and biodiversity offsets are required to be in place prior to construction of an ISP project.<sup>88</sup> In addition, stakeholders noted that applying as incurred depreciation to other asset classes (in addition to biodiversity offsets) would assist in addressing financeability issues relate to actionable ISP project.<sup>89</sup> Section 3.4 discusses how the AER may use as incurred depreciation, amongst other tools, to address financeability issues.

Business NSW and EUAA did not agree with the proposal to allow for the recovery of depreciation for biodiversity offset costs on an as incurred basis. They questioned why biodiversity offset costs should be treated differently from other assets that form part of ISP projects and noted that associated project completion risk should not be borne by consumers.<sup>90</sup>

The Commission considers that the NER already allows the AER to depreciate transmission assets on an as incurred basis, including for ISP projects. Therefore, there is no need to amend the NER specifically to allow depreciation of biodiversity assets on an as incurred basis. The reasons for this are explained below.

- The NER outlines the depreciation framework the AER must apply to distribution and transmission assets<sup>91</sup> and does not specifically provide for or prevent depreciation to be recovered from assets on an as incurred basis. In practice, the AER may consider regulatory accounting methods to assist it in determining whether using as incurred depreciation would be appropriate for the particular circumstances.
- Under the framework for distribution networks in Chapter 6 of the NER, the AER currently allows for as incurred depreciation of distribution assets to reflect the nature of these assets and the shorter time between the DNSP spending the money and commissioning the asset. There is no substantive difference between the existing depreciation provisions for distribution networks in Chapter 6 and for transmission networks in Chapter 6A.<sup>92</sup> Therefore, we consider that under existing clause 6A.6.3, the AER could choose to take the same approach of allowing for "as incurred" depreciation of transmission assets.
- It maintains consistency with the way the AER currently applies the regulatory framework for depreciation and minimises potential stakeholder confusion on the application of the depreciation framework by having different approaches for specific asset classes such as biodiversity assets. This supports timely investment in and delivery of actionable ISP projects.

84 In NSW, environmental offset costs relate to biodiversity offset costs.

85 AER, Final decision - Transgrid Contingent Project - Project EnergyConnect, May 2021, p. 1; 16.

86 In South Australia, environmental offset costs relate to biodiversity offset costs.

87 AER, Final decision - ElectraNet Contingent Project - Project EnergyConnect, May 2021, pp. 1; 12.

88 Submissions to the Financeability consultation paper: Energy Networks Australia, pp.5-6; CEFC, p.8; AER, pp.17-18.

89 Submission to the Financeability consultation paper: AER, pp. 9, and 17-18.

90 Submissions to the Financeability consultation paper: Business NSW, p. 3; Energy Users Association of Australia, pp. 14-15.

91 Chapters 6 and 6A include depreciation provisions for distribution and transmission assets respectively.

92 Although we note that, for transmission, an asset that is dedicated to one or a small group of users and which exceeds the monetary threshold must be depreciated on a straight line basis.



## D.2 Proposal to clarify the treatment of depreciation for asset classes, including biodiversity offsets

The Commission considers there would be benefit in the AER clarifying its approach to depreciation in a guideline (e.g. its Financeability Guideline that would be required under the draft rule). The AER may provide further clarification on matters such as:

- the application of depreciation ‘as incurred’ to different types of biodiversity offsets; and
- depreciation of land purchased for biodiversity offset purposes.

