Public Interest Advocacy Centre

Finance changes for transmission projects

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About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is leading social justice law and policy centre. Established in 1982, we are an independent, non-profit organisation that works with people and communities who are marginalised and facing disadvantage.

PIAC builds a fairer, stronger society by helping to change laws, policies and practices that cause injustice and inequality. Our work combines:

- legal advice and representation, specialising in test cases and strategic casework;
- research, analysis and policy development; and
- advocacy for systems change and public interest outcomes.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program works for better regulatory and policy outcomes so people's needs are met by clean, resilient and efficient energy and water systems. We ensure consumer protections and assistance limit disadvantage, and people can make meaningful choices in effective markets without experiencing detriment if they cannot participate. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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Public Interest Advocacy Centre

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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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1. Introduction

PIAC welcomes the opportunity to respond to the AEMC consultation on accommodating financeability in the regulatory framework. In this submission we provide responses to the rule change requests from the Honourable Chris Bowen MP Minister for Climate Change and Energy and Energy Networks Australia (ENA).

PIAC does not support either rule change and does not consider that a financeability problem has been established. It may be reasonable to say that incumbent transmission network service providers (TNSPs) face financeability issues in the coming years as multiple large transmission projects are demanded as part of the transition. However, it does not follow that there is no supply of capital globally that would be willing to accept the returns and conditions provided by the National Energy Market (NEM) regulatory framework.

Framed with reference to the global capital market rather than the individual firm, the financeability problem to be solved is how to funnel the supply of capital willing to fund large infrastructure projects into identified projects in the NEM, within the regulatory settings and a system predicated on transmission provided by regulated monopolies.

Where potential financeability issues might threaten the viability of actionable Integrated System Plan (ISP) projects, these should be managed firstly by making the investments more contestable. The incumbent TNSPs can retain first rights to invest projects, and contestability would only be triggered where they decline to act. The operation of the asset would remain with the regulated monopoly provider.

Enabling contestability in this way would resolve any potential financeability issue without the inter-generational equity issues that would be created by altering depreciation paths.

Any new powers given to the AER to adjust depreciation paths should be reserved for use as a backstop after an investment contestation process for an actionable ISP process has failed.

In this case, it is preferable for the AER to be given discretion to alter depreciation paths as it deems necessary on a case by case basis with reference to a set of guidelines, per Minister Bowen's rule change request. These guidelines should include reference to the intergenerational equity impacts of any proposed change to a depreciation path. The AER should balance the costs for earlier consumers, and particularly disadvantaged and marginalised consumers, against the long-term interests of consumers in general.

2. Has a financeability problem been established?

It has not been clearly demonstrated that a financeability problem exists. The problem statement from Minister Bowen's rule change request reflects that from 2022's Transmission Investment Planning Review (TPIR), that the existing regulatory framework is not sufficiently flexible to address financeability challenges that may arise in the future. Specifically, given the number of large infrastructure projects needed at the same time, TNSPs may not be able to raise capital to finance projects efficiently.

This may be a relevant concern in relation to a single transmission service provider. However, if the question is asked with reference to the global capital market instead of the individual firm, the case for financeability issues is less clear or compelling. It is very likely that there is adequate demand for investment opportunities in large infrastructure projects in the global economy.

Large infrastructure projects can offer valuable diversification benefits to portfolio investors.[2] They have particular characteristics that set them apart from other assets:

> Long-term assets with a long economic life cycle, low technological risk, provision of key public services, strongly inelastic demand, natural monopoly or quasi-monopoly market contexts, high entry barriers, regulated assets, frequently a natural hedge against inflation and stable, and predictable operating cash flows.[3]

In addition to these, transmission assets are likely to qualify as eligible for green investment vehicles, such as ethical super funds.

Framed with reference to the global capital market rather than the individual firm, the financeability problem to be solved is not how to ensure individual TNSPs can manage the outlays of capital and delayed income streams while providing equity investors with adequate returns and not jeopardise their credit ratings and so cost of borrowing. Rather, it is how the supply of capital willing to fund large infrastructure projects can be funneled to NEM projects within the regulatory settings and within a system predicated on transmission provided by regulated monopolies.

