

8 February 2024

Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2000

Submitted via: <https://www.aemc.gov.au/contact-us/lodge-submission> (ERC0348)

Dear Ms Collyer,

Accommodating Financeability in the Regulatory Framework: Draft Determination

Nexa Advisory welcomes the opportunity to provide a submission on the AEMC's Draft Determination for the Accommodating Financeability in the Regulatory Framework (ERC0348) rule change, proposed by the Honourable Chris Bowen MP, Commonwealth Minister for Climate Change and Energy that sought to address the foreseeable risk that financeability challenges could arise for actionable Integrated System Plan (ISP) projects.

We do not support the draft determination decision by the AEMC which is based on a perceived risk to Transmission Network Service Provider (TNSP) credit ratings with no supporting evidence and in the face of a wealth of evidence that (a) the rule change is unnecessary and (b) the Australian Energy Regulator (AER) already has the powers needed to vary depreciation recovery on a transmission project.

There is lack of support for the rule change beyond regulated TNSPs

An assessment of the responses to the initiation paper¹ indicates that while respondents were supportive of the rule change as proposed by the Minister, there was:

- (a) No support beyond the regulated monopoly TNSPs and the ENA for the ENA rule change². The ENA rule change proposal entirely focused on Transgrid, and the financeability rule change is a re-prosecution of the earlier failed attempts^{3,4} by both the privately-owned monopoly TNSPs of Transgrid and Electranet to shift risk from their shareholders to consumers.
- (b) Ausnet Services did not support the ENA rule change, the only one of the monopoly TNSPs to prefer AER discretion, saying that "affordability for customers is of equal importance, especially given current cost-of-living pressures", and "Customers ultimately bear the risk from the design chosen to address this concern"⁵. Indeed, risks to customers was the primary reason the earlier attempts by Transgrid and Electranet derogations were rejected and it is interesting that Ausnet Services are the only TNSP to recognise the burden that will be placed on consumers should the rule be made as proposed in the Draft Determination.
- (c) Over half the respondents support contestability, covering a very broad range of consumers and industry, including AEMO, AER, AEC, Business NSW, EnergyAustralia, EUAA, Iberdrola and PIAC, suggested that where TNSPs were having difficulties investing in new transmission, then the project should be offered contestably to the broader market; and

¹ <https://www.aemc.gov.au/sites/default/files/2023-06/Consultation%20paper.pdf>

² <https://www.aemc.gov.au/sites/default/files/2023-07/ENA%20rule%20change%20request%20-%209%20June%202023.pdf>

³ <https://www.aemc.gov.au/rule-changes/participant-derogation-financeability-isp-projects-transgrid>

⁴ <https://www.aemc.gov.au/rule-changes/participant-derogation-financeability-isp-projects-electranet>

⁵ https://www.aemc.gov.au/sites/default/files/2023-08/ausnet_0.pdf

(d) AER discretion with a published guideline was the preferred approach, were the aspects of the rule change proposal that were supported.

This assessment of the responses to the initiation paper indicates there will be little support, beyond some of the regulated monopoly TNSPs, for the draft determination, which adopts many of the elements of the ENA rule change proposal, such as a specific formula and the “no worse off” approach.

The AEMC itself notes that “stakeholders were divided”⁶, while considering that alternative proposals were “not appropriate” pushing ahead to make a “worst of both worlds” draft determination.

No evidence presented that a problem exists

Despite the extensive work undertaken by the AEMC in assessing the original Transgrid and Electranet financeability rule change proposals^{7,8} for Project EnergyConnect, the Transmission Planning and Investment Review (TPIR) and the initial consultation paper for the current rule change proposal, no evidence has been presented that demonstrates that there are or are likely to be a financeability problems for ISP projects.

As the AEMC notes:

“revenue profiles are somewhat arbitrary”⁹

Suggesting that the need for any rule change is also somewhat arbitrary.

Additionally, the AEMC states that:

“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.”¹⁰

Further indicating that there is no need for a rule to be made, since the AER already has the powers needed to address financeability concerns.

In the April 2021 decision not to make the rules proposed by Transgrid and Electranet, the AEMC indicated that there were other routes available to the TNSPs to secure financing. No evidence has been presented by the TNSPs, their industry body, the ENA, or the AEMC that anything has changed since that 2021 decision.

Clearly, bar Project EnergyConnect (which has received financial support), new interconnectors are not being built, but the reasons for this are many and complex¹¹ and this rule change does nothing to resolve these serious blockers.

