

# Guideline

**Transmission Efficiency Test and revenue determination guideline for non-contestable network infrastructure projects**

Draft Amendments

May 2024

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# 1 Introduction

## 1.1 Purpose of this guideline

The AER is required to make revenue determinations for Network Operators authorised or directed to carry out<sup>1</sup> network infrastructure projects<sup>2</sup> under the Electricity Infrastructure Investment Act 2020 (NSW) (EII Act) and Electricity Infrastructure Investment Regulation 2021 (NSW) (EII Regulation). These projects relate to implementation of the NSW Electricity Infrastructure Roadmap.<sup>3</sup>

The Infrastructure Planner for a renewable energy zone (REZ) must make assessments and recommendations to the Consumer Trustee about REZ network infrastructure projects required for the REZ.<sup>4</sup> This includes assessing and recommending options to provide the intended network capacity for the REZ, staging and sequencing of REZ network infrastructure projects, funding, procurement and cost recovery for the recommended REZ network infrastructure projects and other matters prescribed in the EII Regulation.

Following this process, a Network Operator may be selected to carry out a network infrastructure project in one of two ways:

- a) Under a non-contestable process, a Network Operator is selected directly by the Infrastructure Planner.
- b) Under a contestable process, a Network Operator is selected through a competitive assessment process conducted by the Infrastructure Planner.<sup>5</sup>

In both cases, the Network Operator must be authorised by the Consumer Trustee, or authorised or directed by the Minister,<sup>6</sup> before carrying out the network infrastructure project. We must make a revenue determination for Network Operators with an authorisation.<sup>7</sup> Under either approach the Network Operator has no discretion in the identification of network options and selection of the preferred project to be carried out.

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<sup>1</sup> EII Act, s. 38 and EII Regulation 47. Carrying out a network infrastructure project may include owning or leasing, constructing, financing, operating, and/or maintaining assets.

<sup>2</sup> Under the EII Act, network infrastructure projects can be REZ Network Infrastructure Projects or Priority Transmission Infrastructure Projects. In this guideline, where we refer to a 'project' or 'network infrastructure project' we are referring to either. Where the EII Act and EII Regulation specify differences in processes for these types of network infrastructure projects, these differences are noted in this Guideline. The key difference is that REZ Network Infrastructure Projects authorised by the Consumer Trustee, require the Consumer Trustee to calculate a maximum capital cost. This is not required for REZ Network Infrastructure Projects directed by the Minister, or for Priority Transmission Infrastructure Projects authorised or directed by the Minister.

<sup>3</sup> Under the roadmap NSW will plan and implement up to five renewable energy zones (REZs). For a detailed explanation of the roadmap and the entities undertaking it, please see <https://www.energy.nsw.gov.au/nsw-plans-and-progress/major-state-projects/electricity-infrastructure-roadmap>.

<sup>4</sup> EII Act, s. 30 and EII Regulation, s. 43.

<sup>5</sup> EII Regulation, ss. 43(2) and 45.

<sup>6</sup> EII Act, ss. 31(1)(b), 32(1)(a) and 36(2). The Consumer Trustee may authorise or the Minister direct or authorise a REZ network infrastructure project. EII Act, ss. 32(1)(b) and s. 36(2), The Minister is the only person able to authorise or direct a priority transmission infrastructure project.

<sup>7</sup> EII Act, s. 38(1).

The regulatory process varies between the non-contestable and contestable processes. However, both processes provide consumer protections by seeking to limit the costs of carrying out network infrastructure projects to an efficient, prudent and reasonable level. The non-contestable process is subject to a more typical regulatory assessment by us, while the contestable process relies on the Infrastructure Planner conducting a competitive assessment process to reveal prudent, efficient and reasonable costs.

To meet the objectives of the EII Act, we are required to prepare guidelines setting out how we will exercise our functions under Part 5 of the EII Act for non-contestable revenue determinations.<sup>8</sup> We have based the non-contestable revenue determination process and regulatory framework on Chapter 6A of the National Electricity Rules (NER). Chapter 6A of the NER does not apply to a revenue determination under the EII Act, however we are required, as far as is reasonably practicable, to make guidelines consistent with Chapter 6A of the NER, as that Chapter applies to making a revenue determination.<sup>9</sup> Therefore, as part of our Guideline for NSW non-contestable network infrastructure projects (Guideline) we include a modified version of Chapter 6A of the NER, which we refer to as EII Chapter 6A **(Appendix A)**.

Our application of this Guideline which includes EII Chapter 6A will be consistent with NER Chapter 6A, except where the EII Act or EII Regulation require an alternative approach, or we consider that compelling reasons exist to deviate based on the relevant objects and principles of the EII Act. In these instances, we shall provide reasons in our non-contestable revenue determination.

It is important to read this Guideline in conjunction with the EII Act, EII Regulation and any supporting guidelines, incentive schemes and models referred to herein.

Consistent with the NSW Government policy paper,<sup>10</sup> in developing this Guideline we have sought to:

- maintain consistency with NER Chapter 6A, NER guidelines, incentive schemes and models to the extent appropriate
- enable the EII Act framework to adapt as rule changes to the national framework are made by the Australian Energy Market Commission or changes to the applicable NER guidelines, incentive schemes or models are made by us
- ensure we have a clear basis to apply an approach that is consistent with the equivalent NER Chapter 6A rules when making or administering revenue determinations under the EII Act
- support continuous improvement by maintaining flexibility for us to adjust aspects of the framework over time in response to market developments and as we, the Infrastructure Planner, Consumer Trustee and Network Operators gain more

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<sup>8</sup> EII Act, s. 64(4).

<sup>9</sup> EII Regulation, cl. 47A(3)(b).