The Minister’s rule change request proposed that the AER develop guidelines to explicitly outline how and when depreciation is expected to be applied to different asset classes, including biodiversity offsets, in circumstances where financeability challenges are, and are not, present. The Minister considered that amendments to the NER to this effect were intended to promote transparency and provide greater certainty of revenues to TNSPs as well as costs to consumers.<sup>93</sup>

The current arrangements are:

- TNSPs’ assets must be depreciated based on depreciation schedules that use a profile that reflects the nature of the assets or category of assets over the economic life of that asset or category of assets.<sup>94</sup>
- In practice, TNSPs nominate the asset classes and their corresponding lives in their PTRM for the AER to assess and make a decision on depreciation. This approach also extends to TNSPs proposing new asset classes.<sup>95</sup>

Stakeholders had mixed views on the need for additional guidance from the AER on the depreciation of all asset classes. EnergyAustralia questioned the need for additional guidance for specific assets,<sup>96</sup> while EUAA noted the importance of AER exercising its discretion free of external influence.<sup>97</sup> Other stakeholders, however, considered it appropriate for additional guidance in the case of a new asset class<sup>98</sup> or where different depreciation approaches are applied to different asset classes.<sup>99</sup>

Stakeholders also had mixed views on the depreciation of land purchased for biodiversity offset purposes. ENA supported depreciating land purchased for biodiversity offset purposes as it has no alternative use and no future market value.<sup>100</sup> Other stakeholders considered that land should not be depreciated in line with standard accounting practice and it has unlimited useful use.<sup>101</sup>

We do not consider this additional clarification should apply to all asset classes. Asset classes and their associated lives vary currently between TNSPs as they are based on historic categories that predate the NEM.

However, we consider there would be benefit in the AER clarifying its approach to the depreciation of biodiversity offset costs and suggest that the AER may provide this additional clarity in its Financeability Guideline (see section 3.4). This is because biodiversity offsets are a new asset

<sup>93</sup> Minister’s rule change request, p. 4.

<sup>94</sup> NER clause 6A.6.3.

<sup>95</sup> Examples of TNSPs proposing new asset classes include Transgrid, Project Energy Connect Contingent Project Application – PTRM, September 2020; ElectraNet, Project Energy Connect Contingent Project Application – PTRM, September 2020; AER, Final Decision – Transgrid Project Energy Connect Contingent Project Application, May 2021.

<sup>96</sup> Submission to the Financeability consultation paper: EnergyAustralia, p. 4.

<sup>97</sup> Submission to the Financeability consultation paper: EUAA, p. 15.

<sup>98</sup> Submissions to the Financeability consultation paper: Energy Networks Australia, pp. 9-10.

<sup>99</sup> Submission to the Financeability consultation paper: Origin, p. 6.

<sup>100</sup> Submission to the Financeability consultation paper: ENA, p. 10.

<sup>101</sup> Submission to the Financeability consultation paper: AEC, p. 2; Origin, pp. 1 and 4.

class and TNSPs have different options for meeting their biodiversity offset obligations depending on the jurisdiction.

We consider such clarification would provide more transparency and predictability for TNSPs on the AER's treatment of biodiversity offset costs (including the treatment of land purchased for biodiversity offset purposes) supporting the timely investment in ISP projects.

We suggest that the AER may develop guidelines to clarify its treatment of depreciation for different asset classes, but it is not necessary to require this in the NER. This differs from the Minister's rule change request that proposes to amend the NER, so that the AER must set out how it would depreciate different asset classes in guidelines.