No evidence that the draft rule would resolve any perceived problem

While it’s true that the delivery of the new transmission that is needed to underpin a transition to a low carbon power system is delayed. The reasons for this are complex and include:

⁶ <https://www.aemc.gov.au/sites/default/files/2023-12/Draft%20determination.pdf>, page ii

⁷ <https://www.aemc.gov.au/rule-changes/participant-derogation-financeability-isp-projects-transgrid>

⁸ <https://www.aemc.gov.au/rule-changes/participant-derogation-financeability-isp-projects-electranet>

⁹ <https://www.aemc.gov.au/sites/default/files/2023-12/Draft%20determination.pdf>, page v

¹⁰ Ibid, page 16

¹¹ <https://nexaadvisory.com.au/site/wp-content/uploads/2022/04/Removing-transmission-roadblocks-discussion-paper-080422.pdf>

- Securing and maintaining social licence: Australia’s regional and rural communities will be expected to host new transmission lines and it is evident that these communities have not been appropriately engaged nor provided with any evidence of the benefits that they will receive for hosting new transmission (and renewable generation) projects¹². Shifting the risk from TNSPs to customers of financing new transmission will not resolve the need for social licence.
- Supply chain issues: Australia is a small player in a global environment where many countries are accelerating their own decarbonisation, resulting in significant competition for the equipment and resources needed to build new interconnectors¹³.
- Access to skilled people: As for equipment, there are a limited number of people internationally with the skills to build new large transmission lines.

Additionally, as the AEMC state, the TNSPs have an exclusive right, but no obligation to deliver actionable ISP projects and the draft rule does not resolve this issue.

The continuing re-prosecution by the TNSPs of financeability issues for ISP projects can be seen as the regulated monopolies leveraging the urgency of the need for new transmission to drive the market bodies, politicians and Australians into underwriting new transmission to deliver the critically important transition to clean energy.

This is even though the TNSPs and their shareholders will benefit from the vastly enhanced regulated income from their ISP-project enhanced Regulated Asset Base (RAB) for decades to come. In NSW alone, Transgrid anticipates growing its RAB to at least \$14 billion by building 2,500 km of new transmission in the next decade¹⁴ and as the regulated monopoly TNSP, Transgrid currently faces no competition or requirement to build the new lines at lowest cost or on time.

Risks are borne by energy consumers rather than TNSP shareholders

The current arrangements mean that Australian electricity customers, both big and small, will fund new transmission lines. Of the consumer groups that provided a response to the initial consultation there was no support for the proposed rule changes or AER discretion, with both organisations proposing contestability as a solution to the TNSPs inability to invest in ISP projects.

The AEMC in its current determination has reversed its earlier decisions on the previous derogations¹⁵, where it identified that:

“By applying depreciation as incurred ... the proposed rule would transfer some risks — in particular, inflation risk and completion risk — from TransGrid to consumers who are not best placed to manage these risks” and

“... [the] proposed rule would represent a significant departure from established principles of regulation in Australia. It has the potential to undermine the AER’s role in administering the regulatory framework.”

However, in just 2 years, the AEMC has determined that a similar rule *is* in the interests of consumers and that the transfer of risk from the TNSPs and its shareholders to Australian electricity customers *is* justified, inevitably resulting in higher electricity bills for householders and businesses, at a time when the higher costs of living and already high electricity prices are causing distress.

¹² Ibid

¹³ https://nexaadvisory.com.au/site/wp-content/uploads/2023/06/Nexa-Advisory_Transmission-Contestability-in-Australia-Research-Report-June-2023.pdf

¹⁴ <https://www.transgrid.com.au/media/avyondr4/system-security-roadmap-2023.pdf>

¹⁵ https://www.aemc.gov.au/sites/default/files/documents/erc0320_-_final_determination_-_transgrid_-_final.pdf

The extensive work undertaken by CEPA¹⁶ at the AEMC’s request to underpin the original April 2021 decisions to not make the TNSPs’ proposed rule changes, makes it clear that there are multiple avenues for a TNSP to gain finance for an ISP project without the need for changes to the depreciation profile. Further, the CEPA work occurred prior to the establishment of the Rewiring the Nation program, which provides additional options to support the delivery of ISP transmission projects.

Conflict of interest is not managed under the regulatory arrangements

Outside of Victoria, there is a conflict of interest where TNSP is both the planner of new transmission lines and owner and operator of transmission lines, and where the income and value of the company is directly related to the asset base and the expansion of the RAB.

The boards of the privately owned TNSPs are duty bound to act in the best interests of shareholders, not Australian electricity consumers. This duty means that TNSPs will be highly motivated to pursue options that will minimise risk to shareholder income, while maximising that income. This means that the TNSPs will undoubtedly pursue financeability claims with the AER (and seek concessional financing).

The AEMC in its draft determination have indicated that the TNSP can seek a decision from the AER on bringing forward depreciation as part of the Contingent Project Application (but not early works) following the Regulatory Investment Test – Transmission decision that an ISP project has net benefits for consumers.

The AEMC has not made it clear whether a TNSP can repeatedly seek a financeability assessment from the AER on a specific project, should its financeability position change (for instance undertaking another transmission project) or whether the assessment is made once and once only. The number of times a TNSP can seek a financeability assessment for a specific project needs to be clarified.

The prescriptive approach will drive gaming of the formula

While all stakeholders, including Ausnet Services and the Minister, bar the TNSPs and ENA, supported a principles-based approach, the AEMC has adopted the ENA’s suggestion of a prescriptive solution through a defined formula, albeit in an AER guideline rather than the Rules.