<sup>10</sup> NSW Government (Office of Energy and Climate Change), [Regulatory framework for the Transmission Efficiency Test and Regulator's determinations for network infrastructure projects: Policy paper](#), April 2022. We note from 1 January 2024 the Office of Energy and Climate Change is known as Energy, Climate Change and Sustainability and is part of the NSW Department of Climate Change, Energy, the Environment and Water.

operational experience implementing the EII Act framework

- substantially replicate Chapter 6A of the NER to provide clarity and certainty for Network Operators and investors in network infrastructure projects.

### 1.1.1 Our approach to this Guideline

EII Regulation 47A<sup>11</sup> prescribes what our Guideline for non-contestable revenue determinations must and must not deal with. It states that our Guideline must deal with matters set out in the NER, Chapter 6A, including:

- a) The building blocks approach
- b) The regulatory asset base
- c) Return on capital (applying the AER Rate of Return Instrument).
- d) Depreciation
- e) The estimated cost of corporate income tax
- f) Forecast operating expenditure (opex)
- g) Forecast capital expenditure (capex)
- h) Reopening of a revenue determination for capex
- i) Network support pass through
- j) Cost pass through.

Our approach to these matters is set out in **Appendix A** (EII Chapter 6A), with additional explanatory material in this Guideline for matters where our approach differs significantly to our application of the NER. The body of this Guideline focuses on how we will undertake our regulatory role in making non-contestable revenue determinations,<sup>12</sup> including:

- which of our NER guidelines, incentive schemes and models apply to non-contestable determinations, or where we will develop specific EII guidelines, incentive schemes and models, (**section 3.3**)
- the information and consultation requirements on a Network Operator in submitting a revenue proposal to us, (**sections 3.5.1** and **3.5.2**)
- our approach to assessing a Network Operator's revenue proposal and making a revenue determination (i.e., a propose/respond model), with a focus on where this approach significantly deviates from our application of NER Chapter 6A, (**chapter 5**)
- how we will apply the Transmission Efficiency Test to each network infrastructure project, (**section 5.2**)
- our approach to depreciation, (**section 5.3**).

EII Regulation 47A(5) states that our Guideline for non-contestable revenue determinations must not deal with the following matters under the NER, Chapter 6A:

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<sup>11</sup> EII Regulation, cl. 47A(4).

<sup>12</sup> EII Regulation, cl. 47A(3)(a). We have developed a separate guideline for our role under the contestable process, available at: <https://www.aer.gov.au/industry/registers/resources/guidelines/revenue-determination-guideline-nsw-contestable-projects>.

- a) Pricing
- b) Benchmarking reports
- c) Ring-fencing arrangements
- d) Shared assets
- e) The X-factor
- f) Small-scale incentive schemes
- g) Demand management innovation allowance mechanism
- h) Contingent projects
- i) Transmission consultation procedures
- j) Removal of assets from the regulatory asset base.

The EII Regulation contains a framework for the AER to make revenue determinations for contestable augmentations.<sup>13</sup> The guideline sets out the process we will follow for assessing a non-contestable cost component of a contestable augmentation revenue determination (**chapter 6**).

Ring-fencing arrangements do form part of the non-contestable regulatory framework but these arrangements will be set out in separate EII guidelines. This requirement is specified under EII Regulation 42.

## 1.2 Who are we?

The AER exists to ensure energy consumers are better off, now and in the future. We are the economic regulator for electricity and gas networks in every state and territory in Australia except Western Australia. We regulate electricity networks under the National Electricity Law (NEL) and NER. We also regulate natural gas pipelines under the National Gas Law and the National Gas Rules.

On 12 November 2021 we were appointed as a Regulator under the EII Act.<sup>14</sup> A key function in this role is to apply a Transmission Efficiency Test and make revenue determinations for Network Operators authorised by the Consumer Trustee or authorised (or directed) by the Minister to undertake network infrastructure projects in NSW (under Part 5 of the EII Act).<sup>15</sup> This Guideline only applies to non-contestable revenue determinations. Other functions undertaken by us under the EII Act, which are not covered by this Guideline, include:

- making annual contribution determinations in relation to the Electricity Infrastructure Fund (Part 7 of the EII Act);
- approving a risk management framework developed by the Consumer Trustee (Part 6 of the EII Act); and
- being consulted on tender rules in relation to long-term energy service agreements (Part 6 of the EII Act).

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<sup>13</sup> EII Regulation, cl. 47E.

<sup>14</sup> IPART has also been appointed as a Regulator to undertake certain functions under the EII Act. See: <https://www.aer.gov.au/networks-pipelines/nsw-renewable-energy-zones>.

<sup>15</sup> EII Act, s. 36(4).

## 1.3 Authority for this Guideline

This Guideline is consistent with the regulatory framework for making revenue determinations established under the EII Act and EII Regulation.<sup>16</sup> The NSW Government developed these regulations based on policy positions published in April 2022.<sup>17</sup>

Section 38(5) of the EII Act requires us to publish guidelines on our website about the Transmission Efficiency Test. We apply the Transmission Efficiency Test to calculate the prudent, efficient and reasonable capital costs for development and construction of a network infrastructure project (Transmission Efficiency Test guideline). Section 47 of the EII Regulation also requires us to publish guidelines about the exercise of our functions more broadly under Part 5 of the EII Act, which include making (and remaking) revenue determinations. We have combined these two functions into a guideline relating to non-contestable network infrastructure projects (this Guideline) and a separate guideline for contestable network infrastructure projects.<sup>18</sup>

Any references in the EII Act or EII Regulation to ‘transmission efficiency test guidelines’ and ‘guidelines published by the regulator under section 47’ should be taken to refer to this Guideline and our guideline relating to contestable network infrastructure projects.