3. A contestability model for transmission assets

There are two broad ways to connect the supply of capital for large infrastructure projects to the needs of the NEM: (a) the creation of special investment vehicles tied to individual projects, which would be owned and managed by the TNSPs; or (b) the opening up of ownership of transmission assets to contestability. That is, allowing entities other than the regulated monopoly providers in each jurisdiction to invest in and/or own and/or build assets. The operation of the assets in this option would always remain with the regulated providers.

PIAC's preferred option is the contestability model.

3.1 Overview of concept

The model of contestability outlined here is basic, but provides a transparent, principled and predictable framework for how the cost and risk of transmission investments could be shared between consumers, generators, transmission network service providers, and other investors. It is open to additional elements, such as government underwriting.

The essential points are:

[2] Demirel, H.C., Leendertse, W., and Volker, L. (2022) 'Mechanisms for protecting returns on private investments in public infrastructure projects'. *International Journal of Project Management*, 40(3), 155-166.
[3] *Ibid.* p.157.

- Early works including determining design and route, market testing of prospective generators, commencing planning and approval processes, and specifying prescribed capex will be completed by the monopoly provider, per the current situation.

- The monopoly provider will then have an opportunity to accept the revenue determination by the AER.

- If the monopoly provider refuses this, the transmission investment will be divided into two portions:
    - The first, consistent with the current cost recovery is rolled into the Regulated Asset Base (RAB) of the incumbent TNSP and is recovered through regulated revenue.
    - The second contestable portion is funded by a private speculative investor. This may be recovered in several ways.

- Once contestability is declared, a tender or reverse auction process occurs. The incumbent TNSP has the right to partake in this process, but if successful they are required to accept the project on the terms of the contestable process, not the original uncontested revenue determination.

- There are different options regarding the range of services open to contestability. The exception to this is operation, which will need to remain with the incumbent TNSP. Depending on the credentials of the speculative investor, however, owning and/or building the asset could be opened to contestation along with investment. How the financial arrangement would work would differ in each of these cases, and there are options within each scenario. As an example, where investment and ownership are won by a speculative investor, this investor would fund the incumbent TNSP to build the asset and would have capex returned to them from consumers under terms approved by the AER and determined through the tendering process. This would most likely be via a transmission use of service (TUoS) charge. The operation and maintenance would remain with the incumbent TNSP, who would recover costs via their opex allowance.

- There are different options with regard to cost allocation.
    - Option 1: the full costs could be borne by consumers, per the existing structures.
    - Option 2: the PIAC cost allocation model, outlined below based on the primary principle of beneficiary pays followed by causer pays, with costs recovered from generators and consumers across the NEM.

In summary, contestability of investment is used to overcome the financeability issues facing individual TNSPs in the NEM and enabling potential investors beyond the TNSPs to invest in transmission assets directly, while retaining adequate regulatory oversight of transmission services.

3.2 Regulating revenues within the existing cost allocation structures

It would be possible to open investment in transmission assets to contestability without altering the cost allocation principles.

Depending on the outcome of the tendering process, costs to cover the remaining services (certainly operation of the asset and possibly building and owning it) would be recovered by the TNSP via an increase to its regulated asset base (RAB).

The costs of the speculative investor would be recovered according to the terms agreed in the tendering process, which would be approved and overseen by the AER.

3.3 Regulating revenues using a beneficiary pays model

Instead of leaving cost allocation structures in place, PIAC advocates alterations to the cost recovery framework,[4] based on the following principles:

- Costs are recovered on a beneficiary-pays basis, such that the primary beneficiaries of a given investment or mechanism should pay for that investment.

- Where there are multiple beneficiaries, the costs should be recovered proportionally to their share of the benefits. This extends to consumers in other jurisdictions within the NEM, who pay a share of costs proportionate to the benefits they receive. It also extends to generators, who are key beneficiaries of new transmission builds, and so contribute to their costs.

