

# Regulatory framework for the Transmission Efficiency Test and Regulator's determinations for network infrastructure projects

Policy paper





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Regulatory framework for the Transmission Efficiency Test and Regulator's determinations for network infrastructure projects

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# Shortened forms

| Term                  | Meaning   |
|-----------------------|---|
| AEMC                  | Australian Energy Market Commission   |
| AEMO                  | Australian Energy Market Operator   |
| AER                   | Australian Energy Regulator   |
| CESS                  | Capital efficiency sharing scheme   |
| DNBP                  | Distribution network service provider   |
| Draft Guidelines      | Draft Guidelines developed by the Regulator on the TET and revenue determinations for contestable network infrastructure projects |
| EBSS                  | Efficiency benefit sharing scheme   |
| EII Act               | <i>Electricity Infrastructure Investment Act 2020</i>   |
| EnergyCo              | Energy Corporation of NSW, appointed as the Infrastructure Planner under the EII Act  |
| IIO Report            | Infrastructure Investment Objectives Report   |
| ISP                   | Integrated System Plan  |
| LTESA                 | Long-term Energy Service Agreement  |
| National framework    | The regulatory framework under the National Electricity Law and National Electricity Rules  |
| NEL                   | National Electricity Law  |
| NEM                   | National Electricity Market   |
| NER                   | National Electricity Rules  |
| NSP                   | Network service provider  |
| OECC                  | Office of Energy and Climate Change within NSW Treasury   |
| PTIP                  | Priority transmission infrastructure project  |
| RAB                   | Regulatory asset base   |
| Regulator             | The Australian Energy Regulator appointed as a Regulator <sup>1</sup> under the EII Act   |
| Revenue determination | A determination of the amount payable to a Network Operator made by the Regulator under section 38(1) of the EII Act              |
| REZ                   | Renewable Energy Zone   |
| RIT-T                 | Regulatory investment test for transmission   |
| RNIP                  | REZ network infrastructure project  |
| SFV                   | Scheme Financial Vehicle  |
| TET                   | Transmission Efficiency Test  |
| TNSP                  | Transmission network service provider   |

<sup>1</sup> IPART has also been appointed to undertake certain functions under the EII Act.

# Summary

This paper provides an overview of the regulatory framework within which the Regulator will undertake the Transmission Efficiency Test (TET) and revenue determination for network infrastructure projects under the *Electricity Infrastructure Investment Act 2020* (NSW) (EII Act). The Australian Energy Regulator (AER) is the Regulator for Part 5 of the EII Act.

It includes a summary of the provisions of the EII Act relevant to the Regulator's functions under Part 5 of that Act as well as the policy intent that will be used to inform regulations and the Regulator's Guidelines.

The EII Act permits a Network Operator to be selected on a project-specific basis, which introduces the opportunity for competition in the construction and operation of network infrastructure. Where feasible, the Infrastructure Planner is expected to conduct a competitive process to procure network infrastructure projects. This paper focuses on contestable network infrastructure projects.

This paper is published at the same time as the draft Guidelines are published. This paper aims to assist stakeholders to better understand what the draft Guidelines cover, how they implement the policy intent and how they fit into the broader regulatory framework. It will also enable stakeholders to provide more informed submissions to the Regulator on the draft Guidelines.

A high-level summary of the approach and process for revenue determinations for non-contestable network infrastructure projects is also included in this paper. The Office of Energy and Climate Change and the Regulator are continuing to develop the framework for non-contestable network infrastructure projects, which is intended to reflect the approach to economic regulation under the National Electricity Rules. More details will be made available later in 2022 as part of the development of the regulations and the Regulator's draft TET and Revenue Determination Guidelines for non-contestable projects.

Network infrastructure projects can be 'REZ network infrastructure projects' or 'priority transmission infrastructure projects', each as defined in the EII Act. The revenue determination arrangements for these projects are largely similar and therefore this paper refers to them collectively as 'network infrastructure projects'. Any material differences are noted.

Network infrastructure projects could involve either transmission or distribution assets, or a mix of both. The regulatory framework for the TET and revenue determination for network infrastructure projects will not distinguish between transmission and distribution assets and will regulate both types of assets in the same manner.

# Introduction

This paper explains the proposed nature, scope, timing and process of the Transmission Efficiency Test (TET) to be undertaken and the revenue determination to be made by the Regulator for network infrastructure projects under the NSW *Electricity Infrastructure Investment Act 2020* (EII Act), with a focus on contestable projects. It is published at the same time as the draft Guidelines developed by the Regulator on the TET and revenue determinations for contestable projects (see 'More information' at the end of this document). The Australian Energy Regulator (AER) is the Regulator for Part 5 of the EII Act.

The purpose of this paper is to provide stakeholders with an overview of the broad regulatory framework within which the Regulator's draft Guidelines will operate. It includes a summary of the policy intent that will be used to inform the regulations to be made under the EII Act relevant to the Regulator's functions under Part 5 of the EII Act that include undertaking the TET and making a revenue determination for a contestable network infrastructure project.

This paper also provides stakeholders with an update on the key issues raised in submissions to the Network Infrastructure Projects (Part 5 of the EII Act) Policy Paper (Part 5 Policy Paper), published in October 2021.

The information provided will enable stakeholders to:

- better understand the policy context for the Regulator's draft Guidelines and why they cover what they do, and
- provide more informed submissions to the Regulator on its draft Guidelines.

The Office of Energy and Climate Change (OECC) is not seeking submissions on this paper. The policy intent regarding the TET and revenue determination has been established via the legislative process and further detail has been developed via the Network Infrastructure Projects (Part 5 of the EII Act) Policy Paper process (discussed further below).

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## Focus of this paper

The EII Act and its regulations enable Network Operators to be selected to undertake network infrastructure projects in one of 2 ways:

- Where the Infrastructure Planner considers feasible, a Network Operator may be selected through a competitive procurement process run by the Infrastructure Planner, where proponents will compete to carry out the network infrastructure project (referred to as contestable network infrastructure projects). In deciding whether or not to conduct a competitive process, the Infrastructure Planner may consider factors such as the separability of the new infrastructure from the existing network and the capacity and capability of the market to deliver the project in the time required.
- Where a competitive process is not considered feasible by the Infrastructure Planner, the Infrastructure Planner will directly select the Network Operator to carry out the network infrastructure project (referred to as non-contestable network infrastructure projects).

In both cases, a project must then proceed through the relevant authorisation or direction process.

The focus of this paper is on the Regulator's functions under Part 5 of the EII Act for contestable network infrastructure projects. The paper also provides a high-level summary of the proposed regulatory framework for the TET and revenue determinations for non-contestable network infrastructure projects. The OECC and the AER are continuing to develop the framework for non-contestable network infrastructure projects, which is intended to largely reflect the approach to economic regulation under the National Electricity Rules (NER). The relevant regulations and a further set of draft AER Guidelines for non-contestable network infrastructure projects are intended to be released later in 2022.

Network infrastructure projects can be 'REZ network infrastructure projects' (RNIPs) or 'priority transmission infrastructure projects' (PTIPs), each as defined in the EII Act. The revenue determination arrangements for these projects are largely similar and therefore this paper refers to them collectively as 'network infrastructure projects'. Any differences between RNIPs and PTIPs are noted.

In addition, network infrastructure projects could involve either transmission or distribution assets, or a mix of both. The regulatory framework for the TET and revenue determination for network infrastructure projects will not distinguish between transmission and distribution assets and will regulate both types of assets in the same manner.

# Overview of the Electricity Infrastructure Roadmap

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## What is the NSW Electricity Infrastructure Roadmap?