We may amend this Guideline from time to time. Should we amend this Guideline, we will publish the proposed amendment on our website for a period of at least 20 business days and consider any submissions received within that period.<sup>19</sup> We are not required to consult on any amendments we consider to be minor or administrative.<sup>20</sup> It is likely that most updates to Appendix A resulting from relevant changes to Chapter 6A of the NER will be minor or administrative in nature.<sup>21</sup> However, should a change to Chapter 6A of the NER have a material impact on Appendix A, we will consult on the proposed change.

## 1.4 Interaction with the National Electricity Rules

Chapter 6A of the NER sets out the national framework for economic regulation of transmission network service providers, including the making of revenue determinations.<sup>22</sup>

Some differences exist between the EII and NER revenue determination approaches which reflect that the scope of our assessment under the EII Act is narrower than the scope of our assessment of a transmission network service provider’s revenue proposal under the NER. For example, revenue determinations made under the EII Act will not consider the prudence of the authorised network option against other potential network options. The Infrastructure Planner performs this role. Our assessment is limited to considering the prudence,

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<sup>16</sup> See Electricity Infrastructure Investment Regulation 2021 (NSW). Also, EII Act s. 64(4) and EII Regulation, cl. 47A.

<sup>17</sup> NSW Government (Office of Energy and Climate Change), [Regulatory framework for the Transmission Efficiency Test and Regulator’s determinations for network infrastructure projects: Policy paper](#), April 2022.

<sup>18</sup> Our contestable guideline was published on 19 August 2022.

<sup>19</sup> EII Regulation, cls. 47C(1).

<sup>20</sup> EII Regulation, cl. 47C(2)(b).

<sup>21</sup> EII Regulation, cl. 47C(2).

<sup>22</sup> The NEL and NER do not regulate the carrying out of a network infrastructure project by a Network Operator under the EII Act.

reasonableness and efficiency of capital costs the Network Operator proposes in its revenue proposal to comply with the terms of the Consumer Trustee's authorisation or the Minister's authorisation or direction.

### 1.4.1 EII non-contestable framework

Section 37 of the EII Act sets out principles that we must consider in making our revenue determination. The principles are:

- a) a Network Operator is entitled to recover the prudent, efficient and reasonable costs it incurs in carrying out the infrastructure project,
- b) incentives should be given to Network Operators to promote economic efficiency,
- c) 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,
- d) a Network Operator is entitled to be informed of material issues being considered by the regulator under Division 3 of Part 5 of the EII Act,
- e) other principles prescribed by the EII Regulation.<sup>23</sup>

The EII Act<sup>24</sup> and EII Regulation<sup>25</sup> require that a revenue determination include amounts for different components including:

- a) repayment of capital costs as determined under the Transmission Efficiency Test
- b) return on capital costs that have not been repaid
- c) an allowance for operating costs
- d) indexation of the regulatory asset base
- e) the estimated cost of corporate income tax of the Network Operator
- f) an increase or decrease in the Network Operator's revenue resulting from the operation of AER incentive schemes
- g) other risks for which the Network Operator is not already compensated under the component specified in the EII Act, section 38(2)(b)
- h) repayment of prudent, efficient and reasonable capital costs not included in part (a).<sup>26</sup>

Taken together, these efficiency principles and revenue determination components replicate the structure of the building block model that we apply to regulated network businesses under the NER.

### 1.4.2 Application of this Guideline to distribution network projects

We expect network infrastructure projects under the EII Act to generally be of the nature of transmission networks. However, it is possible that brownfields network infrastructure projects could involve distribution assets. The building block framework we will apply to transmission networks under the EII Act is aligned to the framework we also use for

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<sup>23</sup> Including EII Regulation, cls. 46(1)(b), (2) and (3).

<sup>24</sup> EII Act, s. 38(2).

<sup>25</sup> EII Regulation, cl. 50A.

<sup>26</sup> This component is included because the TET only applies to development and construction capital costs not capex related to other activities such as replacement or augmentation.

regulating distribution networks under the NER. For simplicity, we intend to apply this Guideline to both transmission and distribution network infrastructure projects.

## 2 Overview of the non-contestable framework

Under the EII Act, the Infrastructure Planner will make assessments and recommendations about certain matters relating to regulated network infrastructure projects, to the Consumer Trustee.<sup>27</sup> Following consideration of the Infrastructure Planner's recommendation, the Consumer Trustee may:

1. Recommend that the Minister direct a Network Operator to complete a REZ network infrastructure project; or
2. Authorise a Network Operator to carry out a REZ network infrastructure project.<sup>28</sup>

In addition to directing a Network Operator to carry out a network infrastructure project (only on the recommendation of the Consumer Trustee),<sup>29</sup> the Minister may also direct or authorise a Network Operator to carry out a priority transmission infrastructure project.<sup>30</sup>

We have no role in the authorisation or direction of network infrastructure projects. Our role as the Regulator is to determine the amount payable to the Network Operator for carrying out the network infrastructure project<sup>31</sup> irrespective of how that project was authorised or directed. We do this by assessing the prudence, efficiency and reasonableness of the Network Operator's proposed costs in relation to authorized or directed network infrastructure project.<sup>32</sup>

Table 1 sets out the key steps associated with the non-contestable framework with indicative timing. It covers the process for an initial determination, made following a new authorisation by the Consumer Trustee (or direction by the Minister), and subsequent determinations that are made (generally) every five years or in accordance with the EII Act.<sup>33</sup>

Broadly, non-contestable revenue determinations include two stages:

- **Pre-lodgement**, including steps that the Infrastructure Planner, Consumer Trustee or Network Operator must undertake to recommend a network infrastructure project and to enable the Network Operator to submit its initial or subsequent revenue proposals.
- **Revenue determination**, including steps we will take to consider and consult on a revenue proposal and the preliminary position paper before making the final determination. Further detail on our assessment approach is set out in chapter 5.