## E Summary of other issues raised by stakeholders and the Commission

Table E.1: Summary of other issues raised in submissions

Stakeholder	Issue	Response
<p>AEC, p. 1</p> <p>Business NSW, p. 2</p> <p>EnergyAustralia, p. 1</p> <p>EUAA, p. 2.</p> <p>Nexa Advisory, p. 2.</p> <p>PIAC, pp. 1-2</p>	<p><b>Demonstrating that there is a financeability problem</b></p> <p>AEC, EnergyAustralia and PIAC consider that it has not been clearly demonstrated that a financeability problem exists.</p> <p>Business NSW recommended that further work be done to establish the scale of any financeability problem.</p> <p>EUAA agreed with the Commission's 2021 final determinations on the Participant derogation rule changes from Transgrid and ElectraNet that the regulatory framework did not create a barrier to financing Transgrid and ElectraNet's share of current ISP projects. EUAA does not believe there has been a material change in circumstances to justify the AEMC coming to a different conclusion on financeability in this rule change.</p>	<p>The Commission established in TPIR and continues to hold the view that TNSPs may face financeability issues in future. We consider it is appropriate to have a framework in place now, before any financeability issues begin to impact and potentially cause delays to investment in ISP projects. Further, the AER will establish whether there is a financeability issue as part of its financeability test.</p>
<p>EUAA, p. 1</p>	<p><b>Increasing electricity costs and uncertain benefits</b></p> <p>EUAA is concerned with the assumed net benefits of ISP projects in AEMO's 2022 ISP modelling because EUAA considers that:</p> <ul style="list-style-type: none"> <li>•</li> </ul>	<p>AEMO's modelling of net benefits for the ISP is a matter for AEMO and is outside the scope of this rule change.</p> <p>See section 2.3.1 for how the Commission considers that our draft rule would improve outcomes for consumers in the short and long-</p>

Stakeholder	Issue	Response
	<ul style="list-style-type: none"> <li>new transmission may not be delivered at the estimated cost; and</li> <li>future renewable energy costs may not be significantly lower than today as forecast.</li> </ul> <p>EUAA suggested that the Minister's proposed rule:</p> <ul style="list-style-type: none"> <li>would result in a significant increase in transmission costs in the short to medium-term, and increase in total energy bills, at a time when energy bills have been escalating; and</li> <li>would have benefits that are highly variable in quantum and timing.</li> </ul>	term.
<p>EUAA, p. 2</p> <p>PIAC, p. 5</p>	<p><b>Inter-generational equity issues</b></p> <p>EUAA suggested that the Minister's proposal creates significant inter-generational equity issues. That is, near-term consumers pay higher energy bills, while transmission projects may not deliver net benefits to consumers for 10-15 years.</p> <p>PIAC considers altering the depreciation path to bring forward revenue creates inter-generational equity issues, which is particularly problematic in the context of an energy transition and for disadvantaged or more vulnerable consumers.</p>	<p>See section 2.3.1 on how the draft rule would improve outcomes for consumers, in the short and long-term.</p> <p>See section 3.3.6 on how the draft rule limits the AER's discretion in conducting a financeability test. Given that we decided to apply a more prescriptive approach than proposed by the Minister, our draft rule does not include any principles for how the AER is to assess requests from TNSPs to address financeability issues (including an inter-generational equity principle).</p>
<p>Business NSW, p. 3</p>	<p><b>Impact on incentives to pursue efficient financing</b></p> <p>Business NSW was concerned that TNSPs may pursue favourable outcomes from the AER rather than focusing efforts on obtaining cost-effective</p>	<p>Under the draft rule, the AER would be required to use the benchmark gearing ratio from the applicable RORI to assess financeability, rather than using the TNSP's actual financial position</p>

Stakeholder	Issue	Response
	financing.	(e.g. capital structure). We consider this approach avoids incentive issues where a TNSP may seek to amend its actual financial position in a way that would downgrade its financial metrics, so that it fails the financeability test, and cashflows are brought forward unnecessarily.  For more information, see section 3.3.1.
AEMC, Consultation paper, pp. 22-24 AER, p.18 ENA, p.10	<b>Application of rule for Intending TNSPs</b>  In the consultation paper we asked stakeholders whether, if TNSPs are able to recover depreciation of biodiversity offsets on an as incurred basis, this ability should be extended to Intending TNSPs (ITNSPs)?  The AER noted that it was not clear how this would impact ITNSP's cashflows as it is unclear how revenues could be recovered from consumers before an ITNSP is providing prescribed transmission services.	The Commission did not make a rule relating to ITNSPs. ITNSPs are not able to receive cashflows during the period of time when they are an ITNSP and are not yet providing prescribed transmission services. Therefore, it is not possible for ITNSPs to receive cashflows in the form of as incurred recovery of depreciation for any assets, including biodiversity offsets.
ENA, p 5.	<b>Terminology around biodiversity offsets</b>  ENA supported the Minister's proposal to allow the recovery of depreciation for biodiversity offsets costs on an as incurred basis, however to broaden the terminology to 'biodiversity and environmental offset or remediation costs'.	As explained in Appendix D, the Commission does not consider any changes to the NER are required to allow the recovery of depreciation on an as incurred basis for biodiversity offsets. Given this decision, our draft rule does not define any term in the NER such as 'biodiversity offsets', 'biodiversity and environmental offsets' or similar.  As noted in section 3.4, the AER may include in its Financeability Guidelines its approach to

