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### **Submission to the Proposed Financeability Guideline review**

Thank you for the opportunity to make a submission on the Australian Energy Regulator's (**AER**) *Proposed Financeability Guideline* review.

The Clean Energy Finance Corporation (**CEFC**) is a specialist investor in Australia's transition to net zero emissions by 2050. With access to more than \$30 billion from the Australian Government, we work with co-investors, industry and government to drive economy-wide investment in decarbonisation. The CEFC supports the development of a secure, reliable and affordable electricity system while lowering emissions through its investment activities. The Australian Government has allocated \$19 billion to the CEFC under its Rewiring the Nation (**RTN**) program to help spearhead the necessary transformation of Australia's electricity grid infrastructure.

This proposed guideline seeks to address the financeability concerns that some Transmission Network Service Providers (**TNSP**) have raised as a barrier to the development of large Integrated System Plan (**ISP**) transmission projects. The CEFC agrees there is a foreseeable risk that financeability challenges could arise in relation to large scale and/or concurrent actionable ISP projects, particularly during the construction phase of a project. The CEFC notes that the quantum and scale of actionable ISP projects presents a significant step change in business activities versus incremental network capex spend, and consequently can place pressure on a TNSP's credit metrics.

The CEFC has already seen financeability issues manifest in the delivery of large ISP actionable projects and has supported the financeability of projects EnergyConnect and VNI West to date. The CEFC believes this is an issue that should be addressed by the regulatory framework in the future and considers the finalisation of this guideline as a critical step towards this. Addressing financeability will ensure it does not delay the delivery of critical transmission infrastructure that will enable decarbonisation of the electricity network and put downward pressure on electricity prices.

### **CEFC's in-principle support for a model accepted by TNSPs**

Our approach to addressing financeability has been based on assessing TNSPs' actual financial positions because this is the basis on which credit ratings are set. The financeability rules, however, require the financeability guideline to be based on a benchmark TNSP analysis. In our view it is nevertheless important that the outcomes of the benchmark financeability assessment address TNSPs' concerns based on their actual credit metrics, without placing undue cost on electricity



consumers. Therefore, in considering the draft financeability guideline, the CEFC has been guided by two overarching principles: the application of the guideline:

1. Should be broadly calibrated to addressing the financeability concerns of actual, efficiently financed, TNSPs;
2. Must not materially or systematically over-compensate TNSPs at the expense of consumers.

In our February 2024 submission on the development of the financeability rules, we noted that a benchmark financeability assessment had the potential to achieve a fair balance between these principles but that this would be highly contingent on how the test is applied in practice. During the financeability guideline's consultation period, Energy Networks Australia (**ENA**) provided the CEFC with an amended financeability model for consideration, which we have considered against our principles. The main changes in the ENA's (compared to the AER's) model are the use of more granular credit rating bands and assessing financial metrics on an annual, rather than three-year average approach. On the basis that we understand ENA members support this model, we expect this model meets our first principle and will address TNSPs' financeability concerns. Similarly, we expect that the adoption of the ENA's model (or a similar model) will address TNSPs' financeability concerns and therefore future financeability issues will be resolved via the regulatory framework.

We examined this model from the perspective of whether, in our view, it would materially or systematically over-compensate TNSPs at the expense of consumers. We did this by comparing the model outcomes to those we would expect to see if TNSPs' actual financial positions were used. Our scenario analysis, while limited in scope, did not indicate that the model would materially or systematically overcompensate TNSPs, but note that the model may create revenue volatility (discussed later) which warrants further exploration. On that basis, we are in-principle supportive of the ENA's model with narrower credit rating bands. However, we encourage the AER to conduct further detailed scenario and sensitivity analysis on the outcomes, and make its own assessment on the correctness of the formulae and robustness of model's principles.

#### *Adopting narrower credit rating bands*

As noted, a key change between the ENA's and AER's respective models is that the ENA has adopted narrower credit rating bands. The Moody's bands published in its global methodology and subsequently adopted by the AER are very wide. For example, it suggests that scores in the FFO / Net Debt metric of 5%-11% would return a score of 12, however, this band represents the equivalent of a TNSP doubling its net debt (with no change to FFO) without any negative implications for this score. In practice, however, Moody's provides guidance in a narrower band when conducting an actual credit rating. We agree that the adoption of narrower bands, as proposed by the ENA, is both more reflective of actual credit rating assessments and is likely to better address financeability issues.



### *Method to address a financeability issue*

The AER's and ENA's financeability models do not specify in detail the way in which capex will be adjusted to address a financeability issue.

When conducting our analysis, the guideline states that firstly depreciation will be moved onto an as-incurred (rather than as-commissioned) basis. We believe that a different approach could be adopted to minimise the revenue bring forward associated with addressing the financeability issue which can reduce the near-term impact to consumers. For each year in which the financeability issue exists, the AER could take a portion of the remaining asset value of the new project and depreciate it over a single year (i.e. effectively convert the asset into revenue). The value of that asset depreciated over a single year is set to the minimum amount needed to address the financeability issue. By contrast, in the context of the new financeability rules which provide the AER with more discretion around changing depreciation profiles than was previously afforded, adopting as-incurred depreciation in the first instance may bring forward revenue in years where no financeability issue exists (as well as doing so for years where an issue does exist), and therefore may be a less targeted approach than the one we suggest. We note this has been the basis of our assessment of the ENA's model and our in-principle support for the model.