- Where it is not practical and transparent to identify the beneficiaries, a causer-pays principle should be used.

- Cost recovery should also include the risk, to the extent it exists, of the underutilisation of assets and hence asset stranding. For example, it is appropriate that costs associated with other parties taking on more transmission investment are ultimately passed through to consumers as slightly higher wholesale costs.

- Cross-subsidies should only be permitted where they are immaterially small or widely accepted by the payers of the cross subsidy.

Risk is most efficiently borne by those parties best placed to manage it. Therefore, it is not appropriate for consumers to bear the risk of transmission asset underutilisation. Other parties should carry this risk through measures such as funding additional transmission investment to alleviate physical constraints or by underwriting financial instruments to cover the financial impacts of curtailment.

A fundamental aspect of the PIAC cost recovery model is that transmission capex is recovered from both generators and consumers, rather than just consumers.

Both the portions have elements that are approved by the regulator or some other administrative body and based on a range of factors.

[4] This framework is derived from the PIAC REZ cost recovery model and the PIAC interconnector cost recovery model. Contact the author for details of these.

4. A principles-based approach is preferable to a rules-based approach

PIAC does not support providing the AER with new powers to alter depreciation paths to address financeability concerns. We are not convinced that a financeability issue exists when taking the global capital market as the reference point rather than the individual TNSP. We do not see any cause to take the individual TNSP as the reference point.

If the AER is granted new powers, they should be a backstop to be triggered when (a) a TNSP refuses their right to accept the revenue determination of the regulator and (b) the subsequent contestable investment process fails.

Any new powers to alter depreciation paths should be exercised according to a principles-based approach rather than a rules-based approach..

Altering the depreciation path to bring revenue to transmission providers forward creates an intergenerational equity issue: it shifts costs from future consumers to current consumers, who do not receive the full benefits of the project.

This is particularly problematic in the context of an energy transition. During the transition, it is possible or even likely that energy costs are both high and volatile, relative to the steady states before and after the transition. After the transition, energy costs will be low and relatively stable. Moving costs forward from the later generation consumers to the transition generation consumers moves costs to the cohort less able to bear it.

There is further inequity is when considering the place of disadvantaged or more vulnerable consumers within the wider cohorts of consumers now and in the future. Disadvantaged or more vulnerable consumers are least able to protect themselves against the risks of high or volatile energy prices by using things like rooftop PV, demand response, or switching to smart or more efficient devices. Further, as the cost of these hedging tools can be expected to fall over time, disadvantaged consumers in the earlier (transition) cohort are less able to protect themselves from high or volatile energy prices relative to those in the later cohort.

Varying depreciation rates to bring forward revenue to TNSPs is a problematic solution to financeability concerns. While alterations to the depreciation path may be net present value-neutral from the perspective of the TNSP, this is not necessarily the case for the perspective of consumers, or all consumers.

If new powers are introduced, the AER should be mandated to consider the complex intergenerational equity effects of any alteration, and to balance these against the benefits of the long-term interests of consumers in general.

5. Concessional finance should not be used to manage financeability issues

The stated aim of the ENA rule change is to manage financeability issues without the use of concessional finance from government agencies. Likewise, Minister Bowen's rule change implicitly makes concessional finance the fallback solution to the financeability problem.

PIAC agrees with both Minister Bowen and the ENA that using concessional finance to manage financeability issues for actionable ISP projects is not ideal. It puts market bodies (specifically AEMO and AER) and governments under pressure to approve projects, and so drives up costs the service providers can demand. Ultimately it drives up the costs consumers pay for energy. If a fallback solution is required, government funding of transmission assets is preferrable to concessional financing.

6. Continued engagement

We welcome the opportunity to meet with the AEMC and other stakeholders to discuss these issues in more depth. Please contact Michael Lynch at mlynch@piac.asn.au regarding any further follow up.