Final determination on ElectraNet's financeability participant derogation

Final rule determination

The Australian Energy Market Commission (AEMC or Commission) has made a final determination on the financeability of ISP projects rule change proposed by ElectraNet. ElectraNet sought a rule change to amend NER frameworks to bring forward cash flows for its share of current and future actionable Integrated System Plan (ISP) projects. The Commission's final determination is not to make the rule change.

The Commission's final determination

The Commission has made a final determination not to make the rule change (proposed in the form of a participant derogation). The final determination is the same as the draft determination.

The Commission has made its final determination following consideration of stakeholder submissions to the draft determination and additional advice from its consultant, Cambridge Economic Policy Associates (CEPA). The Commission remains of the view that the proposed participant derogation does not promote the National Electricity Objective (NEO).

The Commission recognises the importance of delivering ISP projects in an efficient and timely manner, consistent with meeting the NEO. However, based on CEPA's analysis and stakeholder feedback, the Commission considers the regulatory framework does not create a barrier to financing ElectraNet's share of current ISP projects (currently Project EnergyConnect (PEC)).

Options to support the timely and efficient delivery of large transmission projects that are in the long- term interests of consumers is a matter that will be explored by the AEMC further outside this rule change process.

Reasons for the Commission's final determination

In assessing the rule change request, the AEMC engaged CEPA to provide advice on the financeability of ISP projects. CEPA's advice helped inform the Commission's draft determination 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 ISP projects.

In making its final determination, the Commission has concluded the following:

- A notional transmission network businesses with an investment profile consistent with ElectraNet's share of Project EnergyConnect, financed at 60 per cent gearing and receiving the benchmark rate of return, would likely be able to retain an investment grade rating.
- 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. This also supports the case that ElectraNet's current investment profile is financeable within the current framework.
- There is no expectation that a transmission network business, such as ElectraNet, will adopt the benchmark efficient entity's capital structure. 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.
- Significant funding options are observed to be available in the market. This was supported by observations that networks in Australia had gained substantial debt and equity financing

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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. The Commission considers the rule proposed by ElectraNet would likely substantially increase costs to consumers in the near to medium term. While lower prices would flow through later in the life of the relevant ISP projects, the intergenerational wealth transfer caused by the proposed change would be unlikely to be in the long-term interests of consumers, particularly given that current consumers would be paying for benefits enjoyed by future consumers.

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

Further, ElectraNet considered there was an inconsistency in the current revenue setting process in that it adopts a BBB+/Baa1 benchmark credit rating but provides a revenue stream that is insufficient to sustain it. It considered 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 proposed to remove indexation of the RAB, incorporating it instead in the rate of return, and to move to depreciation as incurred for its share of current and future ISP projects. It stated that its analysis showed 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 no corresponding obligation. There is also no option for an alternative provider nor any consequence to the TNSP if the asset isn't built or is delivered late. This creates an environment of uncertainty around the timely delivery of future ISP projects.

In light of these issues and other work being carried out by the AER and jurisdictions in respect of large transmission projects, the Commission 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.

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