

Rule determination

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

Proponents

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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

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Summary

- 1 The Australian Energy Market Commission (the AEMC or Commission) has decided to make a more preferable final rule (final rule) to address challenges that Transmission Network Service Providers (TNSPs) may have in efficiently 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 interests 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 The final rule will commence on **29 March 2024**.

Our final rule supports 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 final rule addresses financeability challenges by preventing a TNSP's financeability position from worsening as a result of the ISP project where a TNSP's financeability position is at or below the financeability threshold. The financeability position is determined using the benchmark gearing ratio in the applicable rate of return instrument (RORI), or as adjusted in accordance with any concessional finance agreements. The final rule requires the Australian Energy Regulator

(AER) to bring forward a TNSP's cash flows related to an actionable ISP project through a combination of one or more of as incurred depreciation, varying the depreciation profile of assets, and revenue smoothing within a regulatory control period. This improves 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 final 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 final rule strikes an appropriate balance between these two objectives.

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

- 10 The Commission considers its final rule will better contribute to the achievement of the National Electricity Objective (NEO)¹ than the proposed rules by:
- **Improving outcomes for consumers** – the final rule delivers 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 final rule provides TNSPs and their investors with certainty about how the AER will 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.
 - **Supporting emissions reduction** – the final rule facilitates 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 final rule facilitates 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.
 - **Supporting efficient market arrangements** – the final rule supports 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.

¹ Section 7 of the National Electricity Law (NEL).

How the final rule works

TNSPs can request a financeability test

- 11 The final rule allows a TNSP to submit a financeability request to the AER either:
 - as part of a Contingent Project Application (CPA) stage 2 for construction;²³ or
 - at the same time as it submits its initial revenue proposal or revised revenue proposal as part of the revenue determination process.⁴
- 12 A TNSP cannot request a financeability test as part of a CPA stage 1 - early works.⁵
- 13 A TNSP may only submit one request for a financeability test for each:
 - actionable ISP project; or
 - construction stage of an actionable ISP project.
- 14 In its financeability request, the TNSP can propose adjustments to depreciation or revenue smoothing to address a financeability issue, which can be considered by the AER.
- 15 The AER must apply the financeability test, in accordance with the final rule and financeability guidelines. The AER must bring forward cash flows 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.
 - The AER may, using a new method under the final rule, advance a TNSP's cash flows by depreciating the assets of an ISP project by using a profile that it considers appropriate after the asset has been commissioned (e.g. a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or shorter asset lives).
 - The AER may depreciate actionable ISP project assets using a profile that the AER considers appropriate, prior to the asset being commissioned. The final rule clarifies that the AER may allow as incurred recovery of depreciation (which may apply for all assets that form part of the actionable ISP project in addressing a financeability issue).
 - The AER may smooth revenue within a regulatory control period, if there are sufficient remaining years in the regulatory control period, which is an existing mechanism available under the current arrangements.
- 16 A determination to bring forward cash flows 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 is binding.

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

- 17 If requested by a TNSP, the AER must 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

² Final rule, clause 6A.6.3A(b)(1)

³ .

⁴ Final rule, clause 6A.12.3(a)(2).

⁵ Final rule, clause 6A.6.3A(d)(1).

- below the financeability threshold and its financeability position deteriorates at all with the ISP project.
- 18 The TNSP's financeability position is calculated using the Maximum Allowable Revenue (MAR) derived from the prevailing Post Tax Revenue Model (PTRM). That is, the assessment is based on a TNSP's regulated business only and will use the benchmark gearing ratio set out in the applicable RORI, or the benchmark gearing ratio as adjusted for the increased equity component in that ratio in accordance with any relevant concessional finance agreement. The financeability threshold is equivalent to the benchmark credit rating in the applicable RORI. The AER is not required to assess a TNSP's actual credit rating that is determined by credit rating agencies.
- 19 The AER must apply the Financeability Guidelines when applying the financeability test, and must have regard to the information provided in the financeability request and any relevant concessional finance agreement.

The AER must adjust a TNSP's cash flows if a TNSP has a financeability issue

- 20 If the AER determines the TNSP has a financeability issue, the AER must adjust the TNSP's cash flows 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 final rule introduces the ability for the AER to advance a TNSP's cash flows by depreciating the assets of an ISP project by using a profile that it considers appropriate (e.g. a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or shorter asset lives). The AER could also advance cash flows through as incurred depreciation or smoothing revenue within the current regulatory control period.
- 21 The AER is required to adjust cash flows such that, to the extent possible:
- 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 must make Financeability Guidelines

- 22 The AER must set out further details of how it will 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 is required to explain the basis for its selection of financial metrics and weightings for financial metrics.
- 23 The Guidelines must set out how the financeability position relates to the financeability threshold (the equivalent of the benchmark credit rating in the applicable RORI), and may also include other matters the AER considers appropriate, such as how the AER would treat depreciation for biodiversity offsets.

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

- 24 TNSPs that have received concessional finance from a Government funding body (GFB) after 14 December 2023 are treated differently under the final rule depending on how the benefits of the concessional finance have been treated, as outlined below.
- If all the benefits of the concessional finance have been passed through to consumers in the actionable ISP project that is the subject of the financeability test or a previous actionable ISP

project, 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 cash flow 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 submit a financeability request only if:
 - the government funding body providing concessional finance for the actionable ISP project to which the request relates agrees to the TNSP making a financeability request for that actionable ISP project, and
 - the concessional finance agreements for any other 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.

The government funding body and the TNSP may agree that the AER should account for the benefits of concessional finance by increasing the equity component of the benchmark gearing ratio for the purposes of applying a financeability test.

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

The final rule is a more preferable rule

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

- A TNSP cannot request a financeability assessment as part of an early works CPA (i.e. a CPA stage 1).
- A TNSP can make a financeability request as part of a revenue determination process.
- 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 are not required since the final rule provides a more prescriptive approach to assessing financeability.
- The AER must 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 final rule provides greater certainty to TNSPs and their investors than a purely principles-based approach.
- The final rule does not include a requirement for the AER to consider inter-generational equity since the final rule applies a prescriptive test rather than a principles-based approach to guide discretion. However, the Commission considers that the final rule will 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 will 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 final rule requires the AER to make Financeability Guidelines and sets out the minimum requirements for the Guidelines, 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 will 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 final 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 can apply for a financeability assessment from 29 March 2024

- 26 The final rule commences on 29 March 2024. The AER will be required to finalise its Guidelines within approximately 9 months (by 31 December 2024).
- 27 TNSPs can submit a financeability request from the commencement date of the rule. However, the Guidelines may 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. The AER must use reasonable endeavours to give effect to the requirements of the final rule if it receives a financeability request before the Financeability Guidelines are finalised.

Key differences between draft rule and final rule

- 28 Our final rule includes a number of amendments to the draft rule, as outlined below.
- Clarifies that a TNSP may propose any method available (adjustments to depreciation or revenue smoothing) to the AER to address a financeability issue
 - Clarifies that a TNSP can only submit a financeability request once for each actionable ISP project or stage of an actionable ISP project
 - Clarifies that a TNSP may submit a financeability request as part of a CPA 2, or as part of a revenue determination process.
 - Clarifies that the AER must apply the Financeability Guidelines when applying the financeability test (after the Financeability Guidelines have been made).
 - Clarifies that the AER must have regard to the information provided in the financeability request when applying the financeability test.

- Clarifies that the AER must have regard to any relevant concessional finance agreement when applying the financeability test and the way in which the concessional finance is to be treated.
- Requires the AER to carry out a financeability test using the benchmark gearing ratio adjusted for the increased equity component in that ratio in accordance with any relevant concessional finance agreements.
- Clarifies that the process and timing for the AER's application of the financeability test is aligned with the CPA2 or revenue determination process, as appropriate.
- Clarifies that the Financeability Guidelines may be updated from time to time.

Related rule change process

- 29 The Commission separately considered a rule change request from the Minister on *Sharing concessional finance benefits with consumers*.
- 30 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.
- 31 The Commission also published a final rule determination on *Sharing concessional finance benefits with consumers* on 21 March 2024.

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1 The Commission has made a final rule determination

The Commission's final decision is to make a final 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.

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 final rule will 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 efficiently 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 final rule addresses 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 TNSP's cash flows. 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 final 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 final 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 final 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 and E.

1.3 Our final rule supports 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 will 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 final rule improves the ability of TNSPs to access finance and scale up transmission services by providing TNSPs and their investors with certainty about how the AER will conduct a financeability test. The final rule:

- allows 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 can propose a cash flow adjustment to the AER, which may involve 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 that does not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or shorter asset lives; and/or
 - revenue smoothing within a regulatory control period.
- requires 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 is not permitted to fall below the lower bound of the financeability threshold; or
 - below the financeability threshold, the TNSP's financeability position is not permitted to deteriorate at all.
- requires 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. The AER is bound to apply the financeability test in accordance with the financeability guidelines.

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.⁶

For this rule change, the relevant energy objective(s) is the NEO:⁷

The NEO is:⁸

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.⁹

The final rule will, or will 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 will 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 final rule will 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 preferable final rule will 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.¹⁰

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

⁶ Section 88(1) of the NEL.

⁷ The NEO was updated on 21 September 2023 with the introduction of the Statutes Amendment (National Energy Laws) (Emissions Reduction Objectives) Act 2023..

⁸ Section 7 of the NEL.

⁹ Section 32A(5) of the NEL.

¹⁰ 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.¹¹

Relevantly for this rule change, the revenue and pricing principles provide that:

- A regulated network service provider (NSP) 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.¹²

Our final rule is consistent with the revenue and pricing principles in the NEL. Our final 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 final 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.¹³ However, we do not consider this to be inconsistent with the revenue and pricing principles.

We also note that a TNSP's 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 final rule will also provide effective incentives to promote economic efficiency by promoting efficient investment in actionable ISP projects. By supporting TNSPs' financeability, the final rule will 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 final rule will also support the ability of TNSPs to obtain finance at efficient cost.

Similarly, our final rule will reduce the risk for under-investment by TNSPs in actionable ISP projects. By supporting improved financeability, the final rule will 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.

¹¹ NEL Schedule 1 item 22.

¹² Section 7A of the NEL.