The Electricity Infrastructure Roadmap (the Roadmap) is the New South Wales (NSW) Government's plan to transform our electricity sector into one that is cheap, clean and reliable. It is enabled by the EII Act, which passed into law with strong bi-partisan support in December 2020. The Roadmap facilitates the declaration of Renewable Energy Zones (REZs), authorises new network infrastructure, and encourages private investment.

The Roadmap is intended to coordinate investment in new network infrastructure with investment in new energy generation, long duration storage and firming infrastructure. Generation infrastructure is expected to be developed primarily within REZs, though some projects may be located outside these zones.

Network infrastructure is needed to ensure the electricity produced within the REZs can supply load centres. This network infrastructure includes both greenfield infrastructure, connecting REZ generation to the existing network, and brownfield infrastructure, augmenting existing network infrastructure. Network infrastructure includes transmission and distribution infrastructure, such as power lines and substations, as well as non-network solutions and other technologies or services that provide system strength, enhance energy transfer capacity or other system security services.

### Intent of the Roadmap

- Address the 'chicken and egg' problem, where both new REZ network investment and new generation investment need certainty of each other before they can go ahead
- Bring forward replacement generation and supporting REZ network investment to avoid price shocks that may result from the retirement of existing generation assets, and
- Enable important network projects to progress to development in a faster timeframe than has traditionally occurred

Part 5 of the EII Act establishes a new NSW-specific framework for:

- selecting Network Operators to carry out identified network infrastructure projects (the authorisation or direction process)
- calculating the prudent, efficient and reasonable capital costs for the development and construction of network infrastructure projects (the TET), and
- determining the amount payable to Network Operators authorised or directed to carry out network infrastructure projects (the revenue determination process).



The EII Act also allows for a broader suite of costs and benefits – including environmental externalities, fostering local community support, financing arrangements and other factors – to be considered by the infrastructure planner in making assessments and recommendations for a network infrastructure project, including selecting project options, staging and funding projects, and cost recovery for projects.

To enable greater oversight of the REZ network planning and investment processes in NSW, the EII Act also establishes new functions for the Minister and creates new roles and entities, such as the Infrastructure Planner and the Consumer Trustee.

The EII Act also provides for reliability-based approval processes for PTIPs in response to breaches of the energy security target.<sup>2</sup>

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## Implementing the Roadmap

Following the public release of the Roadmap in November 2020, the OECC (previously part of the NSW Department of Planning and Environment) established a taskforce to coordinate and drive its implementation and detailed policy design. While the EII Act sets out overarching legislative requirements for the Roadmap, there are detailed design issues that must be resolved by way of options including regulations, rules, guidelines and contracts.

The regulations needed under the EII Act are being developed by the OECC in tranches. The first tranche of regulations, specific to the Renewable Energy Sector Board, were made in March 2021. The OECC consulted on tranche 2, relating to urgent and mechanical policy details, in May 2021.

A third tranche of regulations will cover regulations relevant to Parts 5, 6 and 7 of the EII Act, including network infrastructure projects (which are regulated under Part 5 of the Act). The regulations for network infrastructure projects will be progressed as follows:

- regulations for contestable network infrastructure projects are expected to be made in June 2022, and
- further regulations for non-contestable network infrastructure projects are expected to be made in the second half of 2022.

The OECC sought feedback from stakeholders to inform the development of regulations in October and November 2021. This included the release of the Network Infrastructure Projects (Part 5 of the EII Act) Policy Paper. This paper related to how RNIPs are proposed to be assessed and selected, and the proposed process and approach for the TET and the Regulator's revenue determination.

The OECC received 32 submissions on the policy paper and over 100 registrations for an interactive online session held on 4 November 2021. A recording of that session, the OECC's presentation and non-confidential submissions are available to view on the Roadmap's 'Regulatory framework' webpage.

This consultation process has informed the development of policy positions and the regulatory framework supporting the TET and revenue determination process that are summarised in this paper.

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<sup>2</sup> The NSW Government has established an Energy Security Target to provide the market with certainty around how much new electricity is needed to deliver a reliable energy system over the medium to long term. The Energy Security Target serves as an additional framework that complements the existing national reliability measures.

# Network infrastructure projects – roles, responsibilities and activities

This section provides an overview of the roles, responsibilities and activities of key parties involved in the planning, delivery and recovery of costs associated with network infrastructure projects in NSW under the EII Act.

It also highlights the key differences between the NSW regime and that at the national level under the National Electricity Law (NEL) and NER, including in respect of the AER's role under the national framework and as the Regulator under the EII Act.

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## Overview of NSW EII Act framework

### REZ network infrastructure project authorisation or direction

Part 5 of the EII Act establishes a NSW-specific framework for recommending network infrastructure projects and authorising or directing a Network Operator to carry out a specific network infrastructure project.

There are 3 key stages involved in authorising or directing a Network Operator to carry out an RNIP.

#### 1. Identification of a network infrastructure project

The Consumer Trustee is required to prepare an Infrastructure Investment Objectives Report (IIO Report) every 2 years. The IIO Report contains:

- a 20-Year Development Pathway setting out the generation, long duration storage infrastructure and (as required) firming infrastructure required to be constructed over the following 20 years to achieve the infrastructure investment objectives set out in the EII Act, and
- a 10-Year Tender Plan for competitive tenders for Long-Term Energy Service Agreements (LTESAs) over the following 10 years to give effect to the Development Pathway.

The IIO Report will also set out the network infrastructure investments necessary to give effect to the 20-Year Development Pathway. It will be informed by a network investment strategy prepared by the Infrastructure Planner, with input from the Australian Energy Market Operator (AEMO) and the Jurisdictional Planning Body (Transgrid).

A REZ declaration is the first step in formalising a REZ under the EII Act. It sets out the intended network capacity, geographical area and infrastructure that will make up the REZ.

#### 2. Assessment and recommendations for the network infrastructure project

The Infrastructure Planner will next assess and make recommendations for the network infrastructure investments necessary to deliver a network infrastructure project. To avoid delays that can arise under the national framework, certain preparatory activities and early development works (including planning studies and community consultation) may be undertaken by the Infrastructure Planner prior to the authorisation of a network project.

For contestable projects, the Infrastructure Planner may elect to run a competitive procurement process to select a Network Operator to recommend to the Consumer Trustee to carry out the network infrastructure project. Where contestable provision is not feasible, an incumbent Network Operator (such as Transgrid for transmission projects) may be recommended.

The Infrastructure Planner will make recommendations to the Consumer Trustee regarding REZ network infrastructure projects and Network Operators that may be authorised or directed to carry out a specific project.

### 3. Authorisations or directions for the network infrastructure project

The Infrastructure Planner will make recommendations to the Consumer Trustee regarding RNIPs.

The Consumer Trustee will consider whether to authorise the Network Operator to carry out a specified RNIP under section 31 of the EII Act, having regard to:

- its IIO Report which, amongst other things, sets out objectives to deliver certain amounts of generation infrastructure over time, and
- its duty to act in the long-term financial interests of NSW electricity customers.

If the Consumer Trustee authorises a Network Operator following the Infrastructure Planner's recommendation, it must confidentially set a maximum amount for the prudent, efficient and reasonable capital costs for the development and construction of the project. This cap sets an amount above which the capital costs of the network infrastructure project would no longer be justified.

Alternatively, the Consumer Trustee may recommend to the Minister that the Minister give a direction to a Network Operator to carry out an RNIP. The Minister may then direct a Network Operator to carry out an RNIP under section 32 of the EII Act.

### Priority transmission infrastructure project directions

The EII Act sets out the process for the Minister to authorise or direct a Network Operator to carry out a PTIP. The Minister may only direct a Network Operator to carry out a PTIP in response to a breach of the Energy Security Target that is identified in an Energy Security Target Monitor Report.<sup>3</sup>

The Consumer Trustee authorisation process and maximum cap on capital costs described above do not apply to PTIPs. However, a Network Operator for a PTIP could be selected via a contestable or non-contestable process, similar to the process for RNIPs, depending on the circumstances.