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<sup>27</sup> EII Act, s. 30(1) and EII Regulation, cl. 43.

<sup>28</sup> EII Act, s. 31(1).

<sup>29</sup> EII Act, s. 33.

<sup>30</sup> EII Act, ss. 32(1) & 36(2).

<sup>31</sup> EII Act, s. 38(1).

<sup>32</sup> EII Act s. 38(6).

<sup>33</sup> EII Act s. 40.

**Table 1: Key process steps associated with the non-contestable framework**

Milestone	Initial determination	Subsequent determination (generally every 5 years)
<b>Pre-lodgement</b>		
Consumer Trustee or Minister notifies the AER that an authorisation or direction has been made to a Network Operator.	The authorisation or direction is published.	n/a
AER develops and issues information notice under s.38(7) of the EII Act to a Network Operator.	Best endeavours to provide at least 80 business days before Network Operator's revenue proposal is due.	At least 80 business days before Network Operator's revenue proposal is due.
Network Operator submits a cost allocation methodology for approval by the AER. <sup>34</sup>	Best endeavours to submit at least 60 business days before Network Operator's revenue proposal is due.	At least 60 business days before Network Operator's revenue proposal is due.
AER decides to approve or refuse to approve a Network Operator's cost allocation methodology	Not more than 30 business days from receipt of Network Operator's cost allocation methodology.	Not more than 30 business days from receipt of Network Operator's cost allocation methodology.
Network Operator consults with stakeholders on the network infrastructure project and its draft revenue proposal.	Network Operator uses best endeavours to conduct pre lodgement stakeholder consultation consistent with the AER's Better Resets Handbook. <sup>35</sup>  Where stakeholder engagement issues are identified by the Network Operator, these are raised with the AER early.	Prior to submitting a revenue proposal to the AER, noting the time required to accept stakeholder submissions and incorporate them into a final revenue proposal.
<b>Revenue determination</b>		
Network Operator submits to the AER its revenue proposal and response to information notice. <sup>36</sup>	By the date specified in the Consumer Trustee's authorisation or Minister's direction or authorisation, or stated in contractual	At least 160 business days before the end of the current regulatory control period under the EII Act.

<sup>34</sup> Our request for a cost allocation methodology will be included in the information notice issued under EII Act, s. 38(7).

<sup>35</sup> AER, *Better resets handbook - Towards consumer centric network proposals*, December 2021.

<sup>36</sup> EII Regulation, cl. 48

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Milestone	Initial determination	Subsequent determination (generally every 5 years)
	arrangements, for making a revenue determination.	
AER conducts compliance and confidentiality checks and publishes compliant revenue proposal for public consultation and submissions.	Publish compliant revenue proposal upon completion of compliance check.	Publish compliant revenue proposal upon satisfactory compliance check.
Submissions on Network Operator's revenue proposal close	15 business days from the date of publishing the Network Operator's revenue proposal.	15 business days from the date of publishing the Network Operator's revenue proposal.
AER commences assessment under EII Act and EII Regulation, and this Guideline.	We may request further or clarifying information during our assessment process.	We may request further or clarifying information during our assessment process.
AER advises the Network Operator of material issues under consideration and consults with the Infrastructure Planner. <sup>37</sup>	Periodically throughout the revenue determination process, including but not limited to before our final determination.	Periodically throughout the revenue determination process, including but not limited to before our final determination.
AER publishes a preliminary position paper for public consultation	Approximately 55 business days from receipt of Network Operator's revenue proposal.	Approximately 55 business days from receipt of Network Operator's revenue proposal.
Submissions on preliminary position paper close	15 business days from the date of publishing the preliminary position paper.	15 business days from the date of publishing the preliminary position paper.
AER considers submissions received.	Ongoing from receipt of stakeholder submissions.	Ongoing from receipt of stakeholder submissions.
AER publishes final determination and supporting analysis.	126 business days from date of receipt of Network Operator's revenue proposal.	126 business days from date of receipt of Network Operator's revenue proposal.
Annual revenue adjustment process consistent with the revenue control mechanism in the determination. <sup>38</sup>	N/A	See section 5.5.

Note: All timing is indicative only.

The Regulations indicate that, if we are unable to make a revenue determination within 126 business days, we must prepare a report to the NSW Energy Minister that sets out our

<sup>37</sup> EII Regulation, cl. 48; EII Act s. 37(1)d.

<sup>38</sup> EII Act, s. 40 and EII Regulation, cl. 51.

reasons for not making the determination within that timeframe, the date by which we expect to make the revenue determination and publish the report on our website.<sup>39</sup>

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<sup>39</sup> EII Act, s. 50(3).

## 3 Pre-lodgement

There are steps that the Infrastructure Planner, Consumer Trustee, Network Operator and AER must undertake before a Network Operator is able to submit its initial or subsequent revenue proposal and for us to commence assessing that proposal. This section outlines:

- The roles and responsibilities of the Consumer Trustee, Network Operator and AER, under the EII Act and EII Regulation in completing the key process steps set out in Table 1.
- How we will approach the pre-lodgement process.

### 3.1 Consumer Trustee authorisation or Minister's authorisation/direction

As noted in chapter 1, the Consumer Trustee may authorise, or the Minister direct or authorise a Network Operator to carry out a REZ network infrastructure project based on the recommendations of the Infrastructure Planner.<sup>40</sup> The Infrastructure Planner's recommendations for a REZ network infrastructure project must cover:

- the different options for network infrastructure projects to provide the intended network capacity for the renewable energy zone
- staging and sequencing of network infrastructure projects
- funding, procurement and cost recovery for the recommended network infrastructure projects
- other matters prescribed by the EII Regulation.<sup>41</sup>

Should the Consumer Trustee recommend the Minister give a direction<sup>42</sup> to a Network Operator to carry out a REZ network infrastructure project the Minister's direction must specify:

- the Network Operator required to carry out the infrastructure project,
- the location and description of the infrastructure project,
- the requirements for the development and construction of the infrastructure project,
- the staging and sequencing of the planning, design and construction of the infrastructure project,
- the date by which the Network Operator, taking all reasonable steps, is to complete the planning, design and construction stages of the infrastructure project,

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<sup>40</sup> EII Act, s. 31(1). For priority transmission infrastructure projects, the Minister does not require recommendations from the Infrastructure Planner. See EII Act, ss. 32(3) and 34(1).