¹³ For further information, see section 1.3

2.2.3 The final rule will not apply in the Northern Territory

The rule does not apply in the Northern Territory, as it amends provisions in NER Chapter 6A which does not apply in the Northern Territory.¹⁴

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.

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 final rule better 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 final rule will 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.

¹⁴ 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 final rule will 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 will only be adjusted for the ISP project, not for the wider asset base, and it will only be adjusted to the extent necessary to prevent a TNSP's overall financeability position from becoming worse off or to minimise any deterioration.¹⁵ This mechanism will minimise the impacts on today's consumers.

The Commission considers the final 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 cash flows 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 cash flows would again be set to support the benchmark credit rating. Our final rule is more preferable than ENA's alternative option. While

¹⁵ Where a TNSP is assessed as having an overall financeability position that is at or above the financeability threshold, the TNSP's financeability position is not permitted to fall below the financeability threshold. Where a TNSP's overall financeability position is below the financeability threshold, the TNSP's financeability position is not permitted to deteriorate at all.

our final rule and ENA's alternative option both involve a prescriptive financeability test, our final 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 the Financeability Guidelines. In addition, our final 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 final rule provides TNSPs and their investors with certainty about how the AER will conduct a financeability test and predictability in the outcomes of the test, consistent with good regulatory practice. It does 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 the financeability issue must be addressed, which may be by adjusting depreciation or revenue smoothing within a regulatory control period. In addition, the AER is required to set out in its Financeability Guidelines the financial metrics, and weightings to apply for each financial metric, that it will use to conduct its assessment. Therefore, while the NER does not include a prescriptive formula as proposed by the ENA, the metrics and weightings that the AER must apply will nevertheless be locked in via the AER's Guidelines, which the AER must apply when applying the financeability test.

Where the AER determines that a TNSP has a financeability issue as a result of investing in an ISP project, the AER is required to adjust the TNSP's cash flows to prevent the overall financeability position of the TNSP from deteriorating. As explained in section 3.3.2, where a TNSP's financeability position is below the financeability threshold and it is not possible to prevent a TNSP's cash flows from deteriorating, the AER must adjust cash flows to the extent possible to reduce any deterioration.

The Commission considers the final 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 metrics set out in guidelines together 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 metrics, noting that any changes to the Guidelines are subject to the Transmission Consultation Procedures.

The final 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 removes 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 are no longer required due to the prescriptive approach to the financeability test. The financeability test will be transparent, whether the request is made with a CPA 2 or as part of a revenue determination process.

- It requires a TNSP to submit a financeability request, 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 this approach is administratively less costly for the AER.

2.3.3 Contribution to achieving government targets for reducing greenhouse gas emissions

Our final rule will 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 final rule will support emissions reduction targets.

The final rule will support investment in actionable ISP projects in three ways, as explained below.

First, it will 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 is not be permitted to fall below the financeability threshold; or
- below the financeability threshold, the TNSP's financeability position is not be permitted to deteriorate at all.

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

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

Third, by supporting a TNSP's financeability, the final rule will 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 final 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 final rule will support this outcome for the same reasons it will support emissions reduction. That is, it will reduce barriers to TNSPs obtaining efficient finance, it will support timely investment in ISP projects and will remove a disincentive the TNSP may have to invest in actionable ISP projects.

2.3.5 Supporting efficient market arrangements

The final rule will support efficient market arrangements in three ways, as explained below.

- **First, the final rule will support the ability of TNSPs to finance their investments at efficient cost.** In the absence of the final 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 final rule mitigates this risk by supporting the financeability of TNSPs that are investing in ISP projects, as explained in section 2.3.2 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 cash flows where necessary to support financeability seeks to mitigate this risk.
- **Finally, the final rule only allows a TNSP's cash flows 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) will remain unchanged. We consider this approach better meets the NEO than two of the solutions proposed in the ENA's rule change request,¹⁶ as discussed further in chapter 3.

¹⁶ The options raised by ENA are explained in Appendix A.

3 How our rule will operate

Box 1: SUMMARY OF FINAL DETERMINATION

Our final determination allows a TNSP to submit a request for a financeability test, which is defined in the final rule as a ‘financeability request’. If 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.

The final rule is limited to actionable ISP projects and the AER will only adjust cash flows 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 use the benchmark gearing ratio value in the applicable RORI, or the benchmark gearing ratio as adjusted to account for the increased equity component in that ratio in accordance with any relevant concessional finance agreements. The AER must also use the financial metrics and weightings set out in its Financeability Guidelines.

Under the final 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 cash flows 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 cash flows through one or more of the following methods outlined below.

- The AER may, using a new method under the final rule, vary the depreciation of assets that form part of an actionable ISP project after the asset has been commissioned, so that they are depreciated using a profile that the AER considers appropriate. For example, based on a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or using shorter asset lives.
- The AER may depreciate actionable ISP project assets using a profile that the AER considers appropriate, prior to the asset being commissioned. The final rule clarifies that the AER may allow as incurred recovery of depreciation (which may apply for all assets that form part of the actionable ISP project in addressing a financeability issue).
- The AER may smooth revenue within a regulatory control period, if there are sufficient remaining years in the regulatory control period, which is an existing mechanism available under the current arrangements.

The final rule is a more preferable rule than that proposed in 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 final 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

final rule does 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. Section 2.3 explains why the final rule better meets the NEO than the rule change requests.

3.1 Greater flexibility in the regulatory framework will allow cash flows 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).¹⁷ This feature contributes to financeability challenges because it can reduce cash flow early in the life of significant ISP projects.

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 explanation of the financeability problem in the rule change requests from the Minister and ENA are consistent with the Commission's assessment in TPIR.¹⁸ 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.¹⁹ 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.²⁰

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 need to address financeability was supported in submissions to the Draft Determination by the Australian Energy Market Operator (AEMO), the AER, the Clean Energy Finance Corporation (CEFC), the ENA, Marinus Link Pty Ltd (MLPL), Origin Energy, and Transgrid.²¹

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.²² Some stakeholders were also concerned that the Draft Determination would lead to increased costs to consumers in the short term and inter-generational equity issues, including that future consumers who receive the benefits of ISP projects may not be the same as today's consumers.²³ The EUAA was concerned that the

17 The framework for the return of capital through depreciation is set out in clause 6A.6.3 of the NER.

18 For more information, refer to Chapter 2 of the Consultation paper.

19 Commonwealth Minister for Climate Change and Energy, Treatment of financeability for Transmission Network Service Providers - Rule change request, 11 April 2023, p. 2; ENA, Ensuring the financeability of actionable ISP projects - Proposal to change the National Electricity Rules, 9 June 2023, p. 4.

20 Minister's rule change request, p. 1.

21 Submissions to the Draft Determination: AEMO, p. 1; AER, pp. 1-2; CEFC, p. 1; MLPL, p. 1; Origin Energy, p. 1; and Transgrid p. 2.

22 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. Submissions to the Draft Determination: AGL, p. 1; CWO REZist, p. 1; Nexa Advisory, pp. 1-2.

23 Submissions to the Draft Determination: AER, p. 2; AGL, p. 1; CEIG, p. 3; EUAA, pp. 1-2; and Nexa Advisory, pp. 3-4.

financeability framework would not be used as a last resort, and would transfer risk to consumers.²⁴

Some stakeholders continued to consider that introducing contestability for actionable ISP projects and/or ownership of transmission assets, or using the RTN fund would be a more appropriate approach.²⁵

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 or revenue smoothing within a regulatory control period for actionable ISP projects. The Commission acknowledges that if the AER is required to address a financeability issue, today's consumers would face higher costs than they would without the adjustment. However, we have weighed this outcome against the need to support timely investment in transmission infrastructure, to reduce emissions and support the reliable and secure and provision of energy over the long term. As explained further in chapter 2, this rule change is required to minimise the risk that transmission infrastructure that has been identified in the ISP as necessary to support emissions reductions and security and reliability is not built.

We have also designed the final rule to minimise the amount of cash flow that is brought forward, limiting the impact on today's consumers. The final rule does this in four ways:

- limiting its application to actionable ISP projects
- requiring a TNSP to have a demonstrable financeability issue, assessed by the AER using a prescriptive test, in order for cash flows to be brought forward
- limiting the cash flow that can be brought forward to the amount that is required to address the financeability issue
- recognising the impact of concessional finance on a TNSP's financeability.

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 note that government support for ISP projects including through RTN, is a matter for governments to consider and is out of scope of this rule change.

The final 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 that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or shorter asset lives).²⁶ This allows the AER to vary depreciation for actionable ISP projects and to bring forward cash flows, 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 final rule addresses this problem.

²⁴ EUAA, submission to the Draft Determination, p. 2.

²⁵ Submissions to the Draft Determination: AGL, p.1; CEIG, pp. 3-4; and Nexa Advisory, pp. 5, 6.

²⁶ Final rule, clause 6A.6.3A(o)(1)

3.2 TNSPs may request a financeability test

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

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

If 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 (unless adjusted for the increased equity component in that ratio in accordance with any relevant concessional finance agreements).

The final 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 or revenue smoothing with a regulatory control period to address any financeability issue which can be considered by the AER.

The Commission considers that the final rule promotes 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.

Changes from draft to final rule

Our final rule includes a number of further amendments to the draft rule, as outlined below.

- Clarifies that a TNSP may propose any method available to the AER to address a financeability issue
- Clarifies that a TNSP can only apply once for a financeability test for each actionable ISP project or stage of an actionable ISP project if the project is staged in the ISP
- Clarifies that a TNSP may request a financeability test as part of a CPA 2 or a revenue determination process.

3.2.1 TNSPs may request a financeability test

The final rule allows a TNSP to submit a financeability request to the AER in relation to an actionable ISP project. In this request, the TNSP can propose to bring forward cash flows to address a financeability issue through a combination of one or more of the methods outlined below.

- The TNSP can propose that the AER varies the depreciation of assets that form part of an actionable ISP project, after the asset has been commissioned (e.g. a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or using shorter asset lives).
- The TNSP can propose that the AER allows for as incurred recovery of depreciation prior to the asset being commissioned (which may apply for all assets that form part of the actionable ISP project in addressing a financeability issue).

