AEMC

INFORMATION

Draft determination on ElectraNet's financeability participant derogation

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

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

Submissions are due by 18 March 2021.

The Commission's draft determination

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

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

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

Reasons for the Commission's draft determination

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

In summary, the Commission has concluded the following:

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

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

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

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

ElectraNet's proposed rule

On 23 October 2020, the AEMC received a rule change request from ElectraNet in the form of a participant derogation (that is, an exception to applicability of the rules to it) in relation to the financeability of its share of actionable ISP projects.

ElectraNet asserts that the current revenue setting arrangements in the NER, together with the unprecedented level of transmission investment projected in the ISP, create unintended consequences in relation to the financeability of this increased level of investment. In particular, ElectraNet asserts that the approach to revenue setting under the Rules — that is, the regulatory asset base (RAB) is indexed for inflation and capex for depreciation purposes is only recognised when the project is commissioned — has the effect of producing delayed revenue recovery and consequently weak cashflows for new assets compared to existing assets. It considers this amplified for projects that are large relative to the RAB and have long asset lives.

Further, in this course of its analysis, ElectraNet considers an inconsistency in the current revenue setting process has been revealed — that is, this process adopts a BBB+/Baa1 benchmark credit rating but provides a revenue stream that is insufficient to sustain it. It considers that a lower credit rating increases the cost of debt and increases the possibility that the TNSP may be unable to obtain finance, threatening timely delivery of ISP projects.

To address this issue, ElectraNet has proposed to remove indexation of the RAB and move to depreciation as incurred for its share of current and future ISP projects. It states that its analysis shows that the proposed rule change would address the financeability issues arising from PEC.

Future considerations on timely and efficient delivery of transmission projects

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

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

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

Consultation

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

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