Having a prescriptive formula will allow the TNSPs to easily ensure that they will have a financeability problem that will obligate the AER to decide in their favour by varying the profile to bring forward depreciation, ensuring that consumers will bear increased risks and costs.

The Draft Rule does not align with the AEMC’s Rule Drafting Philosophy

We are concerned at the AEMC’s management of this rule change proposal.

The AEMC contends that by making a rule to address any future financeability challenges the TNSPs “may”¹⁷ have, and by streamlining the decision-making process to remove proper scrutiny, the draft determination is consistent with “good regulatory practice”.

However, the AEMC Rule Drafting Philosophy¹⁸, indicates that best practice regulation is based on:

- establishing a case for action before addressing a problem;

¹⁶ https://www.aemc.gov.au/sites/default/files/documents/cepa_response_to_submissions_-_final_report_7_april_2021.pdf

¹⁷ <https://www.aemc.gov.au/sites/default/files/2023-12/Draft%20determination.pdf>, page i

¹⁸ https://www.aemc.gov.au/sites/default/files/2020-11/Rule%20drafting%20philosophy_20201102_0.PDF

- exploring a range of feasible options must be considered, including non-regulatory approaches;
- assessing the costs and benefits of the various approaches;
- adopting the option that generates the greatest community benefit; and
- consulting effectively at all stages of the regulatory process.

Given that the AEMC, and the ENA, have not presented evidence that a financeability problem actually exists, the case for action has not been made.

The AEMC has not explored a full range of options and given the AER already has the powers required to address financeability, the case for the rule has not been made.

The draft rule is unlikely to expedite the delivery of new transmission lines because financeability is not the cause of delays in delivering transmission. The real issues, outside the regulatory framework, that are delaying the construction of new transmission lines, have not been addressed.

No formal cost-benefit assessment has been undertaken, even though the AEMC has already determined that the draft rule is beneficial to consumers.

Further, there will be no opportunity for the consumers, who will fund the transmission lines and bear increased risk as a result of the draft rule, to scrutinise the application from the TNSP and issues assessed by the AER.

In addition, the reversal in December 2023 of the April 2021 decision by the AEMC not to make a financeability rule change, without evidence, suggests the AEMC has deviated from the best practice set in its own Rule Drafting Philosophy.

If this draft rule was to proceed, which we urge the AEMC to reconsider and take an impartial view on this issue, then we ask the AEMC to consider the following:

Interaction with concessional finance

TNSPs will be able to receive concessional finance and a financeability assessment from the AER, where the full benefits of the concessional finance have been passed on to consumers.

There is a very real risk that TNSPs will “mine” the two options that provide financial incentives for TNSPs to deliver new transmission (concessional finance and a financeability adjustment) to maximise benefits to the business and shareholders (rather than consumers).

To minimise the opportunity for the TNSP to mine concessional finance, where any part of the concessional finance doesn't flow to consumers, the TNSP must be barred from seeking a financeability assessment from the AER. Currently, so long as some part of the concessional finance benefits consumers, even if a minor proportion, the TNSP can apply for a financeability adjustment.

Additionally, TNSPs can seek support from Rewiring the Nation. There are a myriad of ways the TNSPs can currently minimise their costs and maximise their profits, without placing further burdens on consumers with this financeability rule change.

Transparency needed (AER process)

Given that Australian consumers will fund all new transmission, with or without the proposed rule change, the process that both the TNSPs and the AER will undertake to determine whether there is or isn't a financeability issue for a given ISP transmission project needs to be transparent and must

give consumers the right to be consulted on both the TNSP's application and the AER's approach and decision.

Currently the draft rule does not require the TNSPs or the AER to undertake a public consultation on the financeability requests and assessments. This raises serious concerns on the lack of transparency and scrutiny.

We do not agree with the AEMC decision to remove the requirements for both an initial assessment request from the TNSP and an issues paper from the AER. There must be a public consultation on the financeability assessment and AER decision process.

Why not contestability?

The AEMC continues to dismiss contestability as an option to expediting the delivery of new transmission at lower cost, this is even though half of the respondents to the initial consultation raised contestability, unasked, as a possible solution to TNSP financeability issues.

If the regulated monopoly TNSPs are unwilling or unable to invest in the new transmission lines detailed in the ISP, then the Australian transmission market should be opened up to competition to allow the experienced unregulated entities operating in Australia to deliver the new transmission required.

The AEMC's, TNSPs and ENA's identification of a requirement to make specific financeability rules to enable the local monopoly regulated TNSPs to invest in new transmission strongly suggests that these local private companies are not financially robust enough to meet the needs of underpinning Australia's transition to a low carbon electricity system. Or suggests that the TNSPs are seeking to leverage their unique and exclusive right to build ISP-related transmission to enhance profits for their shareholders at the expense of Australian electricity consumers.

Thank you for the opportunity to provide input on the Draft Determination, we would welcome the opportunity to directly discuss our concerns with this rule change and the resultant impacts on consumers if it does progress. Please contact me, if you need further information.

Yours Sincerely

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