- The TNSP can propose that the AER smooths revenue within a regulatory control period, if there are sufficient remaining years in the regulatory control period, which is an existing mechanism available under the current arrangements.

In submitting a financeability request, the TNSP is required to provide the AER with:

- its proposed adjustments to bring forward cash flows, using one or more of the methods outlined above,
- any applicable information about any concessional finance received (see section 3.5),
- any information required by the AER under the Financeability Guidelines (see section 3.4), and
- additional information that the AER reasonably requests for the purpose of applying the financeability test or addressing the financeability issue.

In addition, TNSPs must include the following information in a financeability request, regardless of whether or not the TNSP has received concessional finance for the actionable ISP project.

- an estimate of its revenue requirement without the actionable ISP project; and
- an estimate of the incremental revenue that the TNSP considers is likely to be required to be earned in each remaining year of the regulatory control period with the actionable ISP project, both with and without the request for a financeability adjustment.²⁷

The financeability test will not be automatically triggered for every actionable ISP project. Rather, the TNSP must submit a financeability request for the AER to apply the financeability test. The Commission considers that the final rule will promote sufficient investor certainty through a prescriptive approach to the financeability test (see section 3.5). 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, whether any benefits of the finance are retained (see section 3.4). As such, requiring TNSPs to apply for the financeability test is consistent with this approach.

The final rule clarifies that a TNSP may only request a financeability test once for a given actionable ISP project or stage of an actionable ISP project if the project is a staged project in a draft or final ISP.²⁸ A TNSP cannot submit a financeability request in relation to an early works²⁹ CPA.³⁰ For example, if AEMO's ISP includes two proposed construction stages for one actionable ISP project, the TNSP could:

- firstly request a financeability test in relation to stage 1 of construction
- at a later point in time, if stage 2 proceeds, request a second financeability test in relation to stage 2 of construction
- not request a financeability test in relation to early works costs.

There is no ability for a TNSP to request a second financeability test for the same stage (construction) of an actionable ISP project if the project has multiple construction stages in the ISP, or have adjustments made at a later date. This recognises that the purpose of the financeability test is to assess the ability of a TNSP to obtain finance at efficient cost, to support a decision to invest in an actionable ISP project at that point in time. The financeability framework is

²⁷ The estimate of incremental revenue which the TNSP considers is likely to be required to be earned in each remaining year of the regulatory control period without the request for a financeability adjustment is an existing requirement for a CPA under clause 6A.8.2(b)(7)

²⁸ Final rule, clause 6A.6.3A(d)(2)

²⁹ We note that if the AER approves an early works CPA, the TNSP will start earning incremental revenue for the early works CPA in the next regulatory year where this is possible. This supports TNSPs cash flows to some extent.

³⁰ Final rule, clause 6A.6.3A(d)(1).

not intended to be an ongoing mechanism to adjust cash flows for actionable ISP projects. In addition, requiring the AER to apply multiple financeability tests for each actionable ISP project would add further administrative burden.

This clarification in the final rule is in response to:

- submissions from the ENA and Transgrid suggesting that a TNSP should be able to have the financeability test re-applied in the revenue determination following completion of the ISP project³¹
- a submission from Nexa Advisory, which suggested the rule clarify how many times a financeability test could be requested.³²

3.2.2 TNSPs will be able to submit a financeability request as part of a CPA 2 or the revenue determination process

A TNSP may submit a request for a financeability test to the AER as part of a Contingent Project Application (CPA) stage 2 for construction for an actionable ISP project.³³

Alternatively, a TNSP may submit a request for a financeability test to the AER as part of a revenue determination process. In this case, a TNSP may submit this request either with its initial revenue proposal or revised revenue proposal.³⁴

Where a TNSP requests a financeability test as part of a CPA2, the financeability test will cover the construction costs for the actionable ISP project. Where a TNSP requests a financeability test as part of a revenue determination process, the financeability test will cover the full project costs for the actionable ISP project. A TNSP will not be able to request a financeability test for a subset of the construction costs as part of a revenue determination process, then request a second financeability test for the remainder of the construction costs. As noted above in section 3.2.1, the final rule only permits a TNSP to submit a financeability test once for a given actionable ISP project or stage of an actionable ISP project if the project is staged in a draft or final ISP.

Under the draft rule, TNSPs could only submit a financeability request as part of a CPA2 application. The ENA and MLPL considered that TNSPs should also be able to request a financeability test as part of a revenue determination.³⁵ The Commission agrees that TNSPs should have this flexibility and has incorporated it into the final rule

TNSPs will 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.³⁶ The reason for this final decision is that,

- 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 will allow more accurate forecasts to be used, resulting in a more accurate assessment of whether a TNSP has a financeability issue.

31 Submissions to the Draft Determination: ENA, p. 8; Transgrid, p. 5.

32 Nexa Advisory, submission to the Draft Determination, p. 4.

33 Final rule, clause 6A.6.3A(b)(1).

34 A TNSP is not required to submit a revised revenue proposal under clause 6A.12.3 of the NER although it is common practice for a TNSP to do so. Under the final rule, if a TNSP wishes to apply for a financeability test as part of a revenue determination then it must submit the financeability request either with its initial revenue proposal under clause 6A.10.1(b) or revised revenue proposal under clause 6A.12.3(a)(2).

35 Submissions to the Draft Determination: ENA, p. 8; MLPL, p. 2.

36 The final 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 final 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.

The ENA and Transgrid considered that TNSPs should be able to apply for a financeability test for early works.³⁷ They considered that the required activities for early works can be extensive and note that Transgrid's total forecast costs for early works for Victoria to NSW Interconnector (VNI) West, while atypical, exceeds \$1 billion.³⁸ We note that while early works costs can be large, they are likely to be a relatively small proportion of the total costs of an actionable ISP project. We consider that the financeability request should relate to either total costs, or primary (construction) costs, of an actionable ISP project.

3.2.3 Intending TNSPs are not eligible to request a financeability test

We do not consider that the rule should allow intending TNSPs to request a financeability test. This was our position in the draft determination which we maintain in this final determination.

The ENA and MLPL considered that the financeability framework should apply to intending TNSPs.³⁹

We do not consider the rule should allow intending TNSPs to request for a financeability test for the following reasons.

- Under the current arrangements, Intending TNSPs are not able to receive revenue before they start providing a prescribed transmission services. If we allowed Intending TNSPs to request a financeability test and start receiving revenue before providing services this would have implications that have not been consulted on as part of this rule change, including potential impacts on incentives for project completion for single project entities.
- If the financeability test is applied to intending TNSPs it may create perverse incentive for TNSPs to structure their commercial arrangements for single actionable ISP projects. In effect, this would allow the financeability test to be carried out on the basis of a project level assessment for each actionable ISP project. As explained further below, we decided that financeability test will only apply at the regulated business level and not at the ISP project level.

3.3 The AER is required to apply a prescriptive financeability test and adjust cash flows if the TNSP has a financeability issue

Box 3: FINAL DETERMINATION - THE AER MUST APPLY A FINANCEABILITY TEST AND ADJUST cash flows IF THERE IS A FINANCEABILITY ISSUE

Our final rule requires 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 final rule specifies how the AER must apply the test and under what circumstances the AER must determine that the TNSP has a financeability issue.

The final 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:

- before it has been commissioned, by using as incurred recovery of depreciation for all assets of the actionable ISP project

³⁷ Submissions to Draft Determination: ENA, pp. 7-8; Transgrid, pp. 5-6.

³⁸ ENA, submission to draft determination, p. 8.

³⁹ Submissions to the Draft Determination: ENA, p. 14; MLPL, p. 2.

- after it has been commissioned, using a profile that the AER considers appropriate (e.g. a profile that may not reflect the nature of the underlying assets and their economic life, such as a profile other than straight-line depreciation or, shorter asset lives).

It also allows the determination to be binding in the subsequent regulatory control period, if relevant.

Adapting the regulatory framework to be more flexible will support the ability of TNSPs to access finance at efficient cost. In doing so, the final rule promotes 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.

Changes from draft to final rule

Our final rule includes a number of further amendments to the draft rule, as outlined below.

- Clarifies that the AER must apply the Financeability Guidelines when applying the financeability test (after the Financeability Guidelines have been made).
- Clarifies that the AER must have regard to the information provided in the financeability request when applying the financeability test.
- Clarifies that the AER must have regard to any relevant concessional finance agreement when applying the financeability test and the way in which the concessional finance is to be treated.
- Requires the AER to carry out a financeability test using the benchmark gearing ratio, adjusted for the increased equity component in that ratio, in accordance with any relevant the concessional finance agreement(s).
- Clarifies that the process and timing for the AER's application of the financeability test must be aligned with the CPA2 or revenue determination process, as appropriate.

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

The final rule requires the AER to apply the financeability test in accordance with the NER and the Financeability Guidelines.⁴⁰ When applying the test, the AER must also have regard to the information set out in the TNSP's financeability request and any relevant concessional finance agreement.⁴¹

The financeability test is based on the benchmark gearing ratio, or an adjusted benchmark gearing ratio with an increased equity component if agreed in a concessional finance agreement

In determining whether a TNSP has a financeability issue, the final rule requires 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 PTRM to determine the TNSP's cash flows (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 is based on 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

⁴⁰ Final rule, clause 6A.6.3A(i)(1)

⁴¹ Final rule, clause 6A.6.3A(i)(2)

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 cash flows are brought forward unnecessarily.

However, the final rule requires the AER to use the benchmark gearing ratio in the applicable RORI, adjusted for an increased equity component in that ratio for the purposes of the financeability test where:

- a TNSP has received concessional finance and not all of the benefits of the concessional finance are passed through to consumers (i.e. some concessional finance benefits are retained by the TNSP)
- the relevant GFB and TNSP have agreed that an adjustment to the benchmark gearing ratio is required to take the concessional finance arrangement into account for the purposes of a financeability test.⁴²

This approach will apply to any relevant actionable ISP project that has received concessional financing that must be taken into account by the AER in applying the financeability test. The reasons for this approach are as discussed in section 3.5. For clarity, the adjusted benchmark gearing ratio would only be used for the purposes of the financeability test. If a TNSP submits a financeability request as part of a revenue determination, the AER would use:

- the benchmark gearing ratio for the purposes of the revenue determination
- the adjusted benchmark gearing ratio agreed between the GFB and TNSP for the purposes of the financeability test.