### Network infrastructure project cost recovery

Part 5 of the EII Act also establishes a NSW-specific process for the Regulator to determine the amount payable to a Network Operator authorised by the Consumer Trustee or the Minister, or directed by the Minister (as applicable), to carry out a network infrastructure project.

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<sup>3</sup> The Energy Security Target Monitor Report assesses whether forecast available firm capacity in NSW is sufficient to meet the Energy Security Target for each of the next 10 financial years.

The Regulator's determination must include the amounts for specified cost components as set out in the EII Act or prescribed in the regulations, including repayment of capital costs as calculated under the TET, return on capital costs and an allowance for operating costs.

Before making a determination, the Regulator will undertake the TET to calculate the prudent, efficient and reasonable capital costs for development and construction of the project. The amount determined by the Regulator under the TET must not exceed the maximum amount notified to the Regulator by the Consumer Trustee for an RNIP.

For Network Operators selected through a contestable and non-contestable process, the process and approach to the TET and revenue determination will differ, as explained in later sections of this paper and the Regulator's draft Guidelines.

Once the Regulator has made its revenue determination, the Scheme Financial Vehicle (SFV) is required to pay the Network Operator the amount payable under the determination as a component of the annual contribution determination made by the Regulator. The contribution determination amount will be recovered from NSW distribution network service providers (DNSPs) through contribution orders made by the SFV that require DNSPs to pay this amount into the electricity infrastructure fund that is maintained by the SFV. These amounts will ultimately be recovered from NSW electricity consumers through their retail electricity bills.

The EII Act requires the Regulator to remake a revenue determination once every 5 years and when directed by the Consumer Trustee. In addition, the Regulator may review and remake a determination at any other time. The regulations to the EII Act will provide further details on the Regulator's process to review and remake a revenue determination.

## Key parties

The planning and delivery of RNIPs in NSW involves a coordinated effort between the Consumer Trustee, Infrastructure Planner, Regulator and Network Operators, including the primary transmission network service provider (TNSP) and relevant DNSPs.

A summary of the key roles and responsibilities is set out in Table 1.

Table 1 Roles and responsibilities of key parties involved in network infrastructure projects

| Entity   | Roles and responsibilities  |
|--|---|
| <b>Infrastructure Planner – Energy Corporation of NSW (EnergyCo)</b> | <ul style="list-style-type: none"> <li>• The Infrastructure Planner is responsible for assessing and making recommendations to the Consumer Trustee on RNIPs.</li> <li>• The EII Act requires EnergyCo to be appointed as the Infrastructure Planner for the 5 REZs specified in the EII Act.</li> <li>• For contestable projects, the Infrastructure Planner will undertake a competitive procurement process to select the preferred Network Operator(s) to carry out the network infrastructure project. As part of this process, the Infrastructure Planner will consult with the Regulator on the development and implementation of a contestable procurement strategy and submit a report to the Regulator on the procurement process.</li> <li>• The Infrastructure Planner is also responsible for undertaking preparatory activities and early development works for RNIPs, which will assist in further scoping a project and gaining the social license for the project through community engagement. Once a Network Operator is authorised or directed to undertake the network infrastructure project, the Network Operator will be required to reimburse the Infrastructure Planner for its costs in undertaking such activities and works and amounts for those costs will be included in the revenue determination.</li> <li>• The Infrastructure Planner, with input from AEMO, the Jurisdictional Planning Body (Transgrid) and the Consumer Trustee, will also prepare a network investment strategy.</li> </ul> |
| <b>Consumer Trustee – AEMO Services Limited</b>                      | <ul style="list-style-type: none"> <li>• The Consumer Trustee is responsible for preparing the IIO Report every 2 years. The IIO Report sets out a plan for coordinated and timely investment in generation, long duration storage and firming infrastructure over the next 20 years. The IIO Report is informed by information about network infrastructure projects provided by the Infrastructure Planner.</li> <li>• The Consumer Trustee may authorise, or make a recommendation that the Minister direct a Network Operator to carry out an RNIP, following a recommendation from the Infrastructure Planner. The Consumer Trustee also sets a maximum amount for the prudent, efficient and reasonable capital costs for the development and construction of an RNIP. This amount is submitted to the Regulator and is confidential.</li> </ul>  |
| <b>Minister</b>  | <ul style="list-style-type: none"> <li>• The Minister may direct a Network Operator to carry out an RNIP on the recommendation of the Consumer Trustee. The Minister may also authorise or direct a Network Operator to carry out a PTIP without a recommendation from the Consumer Trustee.</li> </ul>   |

| Entity   | Roles and responsibilities   |
|--|--|
| <b>Regulator – Australian Energy Regulator (AER)</b>             | <ul style="list-style-type: none"> <li>• The AER has been appointed as the Regulator for Part 5 of the EII Act, which includes undertaking the TET and revenue determinations for network infrastructure projects.</li> <li>• The Regulator makes a revenue determination to determine the amounts payable to Network Operators authorised by the Consumer Trustee, or directed or authorised by the Minister, to carry out an RNIP or PTIP. Before doing so, the Regulator is required to undertake a TET to assess the prudent, efficient and reasonable capital costs for the development and construction of a network infrastructure project. Network Operators are also entitled to recover prudent, efficient and reasonable costs for carrying out a project, including operating costs. As part of the revenue determination, the Regulator also determines the payment schedule for payments to a Network Operator by the SFV.</li> <li>• For contestable projects, the Infrastructure Planner will consult the Regulator on the competitive procurement strategy and, when applying the TET and making its revenue determination, the Regulator will have regard to the outcome of the competitive procurement process.</li> <li>• The Regulator is required to publish TET and Revenue Determination Guidelines to provide stakeholders with an understanding of how the TET and revenue determination process will be undertaken. It is intended that the Regulator also apply other guidelines, similar to those developed under the NER to Network Operators relating to confidentiality, ring-fencing and cost allocation requirements.</li> <li>• The Regulator must make a Contribution Determination to determine the annual amounts to be recovered from each NSW DNSP to meet the amounts to be paid out of the electricity infrastructure fund under the EII Act. These amounts will be passed through to NSW electricity consumers through their retail electricity bills.</li> </ul> |
| <b>Network Operators</b>   | <ul style="list-style-type: none"> <li>• Network Operators that have been authorised by the Consumer Trustee, or directed or authorised by the Minister, to carry out a network infrastructure project, which may include owning (or leasing/licensing), constructing, financing, maintaining and/or operating the network infrastructure project.<sup>4</sup> Network Operators will receive payment from the SFV for carrying out the network infrastructure project in accordance with the Regulator’s determination.</li> <li>• Network Operators are required to provide information to the Regulator, in accordance with the TET and Revenue Determination Guidelines and any additional requests for information from the Regulator, to assist the Regulator to undertake a TET and make a revenue determination.</li> </ul>  |
| <b>Primary TNSP and Jurisdictional Planning Body – TransGrid</b> | <ul style="list-style-type: none"> <li>• Transmission system control will remain the responsibility of Transgrid as the primary TNSP in NSW. Transgrid will also provide input to the Infrastructure Planner on the development of the network investment strategy that informs the IIO Report.</li> </ul>   |

<sup>4</sup> The precise scope of the Network Operator’s role would be documented in the authorisation or direction instrument.

| Entity                                 | Roles and responsibilities   |
|--|--|
| <b>Other incumbent TNSPs and DNSPs</b> | <ul style="list-style-type: none"> <li>• Augmentation of existing assets both inside and outside the geographic area of a REZ will be developed, built, owned and maintained by the owners of those transmission or distribution networks.</li> <li>• DNSPs will pay contributions to the SFV in accordance with contribution orders made by the Regulator. DNSPs pass these amounts through to NSW electricity consumers through their retail bills.</li> </ul> |
| <b>Scheme Financial Vehicle (SFV)</b>  | <ul style="list-style-type: none"> <li>• The SFV establishes and maintains the Electricity Infrastructure Fund. The SFV pays the Network Operator the amount the Network Operator is entitled to in accordance with the Regulator’s revenue determination. The SFV is funded by contributions made by NSW DNSPs in accordance with annual contribution orders made by the SFV.</li> </ul>  |

## Key differences between the national and NSW frameworks

Until recently, the process for developing new network infrastructure under the NER was largely driven by the incumbent TNSPs, which were responsible for planning and investing in their respective networks in response to system limitations.