<sup>41</sup> EII Act, s. 30(2).

<sup>42</sup> EII Act, s. 31(a).

- other matters prescribed by EII Regulation.<sup>43</sup>

## 3.2 Maximum capital cost for a REZ network infrastructure project

Where the Consumer Trustee authorises a Network Operator to carry out a REZ network infrastructure project, the Consumer Trustee must also set a maximum capital cost for the prudent, efficient and reasonable capital costs to develop and construct each network infrastructure project,<sup>44</sup> and to notify us of that amount.<sup>45</sup>

This maximum capital cost remains confidential and acts as an upper constraint on the capital expenditure (capex) allowance for development and construction costs that we can determine as part of applying the Transmission Efficiency Test.

## 3.3 Application of guidelines, incentive schemes and models

The EII Regulation requires us to make guidelines that are consistent with Chapter 6A of the NER as far as reasonably practicable.<sup>46</sup>

Where applicable, we intend to apply our current NER Chapter 6A guidelines, incentive schemes and models to non-contestable infrastructure projects under the EII Act,<sup>47</sup> subject to terminology modifications (see Appendix A).

The benefits of this approach include:

- It achieves the requirements in the EII Regulation of maintaining consistency with NER Chapter 6A, NER guidelines, incentive schemes and models to the extent appropriate.<sup>48</sup>
- The current NER Chapter 6A guidelines, incentive schemes and models were developed through extensive stakeholder consultation, including with transmission network service providers, who will likely be the Network Operators for non-contestable determinations.
- Network Operators (who are likely to be incumbents) and other key stakeholders are familiar with the policy intent, application and operation of the guidelines, incentive schemes and models.

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<sup>43</sup> EII Act, s. 32(2), EII Regulation, cls. 20(1)(a); specify the grounds on which the Minister is satisfied giving the direction is consistent with the objects of the Act, and (a1); specify the contractual arrangements that the network operator is required to enter to carry out the infrastructure project, and (b); contain other matters the Minister considers relevant.

<sup>44</sup> Excluding priority transmission infrastructure projects.

<sup>45</sup> EII Act, ss. 31(2), 38(6).

<sup>46</sup> EII Regulation, cls. 47A and 47B. The list in the EII Regulation is not exhaustive and we may also apply any other supporting guidelines, incentive schemes or models that are consistent with those made under Chapter 6A of the NER.

<sup>47</sup> A small number of NER transmission guidelines, incentive schemes and models are not relevant given the nature of network infrastructure projects under the EII Act.

<sup>48</sup> EII Regulation, cl. 47B(3).

- Minimising the possibility for inconsistency between the EII Act and NER guidelines that have no material differences, including in their application.
- Reducing the administrative burden on Network Operators, stakeholders and us by not having to consult on a suite of EII Act specific guidelines that are identical to or are not materially different to their NER equivalent.
- It sets a reasonable precedent should we have a regulatory role in renewable energy zones in other jurisdictions.

The following current NER Chapter 6A guidelines, models and incentive schemes will apply to Network Operators under the EII framework:<sup>49</sup>

**1. AER current NER guidelines**

- a) Better Resets Handbook – Towards consumer centric network proposals
- b) Expenditure forecast assessment guideline
- c) Expenditure incentives guideline

**2. AER current NER incentive schemes**

- a) Efficiency benefit sharing scheme
- b) Capital expenditure sharing scheme

**3. AER current models**

- a) Electricity post-tax revenue model (PTRM) and associated handbooks, as modified in accordance with the AER's guidance note 'Amendments to NER PTRM for determinations under the Electricity Infrastructure Investment Act and Regulations'<sup>50</sup>
- b) Electricity roll-forward model and associated handbooks.

The financeability guidelines as developed under the NER Chapter 6A.6.3A(p)–(s) will also apply under the EII Framework.

In its revenue proposal a Network Operator may propose to modify the application of a guideline, incentive scheme or model but must provide reasons for doing so. Depending on the circumstances and the reasoning, we may be willing to consider modifying our current incentive schemes and we would do this on a case-by-case basis.

We will amend or update guidelines, incentive schemes and models made under Chapter 6A of the NER in accordance with the NER. When this occurs, we will direct Network Operators, scheme entities and other key stakeholders to the consultation process. This approach aligns with that outlined in section 1.1.1 and avoids duplication of consultation processes unless material differences arise.

**4. EII specific guidelines**

Regulation 42 requires us to:

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<sup>49</sup> All current relevant supporting handbooks, guidance notes and the like published on the AER's website will also apply to Network Operators under the EII framework

<sup>50</sup> The guidance note provides direction on how to modify the PTRM to remove sections or calculations that are to be excluded from an EII determination, such as the X-factor smoothing (EII Regulation, cl. 47A(5)(e)). Revenue smoothing occurs through the annual contribution determination process under EII Act, s. 56.

- a) issue guidelines for Network Operators that address the following:
  - i) the legal separation of the entity through which a network operator conducts regulated activities from any other entity through which it conducts business,
  - ii) the establishment and maintenance of consolidated and separate accounts for regulated activities and other activities conducted by the network operator,
  - iii) the limitations on the flow of information from or within the network operator if there is the potential for a competitive advantage or disadvantage to arise, and
- b) set standards about the legal and functional separation of the regulated activities of a network operator from other activities of the network operator, and
- c) monitor compliance by network operators with the standards.