How the AER determines whether there is a financeability issue

The final rule requires the AER to determine that there is no financeability issue where the financeability position including the actionable ISP project remains equivalent to or above the financeability threshold (i.e. is equivalent to, or higher than, the benchmark credit rating in the applicable RORI)⁴³ Under the current 2022 RORI this means that cash flows would, and would not, need to be adjusted, as outlined below.

- **cash flows don't need to be adjusted:**
 - if a TNSP's regulated revenue has cash flows 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 cash flows.
 - if a TNSP's regulated revenue has cash flows 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 cash flows.
- **cash flows 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.

⁴² For example, where a concessional finance agreement includes a concessional equity component.

⁴³ In the final rule, clause 6A.6.3A(a), "financeability threshold" is defined as the benchmark credit rating used to estimate the return on debt component of the applicable rate of return instrument.

- 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 will 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 will apply for each of the financial metrics that the AER selects for the financeability test.

The financeability test is at the TNSP RAB level and not the ISP project level

The final rule specifies that the AER must apply the financeability test using the TNSP's regulated revenue, meaning that the financeability test occurs at the RAB level rather than the project level. This reflects the nature of the "with or without" test, noting this approach cannot be applied to a single project since a financeability position cannot be determined without the project.

We have addressed stakeholder feedback on the draft determination on other aspects of the financeability test

The final rule also clarifies that the AER must make its decision on a financeability test at the same time as it decides on:

- a CPA 2, where the TNSP submits a financeability request as part of a CPA 2
- a final revenue determination, when a TNSP submits a financeability request as part of a revenue determination.

This responds to feedback from the ENA that the rule should specify a timeframe for the AER to make a decision on a financeability test.⁴⁴

The requirement for the AER to apply the financeability test in accordance with the Financeability Guidelines and have regard to the information set out in the TNSP's financeability request was added in response to feedback in the ENA submission.⁴⁵ We agree that including these requirements in the NER better reflects the policy intent. However, we have not accepted ENA's proposal in full, which would have required the AER to "apply the formulae and methods specified in the financeability guidelines". The reasons for this are discussed in section 3.4. The requirement for the AER to have regard to any concessional finance agreement was included in response to feedback in the CEFC's submission.⁴⁶ The Commission agrees that this clarifies the policy intent.

The AER considered that the financeability test should not be linked to the benchmark credit rating in the RORI on the basis that the benchmark credit rating was not intended for this purpose.⁴⁷ The AER considered that if they are required to perform a financeability test that is linked to a given benchmark rating, that it would need to consider qualitative factors. As an alternative approach, the AER suggested a "material change" assessment approach whereby a TNSP's financial position should not materially change a result of an actionable ISP project, and that the definition of "material change" could be specified in the Financeability Guidelines.

⁴⁴ ENA, submission to the Draft Determination, p. 12.

⁴⁵ ENA, submissions to the Draft Determination, pp. 6&11.

⁴⁶ CEFC, submission to the Draft Determination, p. 3.

⁴⁷ AER, submission to Draft Determination, p. 3.

The Commission continues to consider that it is necessary to have a clear threshold against which financeability is assessed, and that the benchmark credit rating is appropriate for this purpose. The AER may choose to update the Financeability Guidelines at the same time as it reviews the RORI to consider any linkages between the two. We do not consider an assessment of qualitative factors is required. The financeability test deliberately uses quantitative financial metrics and weightings and does not need to consider qualitative factors in order to provide greater investment certainty. Similarly, we do not consider a “material change” approach would provide sufficient certainty for TNSPs and their investors.

Both the AER and Transgrid proposed that an objective for the financeability test be specified in the NER.⁴⁸ The objective proposed by the AER was intended to provide clarity and help ensure adjustments are not made if they are not required, while Transgrid’s proposed objective was intended to support a prescriptive, replicable and predictable financeability test. The Commission considers that the final rule already sufficiently contributes to these outcomes through its prescriptive approach and that adding an objective could have an unintended effect of introducing ambiguity in the application of the financeability test by the AER.

The ENA and Transgrid supported a no worse off approach where a TNSP’s initial financeability position is equivalent to or higher than the financeability threshold, but considered that a project level assessment should occur where the initial financeability position is below the financeability threshold.⁴⁹ They considered that where a TNSP has a sub-investment grade credit rating, the financeability framework would not resolve the financeability issue. In response, the Commission considers that:

- it is appropriate that a TNSP’s financeability position is always assessed based on the TNSPs RAB, and not the actionable ISP project, as explained further above
- our final rule ensures that a TNSP is no worse off “to the extent practicable” from delivering an actionable ISP project, as explained further in section 3.3.2 below.

Transgrid also raised concerns about the long interval between committing to an ISP project and the CPA or revenue determination meaning it is impossible to forecast the financial position of a TNSP with accuracy, noting that the financeability position will change over time e.g. due to other large non-ISP projects.⁵⁰ The Commission considers that the relative predictability and long lead times for transmission investment, combined with a predictable financeability test, help mitigate these concerns.

The ENA proposed that the term “financeability position” be defined in the rules.⁵¹ The Commission does not consider that the term “financeability position” needs to be a defined term in the rules. We consider its meaning is sufficiently clear. However, the AER may choose to define the term in its Financeability Guidelines.

3.3.2 **If there is a financeability issue, the AER must adjust cash flows to prevent the TNSP from being worse off**

Under the final rule, if the AER determines there is a financeability issue, as defined above, it must address the financeability issue by adjusting cash flows for the actionable ISP project. The AER must make adjustments to cash flows such that:

48 Submissions to the Draft Determination: AER, pp. 2-3; and Transgrid, p. 1.

49 Submissions to the Draft Determination: ENA, pp.9, 15; Transgrid, p. 3-5.

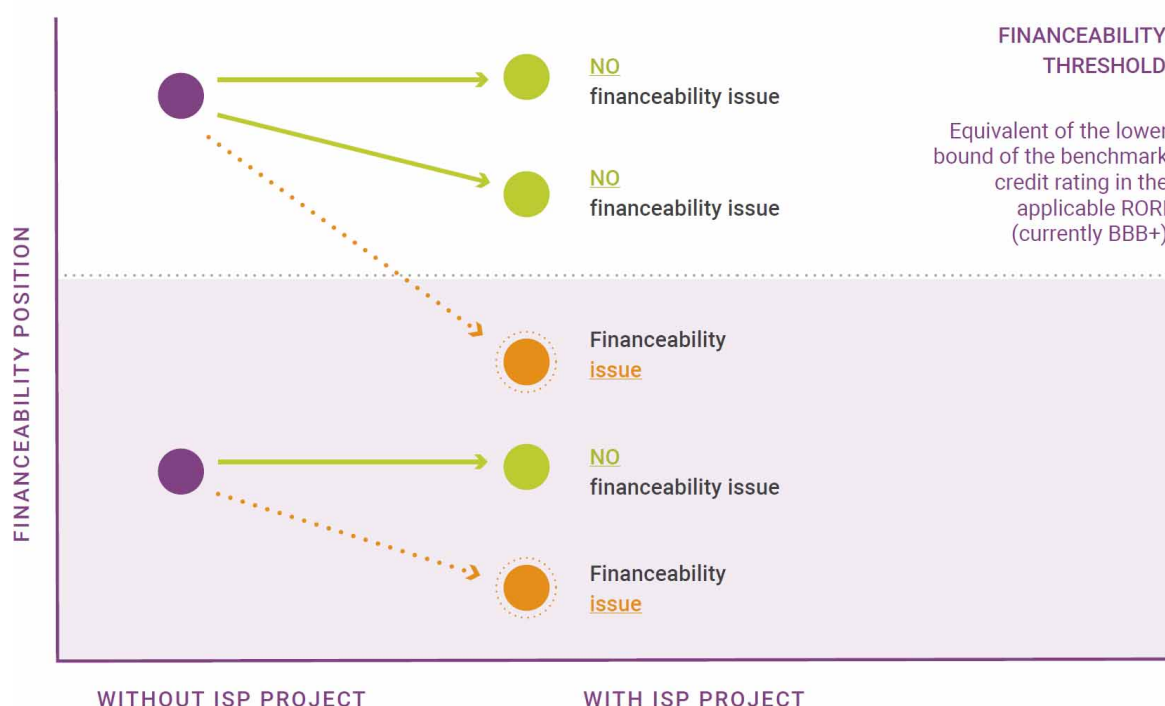
50 Transgrid, submission to the Draft Determination, p. 3.

51 ENA, Submission to the Draft Determination, p. 11.

- 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.

This approach permits 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



The final rule also recognises that it may not always be mathematically possible for the AER to adjust cash flows 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 final rule requires the AER to adjust cash flows "to the extent possible" to achieve the above outcomes.⁵²

3.3.3 The final rule provides the AER with another tool to help TNSPs manage cash flows 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.⁵³

⁵² Final rule, clause 6A.6.3A(m).

⁵³ In practice, "as-incurred" depreciation is not recovered until the year after capital expenditure is incurred.

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

In addition, the AER considers that the nature of transmission assets may preclude it from applying as-incurred depreciation because of the long lead time between when costs are incurred and when they are commissioned, particularly compared to distribution. As such, without a clear requirement in the NER to address a financeability issue, the AER may not consider it is able to approve as-incurred depreciation for TNSPs.⁵⁴

The final rule adds another tool to the AER's toolbox for managing TNSPs' cash flows. It enables the AER to vary the depreciation profile of an actionable ISP project after it has been commissioned using a profile that it considers appropriate. This profile may not reflect the nature of the underlying assets and their economic life (e.g. a profile other than straight-line depreciation or shorter asset lives).⁵⁵

The final rule also clarifies that the AER is able to use as-incurred depreciation to manage a TNSP's cash flows.⁵⁶

This advances the recovery of depreciation to support financeability where the above measures alone are insufficient to maintain a TNSP's financeability position. It also clearly allows the AER to use as-incurred depreciation as one of its tools for addressing a financeability issue. The adjustment will be net present value (NPV) neutral, meaning TNSPs will 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 control 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 is binding on the AER and the TNSP. This approach provides certainty for TNSPs and their investors. Where the TNSP applies for a financeability test as part of a revenue determination, the depreciation adjustment may apply to the five year period that is the subject of the revenue determination and the subsequent regulatory control period (i.e. up to the next 10 years).