In 2020, the Energy Security Board progressed a package of rule changes that amended AEMO’s role as National Transmission Planner and enabled the Integrated System Plan (ISP) to replace the first stage of the regulatory investment test for transmission (RIT-T). This effectively transferred responsibility for the coordinated identification and assessment of options to address needs for investment across the integrated system, from TNSPs to AEMO.

Similar to the ISP framework, the EII Act contemplates a centralised planning approach to network infrastructure planning and investment. New entities appointed under the EII Act will assume network planning responsibilities for network infrastructure projects that would otherwise fall to network businesses. The intent is to allow for a greater degree of coordination between investment in network and generation infrastructure in line with the objectives of the EII Act.

When regulating NSW network infrastructure projects, including payments to Network Operators carrying out such projects, the AER will adopt many of the aspects of its approach for regulating TNSPs under the NER. However, the role of the Regulator under the EII Act is narrower than under the national framework, and this results in several key differences:

- **Contestable projects** – The EII Act provides a process to support the contestable provision of network infrastructure projects. Major consumer funded transmission projects are non-contestable under the national framework, other than in Victoria. It is expected that the Regulator’s revenue determinations for contestable network infrastructure projects under the EII Act will have regard to the outcomes of the contestable procurement process.
- **Cost recovery via SFV** – The EII Act provides for a Network Operator to be paid amounts under the Regulator’s revenue determination by the SFV. This contrasts with the national framework, where network service providers (NSPs) collect revenue directly from customers via transmission or distribution pricing.

- **Regulatory principles and objects of the EII Act** – The NEL has a single legislative object focused on the long-term interests of electricity consumers, whereas the EII Act has a broader set of objects,<sup>5</sup> including to improve the affordability, reliability, security and sustainability of electricity supply, the creation of employment and promoting local industry. Decisions made by the Regulator under the EII Act must be consistent with the objects specified in the EII Act.
- **Single project versus portfolio** – Under the EII Act, the Regulator will undertake a TET and revenue determination for a specific project, whereas in the national framework the AER makes determinations on revenue recovery for all economically regulated services provided by an NSP. The revenue determination process under the EII Act is akin to the AER’s assessment of contingent projects under the national framework.
- **Assessment of efficient project costs versus assessment of efficient project scope** – The Regulator’s role under the EII Act includes the assessment of the prudent, efficient and reasonable capital costs for carrying out a network infrastructure project. The Regulator does not have a role in assessing and authorising the network infrastructure project to be carried out – this is undertaken by the Infrastructure Planner, the Consumer Trustee and the Minister (as applicable).
- **Level and source of prescription** – Transmission revenue determinations under the national framework are made in accordance with detailed requirements set out in Chapter 6A of the NER and numerous guidelines, schemes and models published by the AER. Similar detailed requirements will apply to non-contestable projects under the EII Act. In contrast, an equivalent of these NER requirements, guidelines, schemes and models will not apply to contestable determinations, with a small number of exceptions for specific issues. Instead, these matters will largely be determined through the contestable procurement process established by the Infrastructure Planner, with involvement from the Regulator through its review of the procurement strategy and visibility of the procurement process.
- **Timeframe for determinations** – These differences mean that the Regulator is required to determine a smaller set of issues in its revenue determinations under the EII Act compared with AER revenue determinations under the NER. This is particularly the case for contestable network infrastructure projects, where the Regulator’s determination will have regard to the outcomes of the contestable procurement process. As a result, timeframes for the Regulator’s revenue determinations under the EII Act are significantly shorter than revenue determinations under the NER.

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<sup>5</sup> EII Act Part 1 section 3.



# Overview of the regulatory instruments governing network infrastructure projects

The roles, responsibilities and activities of Network Operators and the Regulator in carrying out their functions under Part 5 of the EII Act will be governed and informed by various legislative, regulatory, and commercial instruments. Collectively, these establish the comprehensive regime supporting the delivery of network infrastructure projects in NSW.

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## Framework governing the scope of a Network Operator's activities

### EII Act Part 5

The EII Act provides for the Consumer Trustee to authorise, or for the Minister to authorise or direct, a Network Operator to carry out a network infrastructure project. The authorisation may give the Network Operator (or Network Operators) the right to develop, build, own (or lease), finance and/or operate new network infrastructure.

### Project Deed, licence conditions and registration as a TNSP

The Network Operator and Infrastructure Planner will enter into a Project Deed for the delivery of the network infrastructure project, which will set out the parties' respective contractual obligations.

The scope of the Network Operator's regulatory obligations and requirements for the ownership and operation of the network infrastructure, including network performance and reliability standards, may be set through a combination of some or all of the following:

- the terms of the Project Deed
- the conditions of a licence issued under the *Electricity Supply Act 1995 (NSW)* by the Minister and administered by IPART
- registration by AEMO under the NEL and NER as a TNSP.<sup>6</sup>

These instruments will collectively set out the 'regulatory obligations and requirements' that are relevant to the Regulator's assessment of the Network Operator's prudent, efficient and reasonable capital costs under the TET.

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<sup>6</sup> Which of these requirements will apply is still to be determined.

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## Framework governing the Regulator's revenue determination

### EII Act Part 5 Division 3

The EII Act creates the role of the Regulator and sets out under Part 5 its role and functions for the economic regulation of Network Operators. The relevant parts of the EII Act are:

- Section 37 sets out the principles the Regulator must take into account in exercising its functions under the EII Act:
  - a Network Operator is entitled to recover the prudent, efficient and reasonable costs incurred by the Network Operator for carrying out the infrastructure project
  - incentives should be given to Network Operators to promote economic efficiency
  - a Network Operator is entitled to revenue for the ongoing ownership, control and operation of an infrastructure project that is commensurate with the regulatory and commercial risks to the Network Operator
  - a Network Operator is entitled to be informed of material issues being considered by the Regulator, and
  - any other principles prescribed by the regulations.
- Section 38 sets out the requirements on the Regulator to determine the amount payable to Network Operators for network infrastructure projects, including:
  - the different components for which amounts must be included in the determination
  - a requirement to calculate the prudent, efficient and reasonable capital costs for development and construction of the network infrastructure project, known as the TET
  - a requirement to publish guidelines on its website about the TET
  - a requirement that the capital amount it determines for a Network Operator does not exceed the maximum amount, if any, notified to it by the Consumer, and
  - an ability to require, by written notice, that the Network Operator provide information necessary to enable the Regulator to make a determination.
- Section 39 sets out the effect of the Regulator's determinations, including obligations on the SFV to pay the Network Operator in accordance with the Regulator's determinations.
- Section 40 sets out the requirements on the Regulator to review and remake determinations, including:
  - that the Regulator must, in accordance with the regulations, remake a determination once every 5 years, and at any time the Consumer Trustee directs, and
  - that the regulator may review and remake a determination at any time, subject to the regulations.

