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Mr Gavin Fox
General Manager, Network Pricing
Australian Energy Regulator

By email: ModelReviews@aer.gov.au

Dear Mr Fox

Response to Proposed Financeability Guideline

Transgrid welcomes the opportunity to respond to the Australian Energy Regulator's (AER) Proposed Financeability Guideline (Guideline). Transgrid notes the AER is required to develop the Guideline under the National Electricity Rules, and that this requirement follows the Australian Energy Market Commission's (AEMC) rule on accommodating financeability in the regulatory framework in March 2024.

Transgrid shares the Government's desire to accelerate the delivery of critical transmission infrastructure projects specified in the Integrated System Plan (ISP), which will put downward pressure on the costs faced by electricity consumers. The Australian Energy Market Operator's (AEMO) 2024 ISP explains that $18.5 billion of net benefits are expected to be obtained from the actionable ISP projects that form AEMO's Optimal Development Path, i.e., the costs of serving electricity consumers will be $18.5 billion lower if these projects proceed as planned. In addition to these benefits, AEMO also identifies these projects would deliver emissions reductions valued at $3.3 billion.

To support the timely delivery of actionable ISP projects, Transgrid notes that the AEMC's accommodating financeability in the regulatory framework rule introduced a whole of regulated business financeability test. Under this test:

- Where a regulated Transmission Network Service Provider (TNSP) is at or above a BBB+ benchmark (the benchmark credit rating used in the AER's rate of return instrument), the AER must provide cashflows to enable the regulated business to achieve a BBB+ benchmark when an ISP project is added.
- Where a regulated TNSP is below the BBB+ benchmark, the AER must provide cashflows so that the regulated business maintains its current position (this is referred to as the 'no worse-off' approach).

While Transgrid welcomes the AEMC's rule as a significant step forward, we maintain that it does not provide the certainty or potential outcomes that it intends and therefore may fall short of providing the confidence that investors need to proceed with the projects without Government support.

Transgrid also notes that the extent to which the rule change could solve a financeability issue will also significantly depend on the AER's Guideline. The AER's Proposed Guideline sets out the financial metrics the AER will use to determine a TNSP's financeability position under the financeability test and the weightings to apply to each financial metric. The Proposed Guideline also sets out how the TNSP's financeability position relates to the BBB+ benchmark (also referred to as the financeability threshold).

We provide our comments on the AER's Proposed Financeability Guideline in the remainder of this submission below. Overall, Transgrid welcomes the AER's approach to the Guideline although there are areas where important changes are required to ensure that the objectives of the AEMC's accommodating financeability rule are achieved to the extent possible. Transgrid has also contributed to Energy Networks Australia's submission to the Proposed Guideline and supports the views in that submission.

Transgrid's comments on the AER's Proposed Guidelines

Basing the financeability test on Moody's Global Rating Methodology for Regulated Electric and Gas Networks

Transgrid supports the AER's proposed approach of adopting the leverage and coverage score card in Moody's Global Rating Methodology for Regulated Electric and Gas Networks as a basis to calculate and define a TNSP's financeability position. We welcome this approach as it would enable TNSPs to replicate and predict the outcomes of the test as intended by the AEMC.

Proposed amendments to the AER's Proposed Guideline

Transgrid submits that two important amendments are required to the way the AER has adopted the leverage and coverage score card in Moody's Global Rating Methodology for Regulated Electric and Gas Networks to ensure the financeability test is fit for purpose and addresses significant financeability issues that may arise in practice, as intended by the AEMC. Currently, the application of the Proposed Guideline would fall short of addressing financeability issues with the ISP projects.

Using the leverage and coverage score card in Moody's Global Rating Methodology for Regulated Electric and Gas Networks, Transgrid submits that:

- The credit rating bands should be disaggregated to ensure that significant deteriorations in financeability are addressed. Under the Proposed Guideline, a TNSP could experience a significant deterioration in financeability, which could result in a credit rating downgrade, but which would go untreated under the AER's proposed approach. This issue is of particular concern for TNSPs involved in multiple ISP projects such as Transgrid. Disaggregating the credit rating bands by linear interpolation would enable this issue to be resolved, noting Moody's uses a similar approach in its Global Rating Methodology for other industries such as for Communications Infrastructure and Toll Roads, Real Estate Infrastructure Trusts and other commercial real estate firms. It would ensure that the financeability test accurately specifies each TNSP's financeability position and maintains it, rather than imprecisely defining its position as being within an excessively broad band.
- Cashflows should be assessed in each year independently and not averaged over a 3-year forward period for the purpose of the financeability test. In contrast to the AER's proposed approach, Transgrid notes that Moody's practice is to consider each year independently when conducting rating assessments of TNSPs in Australia. This approach is taken to ensure that financeability problems in individual years are identified and is regarded as particularly relevant when the TNSP is undertaking major capital programs such as ISP projects. As a consequence, the use of 3-year forward averages,

as proposed by the AER, would be inconsistent with Moody's actual practice in Australia and could inadvertently mask financeability problems that would result in a credit rating downgrade.

Transgrid considers these amendments are consistent with the AER's approach of using the leverage and coverage scorecard in Moody's Global Rating Methodology as a basis to determine a TNSP's financeability position. Transgrid notes that Energy Networks Australia's submission provides further detail on these issues and how our proposed amendments would solve these issues.

Issues to be confirmed in the Guideline

To a large extent, the Proposed Guideline clarifies how the financeability test will be applied in practice, However, Transgrid notes that the Guideline does not explain how it would apply the financeability test in circumstances where a TNSP submits two (or more) actionable ISP Contingent Project Applications (CPA) close together so the resolution of the financeability issues in relation to the first project are not known at the time of the second actionable ISP CPA.

Under the proposed Guideline, the combined effect of actionable ISP CPAs needs to be known in order to check whether the second actionable ISP CPA will push the TNSP below the existing credit band. However, this may not be achievable in practice if the TNSP's financeability request (and therefore its financeability position) following the determination of the first actionable ISP CPA is unknown at the time of submitting the second actionable ISP CPA.

In contrast to the banded approach, the linear interpolation approach has the advantage that the TNSP's financeability position will be unaffected by the first actionable ISP CPA (consistent with the AEMC's intentions). Under the linear approach, therefore, the application of the financeability test for the second actionable ISP CPA can be applied independently of the first CPA. Accordingly, the financeability test is more easily applied under the linear approach rather than the banded approach.

Transgrid considers it important that the AER has regard to the practical operation of its financeability test, including details of how it applies to multiple actionable ISP project CPAs. As explained above, Transgrid's position is that the linear interpolation approach can be applied more easily than the banded approach.

Transgrid has also identified a number of improvements to the AER's proposed financeability model to better align it with the approach specified in the Proposed Guideline and note we are in the process of engaging with AER staff on these improvements. The proposed improvements are set out in ENA's submission. Of particular note, the calculation of the adjustment to debt costs as a consequence of hybrid finance needs refinement to ensure that the model accurately reflects the interest costs faced by a TNSP that has benefited from hybrid finance.

Closing comments

As noted above, Transgrid welcomes the general approach the AER has taken in the Guideline to help resolve the financeability issues associated with actionable ISP projects. Transgrid considers our proposed modifications, and those identified by Energy Networks Australia, will help ensure the Guideline is fit for purpose and promotes the long-term interests of consumers in accordance with the National Electricity Objective.

We look forward to working with the AER as it finalises the Guideline in the coming months. If you have any queries regarding this submission, please contact Neil Howes in the first instance by email at neil.howes@transgrid.com.au

Yours faithfully

Monika Moutos
General Manager Regulation and Policy