Origin Energy agreed that the AER should have discretion on how best to bring forward cash flows.⁵⁷ However, the ENA proposed the AER be required to notify the TNSP if it intends to adopt a different method from what the TNSP proposed, and accept submissions from the TNSP. The Commission does not consider that this is necessary and the final rule provides sufficient opportunity for the TNSP to justify its preferred approach in its financeability request.

⁵⁴ AER, submission to Draft Determination, pp. 6-7.

⁵⁵ Clause 6A.6.3A(b)(3) of the final rule allows a TNSP to submit a request to the AER to approve that the asset (or group of assets) of an actionable ISP project is depreciated on a basis other than in accordance with clause 6A.6.3(b)(1)

⁵⁶ Clause 6A.6.3A(b)(3)

⁵⁷ Origin Energy, submission to Draft Determination, p. 1.

The ENA considered that a decision to bring forward cash flows should apply in one or more regulatory control periods. That is, it shouldn't be limited to the current and subsequent regulatory control periods.⁵⁸ Given that in practice TNSPs are using the staged CPA process, and we expect TNSPs to continue to using the staged CPA process in many cases, the Commission's final rule takes into account how the AER can only approve capex for a CPA project in the current and subsequent regulatory control periods. As such, the depreciation adjustments will only apply to the current and subsequent regulatory control periods.

The ENA also proposed that the rule should clarify that the AER must address a financeability issue using one of the available methods.⁵⁹ The Commission considers the rule is sufficiently clear that the AER must address a financeability issue and that it may choose which method or combination of methods to use to address the issue.

CEIG and Nexa Advisory raised concerns about the limited visibility and lack of consultation on the financeability test.⁶⁰ Irrespective of whether a TNSP requests a financeability test under the CPA2 or revenue determination process, stakeholders will have an opportunity to provide feedback on the request. The AER is required to publish the TNSP's financeability request with its CPA2 application or as part of a revenue determination process (with the initial revenue proposal or revised revenue proposal) and seek stakeholder feedback. While the AER will not be required to publish a draft decision in respect of the financeability test, the test is intended to be predictable, which we consider reduces the need for additional consultation. Further, stakeholders will be able to provide feedback on the development of the Financeability Guidelines which will set out the details of how the test will be applied, as discussed in section 3.4.

3.3.4 The final rule does 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 cash flows 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 is 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 cash flows 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 cash flows 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 cash flows for transmission investment, other than for actionable ISP projects. No more revenue is recovered by TNSPs and no more cash flow is brought forward than necessary to address a financeability issue.

No stakeholder disagreed with this assessment in response to the Draft Determination.

3.3.5 The final rule limits the AER's discretion in conducting a financeability test

As discussed above, the final rule requires the AER to, on request by a TNSP, apply a financeability test to determine whether a TNSP has a financeability issue and, if so, by how much cash flows

⁵⁸ ENA, submission to draft determination, p. 16.

⁵⁹ ENA, submission to draft determination, p. 12.

⁶⁰ Submissions to the Draft Determination: CEIG, p. 3; Nexa Advisory, pp. 5-6.

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 limits the AER's discretion in determining whether a TNSP has a financeability issue.

The final rule differs from the Minister's rule change request,⁶¹ 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:⁶²

- 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.

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.⁶³

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. 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, and better meets the NEO, than a principles-based approach. Given that we decided to apply a more prescriptive approach, our final rule does not include any principles for how the AER is to assess requests from TNSPs to address financeability issues.

The final rule does not go so far as to include a financeability formula in the NER, as proposed by the ENA. 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.

The ENA broadly agreed that the draft rule strikes an appropriate balance between a principles-based approach and specifying a financeability formula in the rules.⁶⁴ However, the ENA and Transgrid called for the rule to more clearly reflect the intention for the financeability test to be predictable and provide investment certainty.⁶⁵ The ENA proposed drafting amendments to achieve this, primarily in respect of the content and application of the Financeability Guidelines, and Transgrid proposed including an objective for the financeability test. Our responses to these proposals are set out in section 3.4 and section 3.3.1 respectively.

61 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.

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

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

64 ENA, submission to Draft Determination, p.2.

65 Submissions to the Draft Determination: ENA, pp. 5-6; Transgrid, p. 2.

The AER continued to support a principles-based approach with a clear objective.⁶⁶ The Commission's view on the inclusion of an objective is discussed in section 3.3.1. More generally, the Commission continues to consider that we have appropriately balanced the need for investment certainty with a mechanism that will ensure cash flows are only brought forward if a TNSP has a demonstrable financeability issue associated with an actionable ISP project, and to the extent necessary to resolve it. We consider a principles-based approach is unlikely to provide sufficient certainty to investors in the time frames required to enable financing to be obtained at efficient cost.

Nexa Advisory was concerned that having a prescriptive approach to the financeability test could facilitate gaming of the formula.⁶⁷ As discussed further in section 3.4.1, the AER will have the discretion to decide whether to develop a formulaic approach in its Financeability Guidelines or retain an element of flexibility in the way that it applies the financeability test. Further, requiring the AER to apply the financeability test using the PTRM, including benchmark gearing (unless adjusted for the increased equity component in that ratio to reflect any relevant concessional financing agreement(s)), will limit any potential for gaming of the test by TNSPs.

Further detail on why we consider the approach to assessing financeability set out in the final rule better promotes achievement of the NEO than either of the proposed rule change requests is set out in chapter 2.

3.4 The AER is required to develop Financeability Guidelines

Box 4: FINAL DETERMINATION - THE AER MUST DEVELOP GUIDELINES TO EXPLAIN HOW IT WILL DETERMINE THE FINANCEABILITY POSITION

Our final rule requires the AER to develop and publish Financeability Guidelines that provide further detail on how the AER will 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.

The Financeability Guidelines may set out any other matters the AER considers appropriate. While not a requirement of the rule, the AER may choose to 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.

Changes from draft to final rule

- Clarifies that the Financeability Guidelines may be updated from time to time in accordance with the transmission consultation procedures.

3.4.1 The Financeability Guidelines must explain how the AER will determine the financeability position

The final rule requires the AER to develop Financeability Guidelines that explain how the AER will determine the financeability position of a TNSP, based on a set of financial metrics and weightings

⁶⁶ AER, submission to the Draft Determination, p. 3. AGL also preferred a principles-based approach would be preferable, noting they did not generally support the rule. See AGL, submission to the Draft Determination, pp. 1-2.

⁶⁷ Nexa Advisory, submission to the draft determination, p. 4.

for these financial metrics. The Financeability Guidelines may be updated from time to time in accordance with the *Transmission Consultation Procedures*.⁶⁸ This addition to the draft rule was in response to feedback from the ENA,⁶⁹ and is consistent with the rule requirements governing other AER guidelines.

The Financeability Guidelines are required to set out the financial metrics that the AER will use to determine a TNSP's financeability position and the weightings that will apply to the financial metrics. The AER will also be required to explain the basis for its approach. The Commission expects that the AER will 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 will have some discretion in determining the financial metrics and weightings it adopts.

The AER's methodology for determining a TNSP's financeability position will differ from credit rating agencies in that it will not be able to adjust the financeability position based on qualitative factors. Rather, the AER must apply a quantitative approach, based only on its chosen selection of financial metrics. This means that the financeability test will 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 will not need to replicate a credit rating for the TNSP. The AER's approach will differ from that applied by credit rating agencies in a number of ways, including that:

- the AER will 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 (unless adjusted for the increased equity component in that ratio to reflect any relevant concessional financing agreement(s)), while credit rating agencies use a transmission business' actual gearing ratio.

The Financeability Guidelines will 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.⁷⁰ This is necessary to determine whether a TNSP has a financeability issue and, if so, to determine how much cash flows must be brought forward.

Finally, the AER is 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 must be developed in accordance with the *Transmission Consultation Procedures*, meaning TNSPs and other stakeholders will be consulted on the development of the Guidelines. The AER is required to publish the Financeability Guidelines by 31 December 2024, which is approximately nine months after the proposed commencement date of the final rule. The AER will 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

68 Final rule, clause 6A.6.3A(q)

69 ENA, submission to the Draft Determination, p. 13.

70 Final rule clause 6A.6.3A(r)(3)

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.

Stakeholders generally agreed with the requirement for the AER to develop Financeability Guidelines that set out the details of how the AER will apply the financeability test.⁷¹ However, the ENA provided some suggested amendments to the content of the Financeability Guidelines and the matters that the AER should take into account in developing them. The EUAA considered that the Financeability Guidelines must be developed in a way that does not erode any AER discretion.⁷² The CEIG noted that the process to assess financeability issues relies on the design of the Financeability Guidelines.⁷³

The ENA proposed the Financeability Guidelines be required to specify a formula for the financeability test that is capable of automatic application.⁷⁴ Consistent with this view, the ENA proposed that, in applying the financeability test, the AER be required to “apply the formulae and methods specified in the Financeability Guidelines”.⁷⁵ The Commission does not consider this approach is necessary. The AER may decide to apply a formula. However, we consider the AER should have the discretion to develop and apply the financeability test as it sees fit within the requirements of the rule and taking into account submissions as required by the *Transmission Consultation Procedures*. We consider the financeability framework provides an appropriate balance between providing certainty to TNSPs and investors while providing a degree of discretion to the AER that may be required to allow it to take into account different circumstances.

The ENA proposed that the AER be required to take into account the following matters in developing the Financeability Guidelines:⁷⁶

- the financial metrics and credit ratings used by credit rating agencies
- the economic costs and risks of under-investment if a financeability issue is not addressed.

The Commission’s response to these matters is outlined below.

- In respect of the first matter, the AER is not required to undertake a credit rating assessment equivalent to credit rating agencies and, as such, we do not consider it appropriate for the AER to be required to take into account the financial metrics and weightings applied by credit rating agencies. However, as noted above, we expect that in practice the AER will adopt metrics that are similar to credit rating agencies.
- In respect of the second matter, the financeability framework is intended to provide TNSPs and investors with greater certainty to support investment decisions in actionable ISP projects by introducing a prescriptive test rather than a principles-based approach. We consider that requiring the AER to have regard to one of the Revenue and Pricing Principles⁷⁷ introduces an element of judgement, undermining the prescriptive nature of the financeability framework set out in the rule.