## Regulations under the EII Act

The EII Act specifies a range of matters that may be addressed in regulations, including issues related to:

- the making of a determination by the Regulator
- the principles and matters the Regulator is to take into account in making a determination
- the information required to be provided to the Regulator by a Network Operator
- the information to be included in a determination
- additional revenue components that must be included in a determination
- other matters relating to the TET
- the remaking of a determination by the Regulator
- other matters relating to a determination by the Regulator
- the effect of the Regulator's determination, and
- the transfer of network infrastructure by a Network Operator to another person.

Regulations may also modify the application of, or disapply, a provision of the NEL or NER in certain specified circumstances.

In accordance with these powers, it is proposed that the regulations include a range of provisions relevant to the Regulator's revenue determinations for network infrastructure projects, as discussed in later sections of this paper.

The preparation and making of regulations applicable to network infrastructure projects will be progressed as follows:

- regulations related to the competitive procurement strategy and certain issues related to the Regulator's initial TET and revenue determination for contestable projects are expected to be made in June 2022, and
- further regulations related to other matters for contestable and non-contestable projects are expected to be made later in 2022.

## TET and Revenue Determination Guidelines

Section 38(5) of the EII Act requires the Regulator to publish guidelines on its website about the TET.

It is also intended that regulations will require the AER to publish guidelines on how it will make, review and remake revenue determinations for network infrastructure projects. It is intended that the AER will be able to:

- publish combined guidelines for the TET and revenue determinations, and
- publish separate guidelines for contestable and non-contestable network infrastructure projects.

The OECC intends to recommend regulations that will also require the AER to publish the guidelines on its website and empower the AER to amend the guidelines from time to time. It is expected that the AER will consult on any proposed amendments to its TET and Revenue Determination Guidelines, other than minor administrative amendments. It is not intended that the regulations will prescribe the form of consultation.

## Chapter 6A of the NER

The approach and process taken by the Regulator when making revenue determinations under the EII Act may adopt aspects of the regulatory framework set out in Chapter 6A of the NER, particularly for non-contestable projects, where the Regulator is intended to generally adopt a similar approach as it currently follows under the NER.

Regulations may be made under section 41(1)(b) of the EII Act to enable a Network Operator to recover costs under the NER or transition between the arrangements under the EII Act and the NER.

It is intended that regulations and the Regulator's guidelines will adopt certain provisions of Chapter 6A of the NER, with appropriate modifications, and require the Regulator to make its determinations in a manner that is consistent with those provisions. It is proposed that the regulations and Regulator's guidelines will set out which Chapter 6A provisions apply to contestable and non-contestable projects, which provisions do not apply, and what modifications are made to those provisions for EII Act revenue determinations.<sup>7</sup>

The regulatory framework for undertaking the TET and making the revenue determination will not distinguish between transmission and distribution assets, as both types of assets will be regulated in the same manner. Where the regulations or the Regulator's guidelines adopt relevant aspects of the NER, it is proposed that they will adopt the approach used for the regulation of TNSPs under Chapter 6A, regardless of whether the network infrastructure project involves transmission or distribution assets.

## AER schemes, models and guidelines

The NER require the AER to develop and publish certain guidelines, models and schemes that apply to the regulation of TNSPs.

It is proposed that regulations provide the Regulator with discretion to apply its current NER guidelines, models and schemes, and to modify their application (where necessary) as set out in the guidelines for the purpose of making revenue determinations under the EII Act.

Where the Regulator applies its guidelines, models and schemes developed under the NER to network infrastructure projects under the EII Act, the general intention is that the version for transmission would be applied, even if the network infrastructure project involves distribution assets.<sup>8</sup> Any modifications made in the TET and Revenue Determination Guidelines may have regard to relevant differences between the versions of the NER guidelines, schemes and models for transmission and distribution where the network infrastructure project involves distribution assets.

As explained below, most of the AER's current schemes, models and guidelines will not apply to contestable network infrastructure projects. In contrast, most will apply to non-contestable projects, with appropriate modifications where necessary.

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<sup>7</sup> For clarity, these modifications will not amend the NER and will not have any impact on the AER's determinations for NSPs regulated under the NER; they will only modify how those NER provisions are applied by the Regulator when performing its functions in relation to network infrastructure projects under the EII Act. This approach of incorporating the relevant provisions of the NER by reference is adopted to avoid the need for lengthy regulations that replicate the relevant sections of the NER and to ensure that relevant amendments to the NER automatically apply to the Regulator's determinations under the EII Act without the need for regular amendments to the regulations or the guidelines.

<sup>8</sup> Further work is being undertaken on the regulatory framework for non-contestable projects in relation to the applicability to distribution assets of the transmission service target performance incentive scheme.

# Revenue determinations for contestable projects

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## Overview of the contestable project scenario

The EII Act permits a Network Operator to be selected on a project-specific basis, which introduces the opportunity for competition in the construction and operation of network infrastructure. Contestable provision of network infrastructure projects is the default approach the Infrastructure Planner is expected to take, unless it is unlikely to be feasible; for example, where the project is not readily separable from the existing system.

The process to deliver contestable projects is summarised in Box 1.

### Box 1 – Overview of the process to deliver contestable network infrastructure projects

A contestable process will involve the following steps:<sup>9</sup>

1. The Infrastructure Planner will prepare a strategy for undertaking a competitive procurement process. The Infrastructure Planner must consult with the Regulator in preparing and implementing the competitive procurement strategy.
2. The Infrastructure Planner will conduct the procurement process (providing updates to the Regulator on request) in accordance with the competitive procurement strategy and negotiate a Project Deed with the successful Network Operator to deliver the project.
3. The Infrastructure Planner will make a recommendation to the Consumer Trustee under section 30 of the EII Act.
4. The Consumer Trustee will authorise the Network Operator to carry out the project under section 31 of the EII Act.
5. The Consumer Trustee will also set the maximum amount for the capital costs of development and construction of the project (only relevant to RNIPs authorised by the Consumer Trustee) and confidentially notify the Regulator of this amount.
6. The Infrastructure Planner will provide a report to the Regulator on the conduct of the competitive procurement process.
7. The Network Operator will submit a revenue proposal to the Regulator that is consistent with the outcomes of the procurement process and the Project Deed.<sup>10</sup>

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<sup>9</sup> These steps are set out broadly in the order in which they are expected to occur, but the timing of steps 3 to 7 could vary or overlap. These steps describe the process that will apply to an RNIP that is authorised by the Consumer Trustee. Aspects of steps 1 to 6 may differ for an RNIP that is instead authorised by the Minister under section 36(2) of the EII Act, or where the Minister directs a Network Operator to carry out an RNIP or a PTIP under section 32.

<sup>10</sup> The Project Deed may be in draft form at the time the Network Operator submits its revenue proposal.

8. The Regulator will undertake the TET and make a revenue determination, having regard to the outcome of the procurement process and the Infrastructure Planner's report on the procurement process.
9. The Regulator will remake a revenue determination every 5 years<sup>11</sup> for the period specified in the Project Deed (the concession period),<sup>12</sup> also taking into account the outcomes of the procurement process. At the end of the concession period, the network infrastructure asset will transition to regulation under the non-contestable provisions of the EII Act framework.

The extent of the Network Operator's role under a contestable project may vary between projects and will be set out in the Consumer Trustee's authorisation (and reflected in the procurement documents and Project Deed).

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## Regulator determination of prudent, efficient and reasonable costs

Where a contestable model is used by the Infrastructure Planner to select a Network Operator, competition between participants will replace many aspects of the usual regulated approach to revenue determinations. Accordingly, the contestable procurement process outcome is expected to be reflected in the Regulator's revenue determination on the basis that the outcome reflects amounts for costs that are prudent, efficient and reasonable.