Stakeholder	Issue	Response
		depreciating different asset classes, including biodiversity offsets. In doing so, the AER may consider the terminology around 'biodiversity offsets' or similar.
<p>AEMC, Consultation paper, p. 13.</p> <p>AusNet, p. 2.</p> <p>AEMO, p. 3.</p>	<p><b>Application of rule in Victoria</b></p> <p>In the consultation paper we noted that the Minister's rule change request did not comment on whether there may be a need for different arrangements to apply in Victoria.</p> <p>In response, AusNet noted that, under Victoria's contestable regime, financing forms a key pillar of competition for large transmission investments.</p> <p>AEMO noted that most transmission projects in Victoria are contestable and therefore not bound by the application of a regulated rate of return.</p>	<p>The draft rule will not have practical effect in Victoria.</p> <p>As the proposed rule is intended to apply to TNSPs who submit a CPA for an actionable ISP project under clause 6A.8.2, it would not have practical operation in Victoria.</p> <p>AEMO, in its role as Victorian planner, is the Regulatory Investment Test for Transmission (RIT-T) proponent for actionable ISP projects in Victoria. However, it does not have a revenue determination to amend, so it would not be eligible to submit a CPA. AEMO also does not own the assets. Further, AusNet as the incumbent TNSP is not a RIT-T proponent for actionable ISP projects in Victoria due to AEMO's Victorian planning role and therefore AusNet would not be eligible to submit a CPA for an actionable ISP project.</p>
<p>EUAA, p.1.</p>	<p><b>Transfer of risk to consumers</b></p> <p>The Minister's proposed rule transfers risk that equity providers should be taking, which is inconsistent with the NEO. Equity providers are best placed to manage this risk.</p>	<p>In the absence of the draft rule, there is a risk that investment in actionable ISP projects could lead to a material deterioration of a TNSP's financial metrics. This could reduce the ability of TNSPs to efficiently (that is, without unnecessary costs) raise finance in the context of the framework used</p>

Stakeholder	Issue	Response
		<p>to determine regulated revenue. The draft rule would mitigate this risk by supporting the financeability of TNSPs that are investing in ISP projects.</p> <p>See section 2.3.5 for further discussion on how the draft rule would support efficient market arrangements.</p>
City of Sydney, p. 2	<p><b>Energy efficiency first</b></p> <p>City of Sydney proposed an ‘energy efficiency first’ principle be introduced, in addition to the emissions reduction objective.</p>	<p>Amending the NEO is outside the scope of the AEMC’s remit and would instead require agreement by energy Ministers and the passage of legislation.</p>
Business NSW, p. 4	<p><b>Impose transparency on TNSPs around financeability assessment</b></p> <p>Business NSW recommended requiring TNSPs to fully open up financing decisions to scrutiny to ensure the amount being asked for is necessary.</p> <p>AEC suggests that a prudent regulator assessing the financeability of a TNSP should require proof that the TNSP cannot obtain finance. This would include (but not be limited to) requiring evidence that the TNSP cannot efficiently raise finance and that their capital structure is sufficiently constrained that investments are unfinanceable.</p>	<p>The AER will establish whether there is a financeability issue as part of its financeability test. The amount of cashflow that will be brought forward will be determined using a transparent approach and is designed to only bring forward sufficient cashflows to support financeability.</p> <p>Under the draft rule, the AER would be required to use the benchmark gearing ratio from the applicable RORI to assess financeability, rather than using the TNSP’s actual financial position (e.g. capital structure). We consider this approach avoids incentive issues where a TNSP may seek to amend its actual financial position in a way that would downgrade its financial metrics, so that it fails the financeability test, and cashflows are brought forward unnecessarily. For more information, see section 3.3.1</p>