We will also develop an:

- EII Confidentiality Guideline.
- EII Cost Allocation Guideline
- EII Service target performance incentive scheme. This scheme would apply to non-contestable determinations from the second regulatory control period onwards.<sup>51</sup>

Following further direction from the NSW Government, we anticipate finalising guidelines required under Regulation 42. We will consult with stakeholders on these guidelines. We will commence development of a service target performance incentive scheme at a later date, noting that this scheme will apply to non-contestable determinations from the second regulatory control period.<sup>52</sup> We will also consult with stakeholders on development of this scheme.

### 3.4 Submitting a cost allocation method

Under clause 6A.19.4 of EII Chapter 6A, a Network Operator must submit a cost allocation methodology to us for approval in compliance with the cost allocation principles<sup>53</sup> and the EII specific Cost Allocation Guideline. We consider it likely that most Network Operators subject to a non-contestable determination will be incumbent transmission network services providers and as such have an existing cost allocation methodology that they can update to address the EII Act, EII Regulation and relevant guidelines. This reduces the administrative burden of having to prepare an additional cost allocation methodology.

A Network Operator must submit a cost allocation method to the AER no less than 60 business days prior to the deadline for the Network Operator to submit its revenue proposal.

We will publish a decision as to whether we have approved or refused to approve a Network Operator's cost allocation methodology within 30 business days of receiving it, failing which we will be taken to have approved it.<sup>54</sup>

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<sup>51</sup> EII Regulation, cl. 47B(2).

<sup>52</sup> EII Ch 6A, cl. 6A.19.2.

<sup>53</sup> EII Ch 6A, cl. 6A.19.4(c).

<sup>54</sup> EII Ch 6A, cl. 6A.19.4(d).

## 3.5 Notifying the AER of an intention to submit a revenue proposal

We encourage open engagement between a Network Operator and us, including prior to lodging a revenue proposal to assist in early identification of potential issues.

When preparing its initial or subsequent revenue proposal, a Network Operator should, provide an overview of its approach to issues like:

- a) The methodology the Network Operator intends to use to forecast operating expenditure and capital expenditure.
- b) The Network Operator's approach to stakeholder consultation in developing its revenue proposal.
- c) The Network Operator's approach to applying incentive schemes and pass-through events.
- d) Any other matter the Network Operator considers relevant to bring to our attention.

We expect that we and the Network Operator would commence these discussions at a reasonable time in advance of the Network Operator submitting its revenue proposal. We intend to have an open dialogue with Network Operators on any emerging issues through bilateral and stakeholder engagement meetings prior to the submission of their formal revenue proposal. Where possible, we will provide feedback to the Network Operator and other stakeholders on any pre-lodgement issues to support and facilitate the engagement process between the Network Operator and its stakeholders in the development of the revenue proposal. The level and timing of our feedback may vary depending upon the nature of the engagement undertaken by the Network Operator and the availability of information and data available to us.

### 3.5.1 Pre-lodgement stakeholder consultation

We expect a Network Operator will use its best endeavours to engage with stakeholders ahead of submitting its revenue proposal to us. This may include, but is not limited to, consulting stakeholders on the nature of the project through to the costs that it proposes to incur to meet the requirements of the Consumer Trustee's authorisation or the Minister's authorisation or direction.

We expect that a Network Operator, where possible and appropriate, will incorporate the findings of this pre-lodgement stakeholder engagement into its revenue proposal. We acknowledge that a non-contestable infrastructure project may have interlinkages with a contestable project that is based on extensive commercially sensitive information. We appreciate that this may constrain the information shared as part of the Network Operator's stakeholder engagement. For an initial revenue determination, the timing between an authorisation or direction and the due date for a revenue proposal is unknown and may vary between non-contestable determinations. In these instances, we expect that a Network Operator will use its best endeavours to publish a draft of its revenue proposal for public comment and reflect consumer views in its revenue proposal to us.

For subsequent revenue determinations our expectation is that a Network Operator will publish its draft revenue proposal and allow time for stakeholders to make a submission and reflect consumer views in its revenue proposal before submitting it to us.

In undertaking stakeholder consultation, a Network Operator should aim to satisfy the principles set out in the *AER's Better Resets Handbook – Towards consumer centric network proposals*.<sup>55</sup>

- a) Clear, accurate and timely
- b) Accessible and inclusive
- c) transparent
- d) measurable.

Our guidance note on regulation of actionable ISP projects also provides helpful advice on best practice stakeholder consultation for large transmission projects.<sup>56</sup>

The Network Operator's stakeholder consultation will be narrower than that of transmission network service providers under the NER, as the Consumer Trustee's authorisation or Minister's authorisation or direction will specify most aspects of the non-contestable project. A Network Operator should adapt our guidance on consumer engagement to reflect the more limited scope of their engagement.

We do not expect Network Operators to re-engage with stakeholders on issues that remain unchanged and previously consulted on and settled by the Infrastructure Planner, Consumer Trustee or Minister. Where it is appropriate to rely on the outcomes of earlier engagement processes to support its revenue proposal, a Network Operator may decide to do so.

### **3.5.2 Information notices under section 38(7) of the EII Act**

Under the EII Act we will issue written notices to a Network Operator requiring it to provide information that we require to make a revenue determination.<sup>57</sup> A Network Operator must comply with any information notice we issue unless it has a lawful excuse.<sup>58</sup>

Prior to receiving a revenue proposal, we will issue a notice for information we require to be included in a proposal to enable us to make a revenue determination. Before issuing this information notice, we will engage with the relevant Network Operator. We may also issue a draft information notice to the Network Operator for comment. The information notice will, as a minimum, include the information contained in section 4.1.1 of this Guideline but may also include expenditure and other information to support our assessment of the Network Operator's revenue proposal. Where relevant, information provided in response to a notice may be required to be subject to independent assurance (audit or review) and be supported by a statutory declaration.