It is intended that the regulations and the Regulator's Guidelines together will set out a framework to provide the Regulator with visibility of the competitive procurement process and confidence that the process has involved reasonable competition and therefore is likely to result in prudent, efficient and reasonable costs, to enable the Regulator to rely on the amounts provided in the outcome of a procurement in undertaking the TET and making a revenue determination.

While the competitive procurement process will generally determine all material aspects of the Regulator's revenue determination, there may be instances where some elements are not determined on this basis. In these cases, the intention is that these elements will be assessed using the Regulator's assessment processes for non-contestable projects.

## Regulations

### Consultation on competitive procurement strategy and provision of information to the Regulator

The intention is that regulations will provide that the Infrastructure Planner may develop a strategy for the eligibility criteria and selection process to select, through a competitive process, a Network Operator that may be authorised or directed to carry out a network infrastructure project (the 'competitive procurement strategy').

It is intended that regulations will require the Infrastructure Planner to consult with the Regulator in preparing and implementing the competitive procurement strategy. It is expected that the Regulator will review and

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<sup>11</sup> Revenue determinations may be remade earlier than 5-yearly in specified circumstances as discussed below.

<sup>12</sup> The Network Operator will own and operate the network infrastructure project for a concession period set out in the Project Deed, which is expected to be around 20 years plus specified renewal options.

provide comments on the competitive procurement strategy up front in the process, with the aim of satisfying itself that the framework is capable of producing outcomes that the Regulator will be able to rely on in undertaking the TET and making a revenue determination.

This approach provides the Regulator with early visibility and oversight of the competitive procurement framework and process, while retaining a degree of flexibility for the Infrastructure Planner to adapt the competitive procurement process to deal with issues that may arise during the process.

The Infrastructure Planner will then conduct the competitive procurement process in accordance with the competitive procurement strategy.

The Regulator may request to be an observer in the procurement evaluation phase.

It is not intended to specify the minimum requirements for bids in regulations; however, bids are expected to contain the following information that will be relevant to the revenue determination process (among other things):

- an overall cost for carrying out the proposed network infrastructure project as the authorised Network Operator for the concession period
- a breakdown of revenue to be paid to the Network Operator for carrying out the project in accordance with a Project Deed, which must be capable of being reflected in a revenue determination by the Regulator. This is expected to include:
  - breakdowns into the component ‘building blocks’ listed in section 38(2) of the EII Act
  - breakdowns into (i) fixed costs and (ii) variable costs, which are to be periodically remade by the Regulator and associated adjustment mechanisms in accordance with a Project Deed
  - the schedule of payments to be made by the SFV to the Network Operator for the duration of the concession period
- a requirement for the successful bidder to enter into a Project Deed with the Infrastructure Planner, and
- any other contractual and regulatory arrangements required by the Infrastructure Planner.

The Infrastructure Planner will be required to provide information to the Regulator to allow it to review the competitive procurement strategy and to make its determination.

Following completion of the competitive procurement process, the Infrastructure Planner will provide the Regulator with a report on the conduct of the competitive procurement process. This step is likely to happen at around the same time as the Infrastructure Planner makes its recommendation to the Consumer Trustee and prior to the Regulator making its revenue determination.

### **Assessment of regulatory proposals, including outcomes of the contestable procurement process**

Following completion of the procurement process and the Consumer Trustee’s authorisation (or authorisation or direction by the Minister, where applicable), the Network Operator will submit a revenue proposal to the Regulator by the date specified in the authorisation or direction.

The revenue proposal will reflect the procurement outcome contained in the Project Deed, including the:

- annual amount payable for each year of the term of the Project Deed
- payments schedule, which is expected to involve quarterly payments for each financial year during the term, and
- formulae and provisions for any variation mechanisms; for example, for inflation or other items of adjustment or pass-through accepted in the procurement process and set out in the Project Deed.

It is expected that regulations will provide that the matters the Regulator may consider when making its revenue determination include:

- the outcome of the competitive procurement process, including the payment amount bid by the successful Network Operator<sup>13</sup> and the relevant building block components of that bid, and
- any opinion expressed by the Infrastructure Planner as to the adequacy of the procurement process and the consistency of that process with the competitive procurement strategy.

It is also expected that regulations will prescribe an additional principle that the Regulator may consider when exercising its functions in relation to the TET and revenue determinations, to support the reliance on the outcome of the competitive procurement process.

The Regulator may request further information about the competitive procurement process from the Network Operator or the Infrastructure Planner.

### Process and timing for regulatory determinations

Consistent with the approach taken in the national framework where timeframes for the AER to make a revenue determination are specified in Chapter 6A of the NER, it is intended that regulations under the EII Act will provide that, for contestable projects:

- where all elements of the revenue proposal are determined through the competitive procurement process, the Regulator must make its revenue determination within 2 months of receiving the Network Operator's revenue proposal, and
- where some elements of the revenue proposal are not determined through the competitive procurement process, the Regulator will have discretion to extend the timeframe for making its revenue determination by up to 2 months if it is satisfied that the determination involves issues of such complexity or difficulty that 2 months is insufficient.

It is intended that regulations will provide that, where the Regulator has not made a determination within the specified timeframes:

- for an initial determination, the Regulator must reflect in the determination an allowance for additional costs incurred as a result of the delay, and
- for a remake of a determination, the amount payable under the current determination would continue to apply until a determination is made, with a true-up when the determination is made.

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<sup>13</sup> Where referred to throughout this paper, the 'amount bid by the successful Network Operator' is intended to include post-bid adjustments negotiated with the Infrastructure Planner in the ordinary course of finalising the commercial arrangement and documenting it in the Project Deed.



It is intended that the regulations will require the Regulator to:

- provide a report to the Minister, and publish that report on its website, that describes the reasons for not making the determination within the specified period and specifies a date by which the Regulator considers the determination will be made, and
- consult with the Infrastructure Planner before making a revenue determination.

The timeframes for the Regulator to undertake the TET and make a revenue determination for projects that are selected through a contestable procurement process are intended to be shorter than the timeframes for non-contestable projects under the EII Act, and for revenue determinations undertaken by the AER under Chapter 6A of the NER. The shorter timeframes recognise that the scope of matters the Regulator will need to determine will be narrower as it is expected to be able to take into account the outcomes of the competitive procurement process to rely on that process to produce revenue proposals that are likely to reflect prudent, efficient and reasonable costs, noting the Regulator's roles in relation to the procurement strategy and process discussed above.

### Remaking of revenue determinations

Revenue determinations will generally apply for a 5-year period, consistent with the usual period for AER revenue determinations under the NER.

The EII Act provides that the Regulator:

- in accordance with the regulations, is to remake a revenue determination every 5 years or at any time the Consumer Trustee directs
- is to remake a revenue determination, in accordance with the regulations, at any time the Consumer Trustee directs, and
- may review and remake a determination at any time, subject to the regulations.

In remaking a determination, the Regulator must follow the same process as that to make an initial determination under section 38 of the EII Act, including to take into account the outcome of the procurement process in remaking the determination.

Upon the expiration of the concession period under the Project Deed, the Regulator will be required to make its 5-yearly determinations under the non-contestable framework.

When remaking the determination within a concession period, the Regulator will not apply the AER's usual regulatory asset base (RAB) roll forward model under the NER. RAB provisions similar to those in Schedule 6A.2 of the NER (including the ex-post review of capex) will not apply. Instead, it is proposed that any adjustments for differences between forecast and actual capital expenditure will only occur if provided for in the Project Deed and that adjustment mechanism is to be included in the Regulator's determination.

### Information requirements for annual reporting by Network Operators

The EII Act allows the AER to issue information notices to Network Operators for the purpose of making a revenue determination and requires that Network Operators comply with these notices.