⁷¹ Submissions to the Draft Determination: ENA, pp. 6-7; Origin, p.1.

⁷² EUAA, submission to the Draft Determination, p.2.

⁷³ CEIG, Submission to the Draft Determination, pp. 1, 3.

⁷⁴ ENA, submission to the Draft Determination, p. 13.

⁷⁵ Ibid, p. 11.

⁷⁶ ENA, submission to the Draft Determination, pp. 16-17.

⁷⁷ ENA’s proposal appears to refer to the revenue and pricing principle that 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 which the operator provides direct network control services. ENA’s proposal only refers to the risk of under-investment and not over-investment.

As noted above, the ENA suggested, and the Commission agreed, that the rule should allow the AER to update the Financeability Guidelines from time to time. The ENA also suggested that the rule require that any amendment to the Financeability Guidelines should not affect any request for a financeability test made prior to the date from when any amendment to the Guidelines is effective. The Commission considers that the AER could consider the need for any transitional arrangements as new versions of the Financeability Guidelines are published, if required.

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

The Commission's final position is, consistent with the draft determination, 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 final rule does 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, the final rule provides that the Financeability Guidelines may set out any other matters the AER considers appropriate.⁷⁸ 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, including feedback from stakeholders on the draft rule.

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

Box 5: FINAL DETERMINATION - TNSPs THAT HAVE RECEIVED CONCESSIONAL FINANCE HAVE ADDITIONAL ELIGIBILITY REQUIREMENTS TO SUBMIT A FINANCEABILITY REQUEST

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

- **all of the benefits of concessional finance flow through to consumers;** or
- **if 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 will prevent TNSPs from benefiting from both concessional finance and a cash flow adjustment unless agreed to by the GFB and will allow the

⁷⁸ Final rule, clause 6A.6.3A(s).

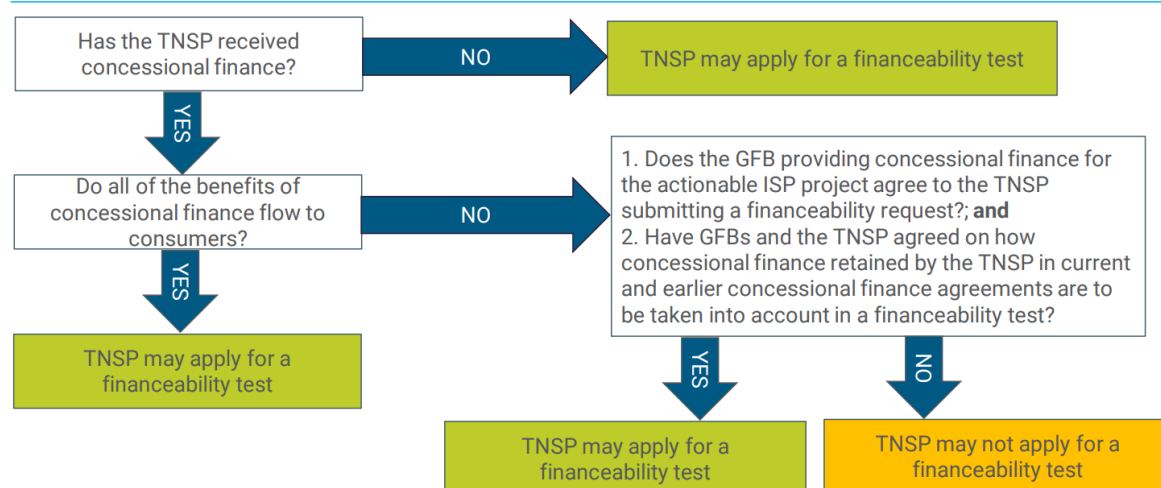
cash flow benefits from earlier concessional finance agreements to be captured in the test, minimising the impact on consumers.

3.5.1 TNSPs with concessional finance where the benefits aren't fully passed through to consumers must meet eligibility criteria

If a TNSP has entered into a concessional finance agreement after 14 December 2023 for an actionable ISP project it will only be eligible to submit a request for a financeability test if:⁷⁹

- all of the benefits from any relevant concessional finance agreements are passed through to consumers, such that the TNSP has not received any concessional finance itself, or
- not all of the benefits from any relevant concessional finance agreements are passed through to consumers, but:
 - the GFB providing concessional finance for the actionable ISP project to which the financeability request relates agrees to the TNSP submitting the 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.

Figure 3.2: TNSPs that have received concessional finance have additional eligibility requirements to apply for a financeability test



Source: AEMC

If this information is not provided to the AER, the TNSP is not 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 cash flow adjustment where the concessional finance is intended to achieve the same purpose as the cash flow 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.

79 Final rule, clause 6A.6.3A(e).

Where a TNSP receives concessional finance and the full benefits of that concessional finance are passed through to consumers, the TNSP is 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 do 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 financeability request relates and some or none of the benefits are passed through to consumers, we do not consider the TNSP should be prohibited from having its cash flows adjusted to address a financeability issue. This is because the concessional finance may have been 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.

While agreeing with this general approach, the AER, AEMO and Origin considered that all existing concessional finance agreements should be captured, not just those that were agreed after 14 December 2023.⁸⁰ These stakeholders were concerned that by not taking into account earlier agreements, a TNSP is more likely to be found to have a financeability issue and more cash flows would be brought forward than required at a cost to consumers. Similarly, Transgrid considered that financeability tests should consider the impact of all concessional finance, including agreements prior to 14 December 2023.⁸¹ The Commission does not consider that it is appropriate or practical to apply the financeability rule to agreements entered into prior to the date of the draft determination. Therefore the final rule is the same as the draft rule, limiting the inclusion of previous concessional finance agreements to those entered into after 14 December 2023. In practice, we understand that this will only exclude the concessional finance arrangement for Project Energy Connect.

The AER also considered the rule should clarify what is meant by "entered into" in respect of a concessional finance agreement, since there may be several stages of negotiation.⁸² Transgrid noted that the draft rule assumes the concessional finance agreement will be in place prior to the AER conducting the financeability test.⁸³ We note that the term "concessional finance agreement" is defined in the *Sharing concessional finance benefits with consumers* rule change as "An agreement between a *Network Service Provider*, or a related entity of the *Network Service Provider*, and a *government funding body* which the *government funding body* specifies to be such an agreement for the purposes of clauses 6.2.9(b) or 6A.3.3(b)." With the inclusion of the reference to the financeability process in this final rule, the Commission considers this definition provides sufficient clarity that, for the purposes of the financeability test, the relevant agreement is the one that the GFB specifies to be the concessional finance agreement. If a concessional finance agreement has not been entered into prior to a TNSP submitting a financeability request, the concessional finance agreement will not be taken into account in the financeability test.

Nexa Advisory considered that a TNSP should not be able to apply for a financeability test if it has received concessional finance and not all of the benefits flow to consumers.⁸⁴ For reasons set out above, the Commission continues to consider TNSPs should be able to apply for a financeability test, even where they have received concession finance and the TNSP retains some, or all, of the

80 Submissions to the Draft Determination: AER, pp. 5-6; AEMO, p. 1; Origin, p. 2.

81 Transgrid, Submission to the Draft Determination, p. 6.

82 AER, submission to the Draft Determination, p. 6.

83 Transgrid, submission to the Draft Determination, p. 6.

84 Nexa Advisory, submission to the Draft Determination, p. 5.

benefits. We consider the protections embedded in the financeability framework, including the requirement for the GFB to agree to requesting a financeability test (as discussed in the next section), provide appropriate protections such that TNSPs will not be able to game both concessional finance and the financeability test.

3.5.2 The GFB must agree to a financeability request and how the concessional finance benefits are treated

The Commission considers the GFB should have visibility over, and consent to, any request by the TNSP to have its cash flows 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:

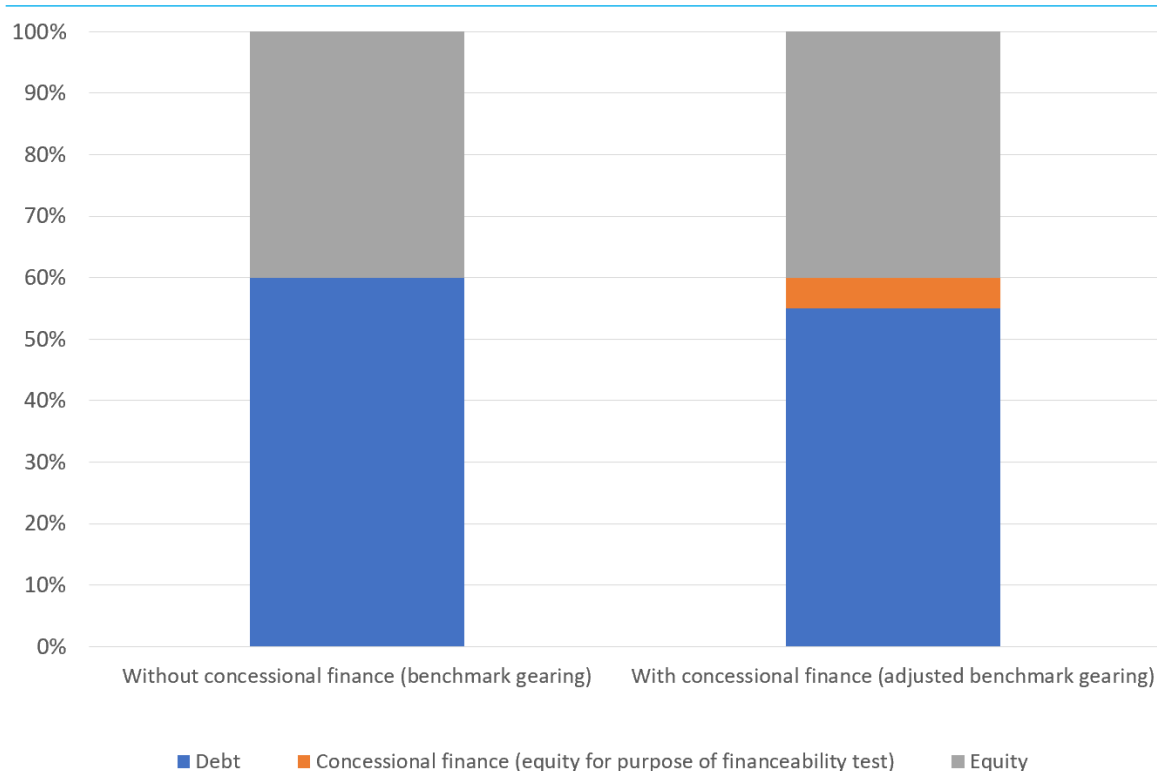
- otherwise the quantum of the benefit that flows to the TNSP will not necessarily be clear from the concessional finance agreement, particularly where some of the benefits flow to consumers and/or the concessional finance was received by a related entity of the TNSP, and
- concessional finance agreements 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.⁸⁵

To cater for a situation where a TNSP has received concessional finance that includes a concessional equity component (see diagram below), the GFB and TNSP may agree that the AER should adjust the benchmark gearing ratio to take into account the concessional finance. The benchmark gearing may only be adjusted by increasing the equity component (i.e. the equity component must not be decreased). This would have the effect of improving a TNSP's financeability compared to a counterfactual where the benchmark gearing ratio was used, minimising the need to bring forward cash flows.