We may also request information be provided voluntarily during our assessment of a revenue proposal to assist us in making our revenue determination.

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<sup>55</sup> AER, *Better Resets Handbook - Towards consumer centric network proposals*, 9 December 2021.

<sup>56</sup> AER, *Guidance note - Regulation of actionable ISP Projects*, March 2021.

<sup>57</sup> EII Act, s.38(7)-(8) and EII Regulation, cl. 48.

<sup>58</sup> EII Act, s.38(9).

## 4 Revenue determination process

This section sets out the revenue determination process, including the contents of a Network Operator's revenue proposal and consultation processes.

### 4.1 Revenue proposal

#### 4.1.1 Contents of a revenue proposal

A revenue proposal from a Network Operator must include all information and matters set out in EII Chapter 6A, Schedule 6A.1.<sup>59</sup> It must further:

1. Include a statement of how the Network Operator's revenue proposal is consistent with the relevant Consumer Trustee authorisation or Minister's direction or authorisation and, if it is different, identify and provide reasons for the differences.
2. Identify any parts of the revenue proposal the Network Operator claims to be confidential and the ground for the confidentiality claim in accordance with the EII Act, EII Regulation and EII Confidentiality Guideline.
3. Include the revenue (in total and annually) to be paid to the Network Operator for carrying out the project, including a break-down of the total and annual amounts into their components (as set out under section 38 of the EII Act and the EII Regulation).<sup>60</sup>
4. Include a schedule of payments setting out quarterly amounts proposed to be paid to the Network Operator by the Scheme Financial Vehicle (as defined under the EII Act) for carrying out the project, and the methodology by which these quarterly amounts are to be calculated from the total revenue.<sup>61</sup>
5. Include a formulaic description of any mechanisms that will be used to adjust<sup>62</sup> the revenue proposed to be paid to the Network Operator and the schedule of payments within the regulatory control period (for example, to adjust payments for actual inflation). For each mechanism, provide:
  - a) a description of the components to be adjusted
  - b) the timing of the adjustment for each component, or relevant trigger event
  - c) a detailed explanation of the proposed method of indexation, escalation or adjustment
  - d) identification of the authoritative source (or sources) of indices or data to be used for any indexation, escalation or adjustment.
6. Include proposed costs incurred by the Network Operator in complying with a regulatory requirement and how those costs were calculated.<sup>63</sup>
7. Include payments required to be made by the Network Operator to the Infrastructure Planner under any contractual arrangement. These costs may include the costs of early development works, preparatory activities and project management undertaken by the

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<sup>59</sup> Some matters in EII Chapter 6A, Schedule 6A.1 only apply to subsequent regulatory control periods. These are noted in appendix A.

<sup>60</sup> EII Act, ss. 38(1), 38(2) and EII Regulation, cls. 48 and 50A.

<sup>61</sup> EII Regulation, cl. 52.

<sup>62</sup> EII Regulation, cl. 51.

<sup>63</sup> EII Regulation, cl. 46(1).

Infrastructure Planner (including land, easements, project development work, client delivery and related costs) that are being passed through to the Network Operator.

8. Include for all financial values the dollar terms in which the amounts are presented.
9. Total development and construction capex necessary to carry out the network infrastructure project according to the Consumer Trustee's authorisation or Minister's direction or authorisation.
  - a) A forecast of development and construction capex the Network Operator will incur in the first regulatory control period.
  - b) A forecast of development and construction capex the Network Operator will incur in one or more subsequent regulatory control periods.
  - c) How the proposed staging of development and construction capex complies with the terms of the Consumer Trustee's authorisation or Minister's authorisation or direction.
  - d) Any actual or forecast development and construction capex the Network Operator has or expects to incur before the commencement of the first regulatory control period.
10. Include matters relating to depreciation for the purposes of EII Regulation 47D(3).
11. Be accompanied by an overview paper which includes:
  - a) a summary of the revenue proposal, the purpose of which is to explain the revenue proposal in reasonably plain language to electricity consumers
  - b) a summary of the scope and terms of the Consumer Trustee's authorisation or the Minister's direction or authorisation and the network infrastructure project required to be carried out
  - c) a description of how the Network Operator has engaged with electricity consumers and, if so, what feedback was provided and how that feedback has been taken into account in developing the revenue proposal and
  - d) for each determination after the initial determination, a comparison of the Network Operator's proposed revenue cap with its approved revenues for the preceding regulatory control period (by total and by component).

A revenue proposal must be accompanied by the information requested in an information notice issued under the EII Act.<sup>64</sup>

The Network Operator must also provide a public version of its revenue proposal that includes a summary of its pre-lodgement engagement and any supporting information (including a response to any information notice) for publication on our website.

#### **4.1.2 Treatment of confidential information through revenue determination process**

The EII Confidentiality Guideline<sup>65</sup> will set out handling of confidential information in relation to:

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<sup>64</sup> EII Act, s. 38(7).

<sup>65</sup> EII Regulation, cl. 47 requires us to publish guidelines on its website about the exercise of our functions under Part 5 of the Act, including making a revenue determination.

- a Network Operator's revenue proposal, which is required for the AER to make a revenue determination under sections 38 of the EII Act and EII Regulation 48.
- a Network Operator's responses to any information notices we issue under section 38(7) of the EII Act.
- any other information provided by the Network Operator that is necessary for us to perform our functions.

The Confidentiality Guideline will also set out how Network Operators should submit confidentiality claims to us and our process for considering confidentiality claims.

A Network Operator is entitled to include commercially sensitive information as part of its revenue proposal.