This enables the Regulator to issue notices to Network Operators to provide it with information on an annual basis throughout the 5-year determination period. This enables the Regulator to gather information that is necessary for administering determinations or preparing for the next remaking of the determination.

### NER clauses and AER guidelines, schemes and models

For non-contestable projects, the intention is for regulations to adopt or replicate most of the provisions of Chapter 6A of the NER and apply relevant provisions to the Regulator's revenue determinations under the EII Act, subject to appropriate modifications (for both transmission and distribution projects). For contestable projects, provisions equivalent to the NER Chapter 6A will not apply.

It is also intended that regulations will provide for the AER to develop the following guidelines (which will be broadly equivalent to those that are made by the AER and apply to TNSPs under Chapter 6A of the NER, subject to appropriate modifications for consistency with the EII Act framework) that will apply to Network Operators for contestable network infrastructure projects:

- Confidentiality Guideline
- Cost allocation guideline, and
- Ring-fencing guideline.

The AER's other transmission guidelines, schemes and models under the NER will not apply to contestable projects, including the rate of return instrument, capital efficiency sharing scheme (CESS), efficiency benefit sharing scheme (EBSS), service target performance incentive scheme (STPIS), shared asset guidelines, post tax revenue model and roll forward model. For non-contestable projects, most of the AER's transmission guidelines, schemes and models under the NER are intended to apply, subject to appropriate modifications (further detail on which will be provided in the Regulator's Guidelines for non-contestable projects later in 2022).

### Other matters

#### Classes of REZ network infrastructure

Under the EII Act, a 'REZ network infrastructure project' must form part of a REZ and consist of network infrastructure of a class prescribed by regulations. It is proposed that regulations prescribe 4 classes of network infrastructure:

- Class 1 – transmission assets as defined in the NER
- Class 2 – distribution assets as defined in the NER
- Class 3 – non-network options to meet transmission or distribution network needs other than by investment in assets described in classes 1 or 2, and
- Class 4 – plant or services providing system security support for a REZ.

An authorisation or a Ministerial direction will specify which class or classes of network infrastructure a particular network infrastructure project falls into.

## Service classification

It is also expected that regulations will address service classification issues by creating the concept of ‘regulated network services’, being the carrying out of a network infrastructure project in accordance with the Consumer Trustee or Minister’s authorisation. The provision of these services will be regulated by the Regulator’s revenue determination.

## Adjustments and variations to a determination

A determination by the Regulator will include a mechanism for adjusting the amount payable to the Network Operator over time. It is intended that this mechanism will allow for different types of adjustments to be made either annually, as part of the 5-yearly remaking process, or on an ad hoc basis.

The scope of adjustments that are permitted under the adjustment mechanism will differ between contestable and non-contestable projects.

For contestable projects, adjustments under the revenue determination should reflect the adjustment mechanisms in the Project Deed. The adjustment mechanism could include variations for a range of matters depending on how risk is allocated under the bid documents and Project Deed. These variations could range from annual adjustments for actual inflation to how increased capital costs caused by specified risk events or allowed scope variations should be incorporated into the amount payable to the Network Operator. If the Regulator is satisfied with the contestable procurement process, the adjustment mechanism would be set out in the Regulator’s determination, based on the mechanism contained in the Project Deed.

Any variations to the annual amounts payable under the revenue determination will be governed by the adjustment mechanisms set out in the Project Deed and reflected in the Regulator’s determination. Contestable determinations will not be subject to other adjustment mechanisms equivalent to the NER provisions for pass-through events (NER clauses 6A.7.2 and 6A.7.3), capital expenditure reopeners (NER clause 6A.7.1) or contingent projects (NER clause 6A.8). For non-contestable projects, most of these regulatory mechanisms are intended to apply (other than contingent projects, which are not relevant under the EII Act framework).

## Early development costs

For network infrastructure projects under the EII Act, the Infrastructure Planner, rather than a Network Operator, will conduct preparatory activities and early development works. The Network Operator will be required to pay some or all of the Infrastructure Planner’s development works costs and then recover these costs through the Regulator’s revenue determination.

For contestable projects, the amount the Network Operator is required to pay for early development costs will be set through the procurement process and the Project Deed. The Regulator will then determine an amount for these costs under the revenue determination. It is intended that the Regulator will treat early development costs to the Infrastructure Planner as similar to ‘regulatory obligations or requirements’ under the NER framework.<sup>14</sup> As the Network Operator has a legally binding obligation to pay these costs, the Regulator may consider that the costs originally incurred by the Infrastructure Planner were reasonable, prudent and efficient.

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<sup>14</sup> For non-contestable projects where the regulations will apply provisions that are equivalent to the NER Chapter 6A capital expenditure and operating expenditure objectives, the regulations will clarify that the Network Operator’s obligations under the Project Deed are ‘regulatory obligations or requirements’ for the purpose of those provisions.

To provide oversight of the reasonableness of these costs, the development works costs will be subject to the Infrastructure Planner's independent assurance processes, with the intention of confirming whether the costs are properly incurred and reasonable.

## TET and Revenue Determination Guidelines

The Regulator's TET and Revenue Determination Guidelines for contestable network infrastructure projects will set out how the AER will make a revenue determination for a Network Operator selected through a competitive procurement process.

The Guidelines will also set out the process and criteria for how the Regulator will review and provide comments on the Infrastructure Planner's procurement strategy and the Regulator's role in monitoring and receiving information on the procurement process.

The Regulator has published draft Guidelines for consultation at the same time as this paper (see 'More information' at the end of this document). The final Guidelines are due to be published in June 2022.

The key issues covered in the draft Guidelines are:

- **Review of the procurement strategy**, including the criteria that will guide the Regulator's review of a procurement strategy, and the additional information it requires the Infrastructure Planner to include in its procurement strategy
- **Review of the procurement process**, including how the Regulator intends to monitor the procurement process, the information required to be included in the Infrastructure Planner's procurement report and the process for the Regulator's review of the procurement process
- **Revenue determination**, including the required content of a revenue proposal and revenue determination, and the Regulator's assessment approach
- **Guidelines, schemes and models**, including modifications to the NER guidelines that will apply to contestable projects, and
- **Information requirements**, including information requirements for the purpose of making a revenue determination and annual reporting requirements on Network Operators.

# Revenue determinations for non-contestable projects

This section sets out a high-level summary of the approach and process for revenue determinations for non-contestable network infrastructure projects. More details will be made available in mid-2022 as part of the development of the regulations and the Regulator's draft TET and Revenue Determination Guidelines for non-contestable projects.

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## Overview of the non-contestable project scenario

Where the Infrastructure Planner opts not to undertake a competitive procurement process to select a preferred Network Operator to carry out a network infrastructure project, the Infrastructure Planner may choose to directly select a Network Operator for this purpose. For example, this may include where the required network infrastructure is not readily separable from the existing system or there is insufficient market capacity to deliver the project.

Under the EII Act, once a Network Operator has been authorised or directed to carry out a network infrastructure project by the Consumer Trustee or Minister, the Regulator must determine the amount payable to that Network Operator.

As part of the revenue determination, the Regulator must conduct the TET to calculate the prudent, efficient and reasonable capital costs for development and construction of the network infrastructure project. The revenue determination will include amounts for the repayment of capital costs calculated under the TET, return on capital costs, and operating costs, as well as other building blocks specified in the EII Act or regulations.

Unlike contestable projects, where the different components of a revenue determination will largely be determined through the contestable procurement process, for non-contestable projects, the intention is that the Regulator will determine all material aspects of a revenue determination using an approach very similar to the AER's approach to transmission revenue determinations under Chapter 6A of the NER process.