### *Volatility of the financeability model*

Notwithstanding our in-principle support for the ENA model, we note the model has the potential to create volatile revenue impacts (not all of the sources of volatility are due to changes that the ENA have made to the model; some were present in the AER model), which we do not consider is in the interests of consumers. For example, this volatility can be driven by:

- A deterioration in the Retained Cash Flows to Net debt (**RCF**) ratio—when this ratio declines, a significant amount of revenue must be brought forward to remedy the financeability issue given the high imputation credit payout ratios assumed under the regulatory framework in the Post Tax Revenue Model (i.e. the majority of the revenue brought forward that is assumed to be paid out to equity holders as dividends and does not end up supporting the RCF metric). We have noticed that often a material improvement in other credit metrics is needed to compensate for a deterioration in RCF, which results in significant revenue being brought forward and volatility in annual revenue.
- Adjusted Interest Coverage Ratio (**AICR**)—when addressing a financeability issue in the model e.g. that has been driven by a deterioration in the Funds From Operations (**FFO**) / Net Debt ratio, the bring-forward of depreciation that occurs to address the FFO / Net Debt ratio may result in a deterioration in the calculated AICR metric. This can make it more difficult to solve the financeability outcome. In some cases, more depreciation needs to be brought forward to further improve other credit metrics to offset the deterioration in AICR. This is not an outcome that would be expected in a real credit assessment given cash flow changes to address financeability are not expected to impact tax (depreciation) in the manner modelled.
- Move to a year-on-year financeability assessment—changing from a three-year average means that a deterioration in a single year must be



addressed in that year, which drives volatile outcomes. While we agree that some rating agencies may undertake a year-on-year assessment in the Australian market, we also understand rating agencies are often willing to look through a single year, once off event.

We encourage the AER to consider ways to reduce the volatility our modelling has indicated so that consumers do not experience undue swings in their electricity prices driven by this proposed guideline.

We and the ENA have constructively engaged on these observations in the lead up to our submission and have discussed a range of potential ways to overcome them. We look forward to continuing to engage with the ENA and AER to find a workable outcome.

#### *Net present value neutrality*

Our understanding is that any financeability adjustment made by the AER under this framework is intended to be Net Present Value (**NPV**) neutral in terms of its overall impact on revenues over the project's life. Our scenarios indicate this may not always be the case in practice. This would not be in the interests of TNSPs or consumers who may pay / receive more / less revenue than as determined in the revenue determination process, and it may not be consistent with the rules which do not envision this financeability framework as being a way to change total revenues. We encourage the AER to ensure the guideline results in NPV neutral outcomes.

#### *Notching vs linear interpolation*

The ENA's model contained two approaches for restoring a TNSP's financial position after the addition of a new project; a notched approach and a linear interpolation approach. The former would allow for some degradation in a TNSP's credit scores but only to the extent its credit rating would be preserved, while the linear interpolation approach would not allow for any reduction to base case scores. In the context of financeability, we consider movements within a band are acceptable and that the key consideration is ensuring TNSPs are not downgraded. This is because the former would not change a TNSP's cost of funds and therefore would not be expected to dissuade an investor from developing a project. On this basis, we support a notched approach over a linear interpolation approach.

#### *The 10-year financeability assessment period*

We note the version of the model we assessed retained the AER's proposed 10-year assessment time horizon, which we understand differs from the ENA's submission. Our analysis has not extended to assessing the model with this ENA proposed change. We would not support a lengthening of the financeability assessment period because in practice we have not observed a financeability issue persisting longer than this, and our benchmark scenarios have not indicated a true financeability concern persisting after 10 years. The longer the assessment



period, the more likely the model will show financeability issues that are a model construct rather than a true financeability issue.<sup>1</sup>

### *Impact of Concessional Finance Agreements*

With respect to the adjustment calculations for hybrids and concessional finance contained in both the ENA and AER financeability models, we note these are illustrative because the rules require the AER to adjust benchmark financeability outcomes in a manner specified in a Concessional Finance Agreement made between a TNSP and a Government Funding Body. Therefore, we do not comment on the appropriateness of the model's calculations in this submission.

We value the opportunity to provide input into this process and look forward to the opportunity to engage further with the AER. Should you wish to discuss this submission further, please contact Frans Jungerth, Associate Director - RTN at [REDACTED].

Sincerely,



Sara Leong  
Acting Chief Executive Officer

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<sup>1</sup> For example, bringing forward depreciation to address a real financeability issue reduces future revenues which can result in an artificial financeability issue appearing that is a function of the model not forecasting ongoing capex rather than a true financeability issue driven by the new project.