INFORMATION

Participant derogation - financeability of ISP projects

Overview of the rule change requests

The proponents consider that there are two aspects of the current economic regulatory framework which, when considered in the context of the unprecedented levels of transmission investment identified in the ISP, will create a profile of cash flows that will make it difficult for TransGrid and ElectraNet to obtain financing for their respective share of ISP projects. The two aspects of the current framework contributing to this issue are:

- indexation of the regulatory asset base (RAB) for inflation, and
- the recognition of depreciation when a project is commissioned rather than when expenditure on the project is incurred.

The changes proposed by TransGrid and ElectraNet to the National Electricity Rules (NER) therefore seek to:

- apply a nominal rate of return to an unindexed RAB, and
- allow depreciation 'as incurred' rather than 'as commissioned'.

Importantly, the changes proposed by TransGrid and ElectraNet would be applied to their share of ISP projects approved through the regulatory process after the date of commencement of the rule, plus any actionable ISP projects for which TransGrid and ElectraNet lodged a contingent project application with the AER after 1 September 2020 but before the commencement date.

The proposed changes would be applied to the proponents' share of ISP projects approved through the regulatory process. For TransGrid, the current ISP projects captured by the rule change request are:

- Project EnergyConnect (PEC) — TransGrid's investment for the New South Wales share of PEC is expected to be $1.94 billion, and
- HumeLink — an investment decision is expected to be made by late 2021.

In addition, TransGrid estimates the total investment required to deliver its share of ISP projects to be between $9 to 10 billion over the next ten years.

For ElectraNet, the current ISP project captured by the rule change request is South Australia's share of PEC. ElectraNet estimates its investment in PEC to be $474 million.

Issues for consultation

The rule change request raises a number of key questions which are further explained in the consultation paper. These include:

- Does the regulatory framework create a barrier to the financeability of the benchmark efficient firm?
- What are the implications of creating a second RAB for ISP assets?
- What are the consumer impacts of the proposed rules?
- How can financeability issues be addressed if the proposed changes are not made?
- Should there be transitional provisions until the next regulatory reset?

Stakeholders are invited to comment on these and other relevant issues.

Background

Transmission network service provides (TNSPs) are regulated by the Australian Energy Regulator (AER). Under the current economic regulatory framework for transmission set

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out in Chapter 6A of the NER, the AER sets TNSPs maximum annual revenue (MAR) with reference to the costs that an efficient firm would incur in building and running its transmission network. The two aspects of the regulatory framework relevant for these rule change request are:

- **The return on capital.** The AER uses a real rate of return framework by applying a nominal weighted average cost of capital (WACC) to an indexed RAB and a negative revenue adjustment through the depreciation component. Removing RAB indexation, as proposed by the proponents, would result in a nominal rate of return framework being applied to the proponents' ISP projects. The application of a nominal rate of return to an unindexed RAB would have the effect of front-loading cost recovery of these projects relative to the current real rate of return framework.
- **The return of capital.** Depreciation is recovered 'as commissioned'. This means that during the construction phase of a project, TNSPs do not earn a return of capital. The proponents have requested a change that would allow depreciation 'as incurred' for their actionable ISP projects. This would enable the proponents to earn a return of capital during the construction phase of these project.

Consultation process

The consultation paper and the rule change request are available on the AEMC's website. Stakeholders are invited to make submissions by 3 December 2020.

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