⁸⁵ NER clause 6A.3.3(b) of the final rule for the *Sharing concessional finance benefits with consumers* rule change, 21 March 2024.

Figure 3.3: Example of adjusted benchmark gearing ratio for financeability test where TNSP has concessional finance



Source: AEMC

This change reflects feedback from the AER and CEFC, who considered that it was necessary for the AER to be able to use a gearing ratio other than the benchmark gearing ratio in the applicable RORI to properly account for hybrid financing instruments.⁸⁶ The Commission agrees that this approach is appropriate.

The Commission also considered requiring that the adjustment to give effect to the concessional finance benefits be an adjustment to the MAR or an alternative methodology, rather than a change to the benchmark gearing ratio. However, we concluded that it would be simpler and more transparent to enable the financeability test to reflect the concessional finance arrangement agreed with the GFB.

The Commission is satisfied that, under the final rule:

- The adjustment is to the benchmark gearing ratio to reflect the benefit of concessional finance agreement(s). The gearing ratio used for the purpose of the financeability test would not take into account the actual gearing of the TNSP. As such it preserves the benchmark approach.
- While the adjusted gearing ratio would be used in the PTRM, the adjustment only reflects the gearing ratio of the actionable ISP project. The adjusted gearing ratio would not impact the gearing ratio for the remainder of the TNSP's RAB. For example, if the actual gearing for the actionable ISP project as a result of the concessional finance was 50/50, the gearing ratio used in the PTRM may only be, for example, 58/42. The exact impact would depend on the

⁸⁶ Submissions to the Draft Determination: AER, pp. 4-5; CEFC, p. 2.

relative size of the actionable ISP project and the RAB. See the box below for a simplified example.

- The adjusted benchmark gearing ratio would only be used for the purposes of the financeability test. It would not be used in any other circumstances or change any other element of how the AER determines revenues.
- The final rule only allows the GFB and TNSP to adjust the benchmark gearing ratio by increasing the equity component and not increasing the debt component, for the purpose of a financeability test. This properly reflects the benefits of concessional finance provided to the TNSP.

The box below provides a simple example of how a concessional equity contribution could be treated as an adjustment to the benchmark gearing ratio.

Box 6: Example of how an adjustment to benchmark gearing might occur for a financeability test

Taylor Ltd is a TNSP with a current RAB (without any actionable ISP projects) of \$5 billion. Based on the benchmark gearing ratio, Taylor Ltd has an implied debt of \$3 billion and equity of \$2 billion.

Taylor Ltd is the local TNSP responsible for developing SwiftLink, an actionable ISP project. SwiftLink is expected to incur capex of \$1 billion, of which the TNSP contributes equity of 40% or \$0.4 billion. To help fund the project, Taylor Ltd has negotiated a concessional finance agreement with a GFB for the remainder amount of \$0.6 billion to fund the ISP. The concessional finance agreement includes a concessional equity component where:

- \$0.3 billion is treated as debt; and
- \$0.3 billion is treated as equity.

Taylor Ltd decides to apply to the AER for a financeability test, with the agreement of the GFB. Taylor Ltd and the GFB agree that the AER should adjust the benchmark gearing ratio in the PTRM for the purposes of taking into account the benefits of the concessional finance agreement to the TNSP.

Taylor Ltd's adjusted benchmark gearing ratio for the purpose of the financeability test in the PTRM is 55% debt and 45% equity, as explained in the calculations below.

- Total debt is \$3.3 billion. This is based on the assumed benchmark debt of \$3 billion (60% of \$5 billion RAB before the ISP project), plus concessional debt of \$0.3 billion for the actionable ISP project.
- Total equity is \$2.7 billion. This is based on the assumed benchmark equity of \$2 billion (60% of \$5 billion RAB before the ISP project), plus the TNSP's contribution of \$0.4 billion and concessional equity of \$0.3 billion for the actionable ISP project.

Table 3.1: Example of gearing ratio for financeability test where the TNSP has received concessional finance

	Without concessional finance	With concessional finance
RAB (\$ billion)	5	5
ISP capex (\$ billion)	1	1
RAB + ISP capex (\$ billion)	6	6
TNSP contribution for ISP project (40%)	0.4	0.4
Concessional debt for ISP project (\$ billion)	n/a	0.3
Concessional equity for ISP project (\$ billion)	n/a	0.3
Debt (\$ billion)	3.6	3.3
Equity (\$ billion)	2.4	2.7
Debt (%)	60%	55%
Equity (%)	40%	45%

Source: AEMC

This approach means that, over time, the gearing ratio for a financeability test carried out by the AER will be as follows:

- **If the TNSP has not received concessional finance** that the GFB and TNSP agree will require an adjustment to the benchmark gearing ratio, the financeability test will be based on the benchmark gearing ratio in the applicable RORI.
- **If the TNSP has received concessional finance** that the GFB and TNSP agree will require an adjustment to the benchmark gearing ratio by increasing the equity component in that ratio, the financeability test will be based on the benchmark gearing ratio in the applicable RORI, adjusted for one or more increases in the equity component.

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 applies to *all* concessional finance agreements for actionable ISP projects entered into after 14 December 2023 (i.e. the date the draft rule was published in this rule change).

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 cash flows that need to be brought forward and so reduce the impact on today's consumers. No stakeholders disagreed with this approach.

The AER suggested a further amendment to the rule to clarify who is responsible for informing the AER if there is a material change in the sharing of concessional finance benefits.⁸⁷ The *Sharing*

⁸⁷ AER, submission to the Draft Determination, p. 7.

concessional finance benefits with consumers rule change considered variations to a concessional finance agreement. However, the Commission considers this is not necessary for the financeability framework. The purpose of a financeability test is to determine whether there is a barrier to the TNSP making an investment decision, taking into account any concessional finance agreements entered into at that time. We do not propose to allow financeability tests to be re-opened to address a change in benefit sharing between the TNSP and consumers at a later point in time.

3.5.3 A TNSP that has received concessional finance must provide additional information with its financeability request

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 (to the extent it has not already been provided to the AER):⁸⁸

- a copy of every concessional finance agreement, including any amendments to it, 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;
- 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 final rule allows 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.⁸⁹

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.⁹⁰

Box 7: How concessional finance arrangements are incorporated into the Financeability and Concessional finance final rules

On 21 March 2024, the Commission published final 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 final 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:

88 Final rule, clause 6A.6.3A(f).

89 Final rule, clause 6A.6.3A(g).

90 Final rule, clause 6A.6.3A(h).

- 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 final 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 final rule includes transitional arrangements

Box 8: FINAL DETERMINATION - TRANSITIONAL ARRANGEMENTS

Transitional rules require the AER to publish its Financeability Guidelines by 31 December 2024, approximately 9 months after the commencement of the final rule. The transitional arrangements also allow TNSPs to submit a financeability request from the commencement of the rule, and for the AER to use its reasonable endeavours to give effect to the application of the financeability test before the Financeability Guidelines are in place.

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

Changes from draft to final rule

- Minor clarifications that if the AER has not yet published its Financeability Guidelines then the Guidelines do not apply and to refer to the relevant aspects of the financeability test

3.6.1 Transitional arrangements allow the financeability rule to take effect before the Financeability Guidelines are in place

The AER is required to publish its Financeability Guidelines approximately 9 months after the commencement date of the final rule.⁹¹ However, the AER is required to apply the rule once it commences, and before the Financeability Guidelines are in place.

Transitional rules allow a TNSP to submit a request for a financeability test from the commencement date of the rule on 29 March 2024. Transitional provisions allow for the AER's determination to approve or reject the request to be binding on both the AER and the TNSP.⁹²

While the AER may not have developed its Financeability Guidelines at this stage, and so the financial metrics and weightings will still need to be established, we consider that the final rule provides sufficient guidance to enable the AER to conduct a financeability test. Under the final rule, if the AER has not yet published the Financeability Guidelines, then the Financeability Guidelines will not apply to a financeability request that has been made.⁹³ If the Financeability Guidelines

⁹¹ Final rule, clause 11.167.2.

⁹² Final rule, clause 11.167.3(b)(3).

⁹³ Final rule, clause 11.167.3(b)(1).

have been published during the transitional period, then the Financeability Guidelines will apply to a financeability request made during the transitional period.

The transitional rules also require the AER to use its reasonable endeavours to give effect to the requirements set out in the final rule, including using similar metrics and weightings to credit rating agencies in applying the financeability test and addressing a financeability issue.⁹⁴

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 will use to determine the financeability position.

Stakeholders that commented on this transitional arrangement supported the early commencement of the financeability rule.⁹⁵ These stakeholders supported the rule commencing operation on the 29 March 2024, as the final rule.