Stakeholder	Issue	Response
CEFC, p. 8	<b>Timely delivery of projects</b>  CEFC notes that TNSPs have no obligation to deliver ISP projects, even with financeability support. As such, the CEFC considers additional rules may be required to enable the timely delivery of these projects.	Rules to support delivery of ISP projects, other than supporting TNSP financeability through advancing cashflows, are outside the scope of this rule change.
AER, p. 9	<b>Ability to recover depreciation on an as incurred basis</b>  The AER note the NER are silent on whether the recovery of depreciation on an as incurred basis is permitted, and that this could be clarified in the Rules.	The Commission considers that the NER already allows the AER to depreciate transmission assets on an as incurred basis, including for ISP projects. Therefore, there is no need to amend the NER specifically to allow depreciation on an as incurred basis.  This is discussed in Appendix D in relation to biodiversity assets, but applies more broadly.
AEC, p. 7.	<b>Gearing level in ENA's proposed rule</b>  The AEC are concerned that ENA's proposal is substantively arguing that a TNSP could choose to gear its business at over 80 per cent debt to RAB, so that the TNSP could force the AER to amend its cashflows so that it maintains a credit rating of BBB+. The AEC asked whether consumers should have to pay for TNSP's capital structure decisions.	ENA's rule change request proposed that the AER assess financeability based on benchmark gearing in the applicable RORI, as opposed to assessing financeability based on TNSP's actual gearing.  We agree with the AEC that a financeability assessment based on TNSP's actual financial position may create incentive issues, as explained in section 3.3.1. Therefore, our draft rule requires the AER to assess financeability based on benchmark gearing in the applicable RORI.
Origin, p. 1.	<b>Project completion risk</b>  Origin questioned whether it is appropriate to	The Commission does not consider that further clarity is required on how completion risk will be

Stakeholder	Issue	Response
	depreciate biodiversity offsets on an as incurred basis, given that project completion risk is effectively transferred to consumers. Origin seeks clarification from the AEMC on how completion risk will be addressed in the regulatory framework.	addressed in the regulatory framework.  The Commission considers that the NER already allows the AER to depreciate transmission assets on an as incurred basis. In practice, the AER may consider whether using as incurred depreciation would be appropriate for the particular circumstances.  For more information, see Appendix D.
City of Sydney, p. 2	<b>Optimal supply mix</b>  City of Sydney recommended that the energy market support an optimal mix of demand and supply side measures, including energy efficiency, demand management, distributed energy resources and electrification.	These specific issues are outside the scope of this rule change request. However, there are several other processes underway both within the AEMC and at State and Federal Government levels to consider these issues.

## Abbreviations and defined terms

AEC	Australian Energy Council
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CEFC	Clean Energy Finance Corporation
COAG	Council of Australian Governments
Commission	See AEMC
DNSP	Distribution network service providers
ENA	Energy Networks Australia
EUAA	Energy Users Association of Australia
FFO	Funds from operations
GFB	Government funding body
ITNSPs	Intending TNSPs
ISP	Integrated System Plan
MAR	Maximum allowed revenue
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NPV	Net present value
NSP	Network service provider
NT	Northern Territory
ODP	Optimal development path
PACR	Project assessment conclusions report
PIAC	Public Interest Advocacy Centre
Proponent	The proponent of this rule change (Minister or ENA)
PTRM	Post tax revenue model
RAB	Regulatory asset base
RORI	Rate of Return Instrument
RIT-T	Regulatory Investment Test for Transmission
RTN	Rewiring the nation
TNSP	Transmission Network service provider
TPIR	Transmission Planning and Investment Review