There are expected to be some key differences between the process and approach under the NER and under the EII Act, which will be set out in regulations and the Regulator's Guidelines for non-contestable projects. These differences will include a shorter timeline for the determination process. The process to deliver non-contestable projects is summarised in Box 2.

## Box 2 – Overview of the process to deliver non-contestable RNIPs

A non-contestable process will involve the following steps:<sup>15</sup>

1. The Infrastructure Planner will make a recommendation to the Consumer Trustee regarding authorisation of the network infrastructure project under section 30 of the EII Act.
2. The Consumer Trustee will authorise the Network Operator to carry out the project under section 31 of the EII Act.
3. The Consumer Trustee will also set the maximum amount for the capital costs of development and construction of the project (only relevant to RNIPs authorised by the Consumer Trustee) and confidentially notify the Regulator of this amount.
4. The Network Operator will submit a revenue proposal to the Regulator.
5. The Regulator will undertake the TET and make a revenue determination.
6. The Regulator will remake a revenue determination every 5 years<sup>16</sup> under section 40.

Non-contestable network infrastructure projects could involve RNIPs or PTIPs. The regulatory framework for both types of projects will be the same, except where modifications are necessary to account for differences in the EII Act (e.g. the Consumer Trustee does not set a maximum capital amount for PTIPs).

Non-contestable network infrastructure projects could also involve either transmission or distribution assets. The regulatory framework will regulate both types of assets in the same manner, which is expected to generally be consistent with the approach used for the regulation of TNSPs under Chapter 6A of the NER (not the DNSP provisions in Chapter 6 of the NER) and the AER's transmission guidelines, schemes and models under the NER (not the AER's distribution guidelines, schemes and models).

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## Regulator determination of prudent, efficient and reasonable capital costs

Unlike contestable projects, for non-contestable projects the Regulator cannot base its assessment of the efficiency, prudence and reasonableness of a Network Operator's proposed capital costs and amounts payable based on the competitive market testing inherent in the contestable procurement process. This necessitates a determination process more akin to that used for incumbent TNSPs under the NER.

The Regulator's approach to applying the TET and determining revenues for a Network Operator that is subject to an authorisation or direction in respect of a non-contestable project is expected to therefore largely be consistent with the arrangements under the national framework. The main obligations and elements of Chapter 6A are intended to be replicated for the making of revenue determinations under the EII Act for non-contestable projects, to the extent possible.

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<sup>15</sup> These steps describe the process that will apply to an RNIP that is authorised by the Consumer Trustee. Steps 1 to 2 may differ for an RNIP that is instead authorised by the Minister under section 36(2) of the EII Act, or where the Minister directs a Network Operator to carry out an RNIP or a PTIP under section 32.

<sup>16</sup> Revenue determinations may be remade earlier than 5-yearly in specified circumstances, consistent with the arrangements for contestable projects discussed above.

When replicating the relevant Chapter 6A provisions for the purpose of EII Act determinations via the regulations or the Regulator's Guidelines, it is intended that modifications be made to ensure consistency with the EII Act and to recognise the differences between the national and NSW frameworks discussed earlier in this paper.

It is proposed to specify which of the AER's transmission guidelines, schemes and models under the NER apply to non-contestable projects under the EII Act, subject to appropriate modifications set out in the Regulator's TET and Revenue Determination Guidelines. It is expected that most of the AER's NER guidelines, schemes and models will apply, except for a small number that are not relevant given the nature of EII Act projects. Those instruments that are expected to apply include the rate of return instrument, CESS, EBSS, shared asset guidelines, ring-fencing guidelines, cost allocation guidelines, post tax revenue model and roll forward model.

It is intended that the Regulator will also be required to develop a modified version of its STPIS to apply to non-contestable projects from the second regulatory period, taking into account relevant differences between EII Act and NER projects.

This approach seeks to:

- maintain consistency with the national approach to the extent possible, and thereby enable the EII Act framework to also adapt as rule changes to the national framework are made by the Australian Energy Market Commission (AEMC) or changes to the applicable NER guidelines are made by the AER
- ensure the Regulator has a clear basis to apply an approach that is consistent with the equivalent Chapter 6A rules when making or administering its determinations under the EII Act
- support continuous improvement by maintaining flexibility for the Regulator to adjust aspects of the framework over time in response to market developments and as the Regulator, Infrastructure Planner, Consumer Trustee and Network Operators gain more operational experience implementing the EII Act framework, and
- provide clarity and certainty for Network Operators by retaining an appropriate level of detail and prescription in the regulations and Guidelines, thereby providing greater certainty for investors in network infrastructure.

The mechanism for implementing this approach in the regulations will be confirmed as the non-contestable regulations are drafted, but it is currently expected that the regulations and Guidelines will set out:

- which of the AER's NER transmission guidelines, schemes and models apply for non-contestable projects, subject to any modifications to their application set out in the Regulator's TET and Revenue Determination Guidelines
- how provisions equivalent to the relevant clauses of Chapter 6A of the NER will apply for non-contestable projects. The intention is that some NER clauses will apply without further modification (other than definitional changes), some will be modified or substituted, and some will not apply. This will be made clear through regulations and the Regulator's TET and Revenue Determination Guidelines, and
- a requirement that the Regulator prepare, publish and maintain a consolidated version of the Chapter 6A provisions that apply to non-contestable EII Act projects.

The timeframe for the Regulator to make non-contestable determinations will be set out in regulations. It is expected that the Regulator will be required to make its TET and revenue determination within 6 months of receiving a Network Operator's revenue proposal. Details of the determination process, including consultation

requirements, will be set out in the Regulator's Guidelines. The Regulator's Guidelines will also set out the required contents of a regulatory proposal.

As for contestable projects, the Regulator must remake the determination every 5 years, or within such other period as applies in accordance with the EII Act or regulations.

Regulations will address a range of administrative matters related to making a determination, such as information provision, confidentiality and annual reporting, consistent with the arrangements discussed above for contestable projects.

As noted previously, the Regulator intends to prepare separate TET and Revenue Determination Guidelines applicable to non-contestable network infrastructure projects and will consult on a draft later in 2022.



# Revenue determinations for consequential augmentations

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## Scenarios

It is expected that there will also be scenarios where the network infrastructure required for an RNIP or a PTIP under the EII Act may include both:

- new shared network infrastructure (greenfield infrastructure), and
- augmentations to existing network infrastructure, including assets required to connect the greenfield network infrastructure to that existing network (brownfield infrastructure).

Greenfield infrastructure is expected to be planned by the Infrastructure Planner as a network infrastructure project under Part 5 of the EII Act and subject to cost recovery arrangements under that Part.

The planning and investment pathway and cost recovery arrangements for some brownfield infrastructure may differ from the arrangements discussed in earlier sections of this document. For example, brownfield infrastructure could be delivered by the incumbent TNSP or DNSP under the non-contestable revenue determination arrangements under the EII Act as discussed above, potentially with a later transition to the NER. Alternatively, some brownfield infrastructure could be regulated under the NER from the outset, or under a hybrid framework where some elements of the planning and cost recovery process are regulated under the EII Act and some elements are regulated under the NER. Section 41 of the Act envisages these potential scenarios and enables regulations to be made to facilitate such arrangements.

The OECC is continuing to investigate the nature and scope of brownfield infrastructure to recommend fit for purpose regulations to provide for planning and cost recovery of this type of brownfield infrastructure. These arrangements will be consulted on at a later date.

# More information

- Draft Guidelines on the TET and revenue determinations for contestable projects
- [Electricity Infrastructure Investment Act 2020](#)
- [Electricity Infrastructure Roadmap webpage](#)
- [Network Infrastructure Projects \(Part 5 of the EII Act\) Policy Paper \(PDF 1.2MB\)](#)
- Roadmap [Regulatory framework webpage](#)