3.6.2 The final rule does not include transitional arrangements relating to Transgrid's Humelink ISP project

The AER suggested that the Commission consider whether to include a transitional arrangement so that Transgrid is eligible to request a financeability test relating to the Humelink actionable ISP project.⁹⁶ The AER published Transgrid's final CPA 2 for Humelink on 1 March 2024⁹⁷, which did not include a request for a financeability test. The AER noted that Transgrid would be ineligible to apply for a financeability test for Humelink under the draft rule, given that the draft rule required that a request for a financeability test be submitted:

- with a CPA 2; and
- after the final rule, if made, was due to commence operation on 29 March 2024.

The Commission raised this matter with Transgrid. Transgrid did not seek to include a transitional arrangement so that it could request a financeability test for Humelink. The Commission therefore did not include such a transitional arrangement.

⁹⁴ Final rule, clause 11.167.3(b)(2).

⁹⁵ Submissions to the Draft Determination: ENA, p. 10; Origin Energy, p. 2; Transgrid, p. 2.

⁹⁶ AER submission to the Draft Determination, p. 6.

⁹⁷ Transgrid, Humelink CPA Stage 2 - A1 Principal Application, 21 December 2023. Published by the AER on 1 March 2024.

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.⁹⁸

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 sought 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.⁹⁹

The Commonwealth Minister considered that there is a foreseeable risk that financeability challenges could arise in relation to actionable ISP projects.¹⁰⁰ 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.¹⁰¹
- **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.

⁹⁸ See our website for more information on the rule change process: <https://www.aemc.gov.au/our-work/changing-energy-rules>

⁹⁹ Commonwealth Minister for Climate change and Energy, *Treatment of financeability for Transmission Network Service Providers— Rule change request*, 11 April 2023, p. 1.

¹⁰⁰ Rule change request, pp. 1-2.

¹⁰¹ 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.¹⁰²

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. 31.¹⁰³ 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.¹⁰⁴
- **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.¹⁰⁵

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.¹⁰⁶

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.¹⁰⁷

ENA's proposal considered that:¹⁰⁸

- 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.

¹⁰² ENA, *Ensuring the financeability of actionable ISP projects - Proposal to change the National Electricity Rules*, 9 June 2023

¹⁰³ ENA, *Ensuring financeability of ISP projects rule change - Letter to the AEMC*, 30 June 2023

¹⁰⁴ ENA, rule change proposal, p. 7.

¹⁰⁵ ENA, rule change request, p. 7.

¹⁰⁶ ENA, rule change request, pp. 8-9.

¹⁰⁷ AEMC, *Accommodating financeability in the regulatory framework*, Consultation paper, 8 June 2023, pp. 4-6.

¹⁰⁸ ENA, rule change request, p. 3.

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

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

- The Minister proposed 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 proposed to specify a financeability formula in the NER to ensure that regulated revenues for each ISP project¹⁰⁹ provide a benchmark credit rating and benchmark rate of return, based on benchmark gearing in the applicable RORI.

A.4 The rule change process

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.¹¹⁰ 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 and 12 submissions in the second round of consultation.

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

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).¹¹¹ These extensions were due to the complexity of the rule change request, such that further time was required to finalise the draft rule determination.

¹⁰⁹ This is ENA's preferred solution, where the financeability test is for each ISP project.

¹¹⁰ This notice was published under section 95 of the NEL.

¹¹¹ 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 final 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	Primary benefits	Stakeholders affected	Methodology
				QT = quantitative, QL = qualitative
Improving outcomes for consumers	Increase transmission costs, with low impact on consumers' total electricity bills	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.	All electricity consumers	QL: stakeholder feedback to assess all benefits and costs.
Principles of good regulatory practice	Additional administrative burden on the AER. New requirements on the AER to develop Financeability guidelines and assess financeability	Provide investor certainty about how the AER will conduct a financeability assessment by including clear direction in the NER on the financeability test, supported by prescription in guidelines (that the AER will be bound to apply) about how the AER will assess financeability.	<ul style="list-style-type: none"> • TNSPs • Investors in the energy sector • AER 	QL: stakeholder feedback to assess all benefits and costs.

Assessment criteria	Primary costs	Primary benefits	Stakeholders affected	Methodology
				QT = quantitative, QL = qualitative
	requests from TNSPs.			
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.	<ul style="list-style-type: none"> All Australians 	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.	<ul style="list-style-type: none"> AEMO TNSPs Generators Storage providers All electricity consumers 	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.	<ul style="list-style-type: none"> TNSPs Investors in the energy sector 	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 final rule determination.

C.1 Final rule determination and final rule

In accordance with sections 102 and 102A of the NEL, the Commission has made this final rule determination for a more preferable final rule in relation to the rule proposed by the proponents.

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

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

C.2 Power to make the rule

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

The more preferable final 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 final rule¹¹²
- its powers to make a more preferable rule¹¹³
- the rule change request¹¹⁴
- submissions received during the first round consultation
- the Commission's analysis as to the ways in which the final rule will or is likely to contribute to the achievement of the NEO
- the revenue and pricing principles¹¹⁵

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.¹¹⁶

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.¹¹⁷ The more preferable final electricity rule is compatible with AEMO's declared system functions because it does not change AEMO's functions in any material respect.

¹¹² See Appendix C.2

¹¹³ See Appendix C.2

¹¹⁴ See Appendix A

¹¹⁵ See section 2.1

¹¹⁶ 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.

¹¹⁷ Section 91(8) of the NEL.

C.4 Making electricity rules in the Northern Territory

The more preferable final 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 final 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 final rule be classified as civil penalty provisions or conduct provisions.

C.6 Review of operation of the rule

The more preferable final 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. This is consistent with the Commission's decision in the draft determination.

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:¹¹⁸

- 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.¹¹⁹ 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:

¹¹⁸ Minister's rule change request, p.5.

¹¹⁹ 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.

- **Humelink:** Transgrid's estimated environmental offset costs¹²⁰ of \$935m or around 28 per cent of the total estimated cost of \$3,317m¹²¹ for Humelink.¹²²
- **Project EnergyConnect:**
 - Transgrid: the AER approved environmental offset costs¹²³ of \$125m or around 7 per cent of the AER's total forecast expenditure of \$1,818m for Project EnergyConnect.¹²⁴
 - ElectraNet: the AER approved environmental offset costs¹²⁵ of \$3m or around 1 per cent of the AER's total forecast expenditure of \$457m for Project EnergyConnect.¹²⁶

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 assets¹²⁷ 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.¹²⁸ 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.

The ENA and Transgrid, while accepting that the rules currently permit biodiversity costs to be depreciated on an as incurred basis, considered the rule should go further and require biodiversity assets to be treated in this way.¹²⁹

The AER maintains that its standard approach to begin depreciating transmission assets only when they are commissioned and providing prescribed transmission services. The AER noted that

120 In NSW, environmental offset costs relate to biodiversity offset costs

121 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.

122 Transgrid's Final CPA 2 for Humelink included an estimated cost for the combined capex category of 'Easements and biodiversity offset costs' of \$634m or around 15 per cent of total capex for this ISP project. Transgrid did not provide an updated forecast capex amount for the individual category of biodiversity offset costs. Transgrid, *Hemelink CPA Stage 2 - A.1 Principal Application*, 21 December 2023. Published by the AER on 4 March 2024, p. 46.

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

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

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

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

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

128 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.

129 Submissions to the Draft Determination: ENA, p. 10; Transgrid, p. 8.

if there is a reason to depreciate an asset or category of assets on an “as incurred” basis—as may be the case for biodiversity offset costs—then the AER will consider such a proposal.¹³⁰

The Commission continues to consider that the AER is better placed to determine the treatment of biodiversity assets for depreciation purposes. However, as discussed below, we consider there are benefits in the AER setting out its approach in guidelines.

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 guidelines (e.g. its Financeability Guidelines that are required under the final rule). The AER may choose to 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.

This is consistent with the Commission’s decision in the draft determination.

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.¹³¹

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.¹³²
- 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.¹³³

In response to the consultation paper, stakeholders had mixed views on the need for additional guidance from the AER on the depreciation of all asset classes. They

also had mixed views on the depreciation of land purchased for biodiversity offset purposes.

Further details are available in Appendix D of the Draft Determination.

Few stakeholders commented on this issue in response to the Draft Determination, other than Origin Energy who supported the AER clarifying its approach to depreciation in the Financeability Guidelines.¹³⁴

As such, we continue to 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 Guidelines (see section 3.4). This is because biodiversity offsets are a

¹³⁰ Submission to the draft determination, p. 7.

¹³¹ Minister’s rule change request, p. 4.

¹³² NER clause 6A.6.3.

¹³³ 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.

¹³⁴ Origin Energy, Submission to the Draft Determination, p. 1.

new asset 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

A summary of other issues raised by stakeholders in the first round of consultation on this rule change are set out in Appendix E of the Draft Determination.¹³⁵

Table E.1 below summarises the other issues raised by stakeholders in the second round of consultation on this rule change.

Table E.1: Summary of other issues raised in submissions on the draft determination

Stakeholder	Issue	Response
Nexa Advisory, p.4	<p>Conflict of interest</p> <p>Nexa Advisory suggested that TNSPs (outside of Victoria) have a conflict of interest as the TNSP is both the planner of new transmission lines as well as the owner and operator of transmission lines. Nexa Advisory noted that the income and value of TNSPs is directly related to the RAB and the expansion of the RAB and TNSPs will be highly motivated to minimise risk to shareholder income and maximise income, through financeability requests and by seeking concessional finance.</p>	<p>The Commission notes that regulatory arrangements in the NEM around the planning, ownership and operation of transmission networks are out of scope for this rule change.</p> <p>The Commission supports providing TNSPs with the ability to request a financeability test, so that if there is a financeability issue, cash flow adjustments can be made by the AER to support timely delivery of actionable ISP projects. Our final rule enables this, as explained further in section 2.3.</p>

¹³⁵ AEMC, *Accommodating financeability in the regulatory framework*, Draft determination, pp. 39-45.

Abbreviations and defined terms

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
CEFC	Clean Energy Finance Corporation
CEIG	Clean Energy Investor Group
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
MLPL	Marinus Link Pty Ltd
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
RTN	Rewiring the nation
TNSP	Transmission Network service provider
TPIR	Transmission Planning and Investment Review
VNI	Victoria to NSW Interconnector