Consistent with this Guideline, a Network Operator should discuss its approach to confidential information with us prior to lodging the revenue proposal so that any issues can be addressed prior to submission.

We may publish on our website the Network Operator's revenue proposal and other information it may provide in response to an information request under section 38 of the EII Act. However, we must not publish this other information if we are satisfied that it is confidential or commercially sensitive.<sup>66</sup>

When publishing our revenue determination, we can decide not to publish parts of our revenue determination if we are satisfied that it is not appropriate, considering the following matters:

- the public interest;
- the extent to which publishing the part of the revenue determination would disclose information that is confidential or commercially sensitive; and
- the effect of publishing the part of the revenue determination on future competitive assessment processes.<sup>67</sup>

Therefore, when assessing a Network Operator's confidentiality claims we may have regard to the above-mentioned matters.

## 4.2 AER preliminary position paper

We will publish a preliminary position paper approximately 55 business days after receiving the Network Operator's revenue proposal. The purpose of this paper is to provide an early indication of our assessment of the revenue proposal and receive feedback from stakeholders.

The preliminary position paper will set out:

- a short summary of the revenue proposal including the areas where we are likely to accept the Network Operator's proposed position in our final decision

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<sup>66</sup> EII Regulation, cls. 53(5) and (6).

<sup>67</sup> EII Regulation, cl. 53(4)(b).

- a short summary of the areas of differences between our assessment and the Network Operator's revenue proposal. Where practical, we will provide an indication of the materiality of these differences on the total revenue amount proposed by the Network Operator.
- explanation of our position on any material and/or contentious matters where we are unlikely to accept the proposed revenue proposal position and are seeking further information from the Network Operator
- our position on any material issues raised in written submissions on the revenue proposal
- upcoming timelines and milestones for the revenue determination process
- information on how stakeholders can provide feedback to the AER.

We will undertake our usual confidentiality checks prior to publication of a preliminary position paper in relation to the revenue proposal or financeability request in accordance with clause 6A.11.2A of EII Chapter 6A.

### **4.3 Consultation on revenue proposal and preliminary position paper**

We intend to publish and consult on:

- The Network Operator's revenue proposal and information requested under an information notice<sup>68</sup> as soon as practicable following our compliance and confidentiality checks<sup>69</sup>
- Our preliminary position paper.

We will provide an opportunity for stakeholders to make submissions on the Network Operator's revenue proposal and our preliminary position paper. We will provide stakeholders approximately 15 business days to provide submissions on each.

We will publish all stakeholder submissions on our website, except where a stakeholder provides a submission in confidence. We prefer submissions that we can publish to enhance the transparency of our determination processes. Where a confidential submission is provided, we request that stakeholders also provide a redacted version suitable for publication.

We may hold a public forum after releasing our preliminary position paper. We will advise of our intention at the time of publishing our preliminary position paper.

We encourage stakeholders to make written submissions and participate in the public forum if they wish to be involved in the revenue determination process.

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<sup>68</sup> EII Act, s. 38(7).

<sup>69</sup> This is consistent with the requirement set out in EII Chapter 6A, cl. 6A.11.3.

## 5 AER's assessment approach

### 5.1 Compliance review of the revenue proposal

Upon receipt of the Network Operator's revenue proposal, we will:

- a) undertake a compliance review of the proposal to ensure that it meets requirements set out in EII Act and EII Regulation and this Guideline, including the completeness of models
- b) assess whether the Network Operator has submitted information in compliance with our EII Confidentiality Guideline
- c) assess whether the revenue proposal is consistent with the requirements of an authorisation made by the Consumer Trustee, or a direction or authorisation issued by the Minister; and
- d) assess that the Network Operator's response to any information notice we issue under the EII Act is complete
- e) for a REZ network infrastructure project authorised by the Consumer Trustee, assess whether the Network Operator's proposed capital cost to develop and construct a project exceeds the maximum capital cost set by the Consumer Trustee.

If the Network Operator's revenue proposal does not comply with requirements (a)–(e), we will notify the Network Operator, Consumer Trustee and Infrastructure Planner and discuss the areas of non-compliance as soon as practicable after receiving the revenue proposal.<sup>70</sup>

If we notify the Network Operator of non-compliance in its revenue proposal the Network Operator must, within 10 business days of that notice, resubmit its revenue proposal or provide further information in a form that complies with the relevant requirements that we have set out.

If we accept the Network Operator's revenue proposal, we will publish the public version of it on our website for consultation, noting that we are unable to consider stakeholder views on aspects of the network infrastructure that have been set out in the Consumer Trustee's authorisation or Minister's authorisation or direction as these are matters outside the control of the Network Operator.

### 5.2 Transmission Efficiency Test and forecast capital expenditure

We will apply the Transmission Efficiency Test and forecast capital expenditure objectives, factors and criteria to calculate the total capex allowance a Network Operator may recover for a REZ network infrastructure project. The following section sets out our approach applying the Transmission Efficiency Test to development and construction capex and assessing a Network Operator's broader forecast capital expenditure.

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<sup>70</sup> EII Act, s. 31(3). Noting that such discussions must preserve the confidentiality of the Consumer Trustee's maximum capital cost, where applicable.

### 5.2.1 Subsequent revenue proposals

In subsequent revenue proposals, Network Operators may seek to recover capex other than development and construction capex. In these instances, we will apply:

- a) The Transmission Efficiency Test for any further development and construction capex (where it goes beyond the initial regulatory control period)<sup>71</sup>
- b) The maximum capital cost for development and construction capex (again, where it goes beyond the initial regulatory control period)
- c) Our forecast capital expenditure assessment for all remaining capex proposed (which is equivalent to the TET).

Therefore, in subsequent revenue proposals the Transmission Efficiency Test is an input to determine a Network Operator's total capex allowance (assuming development and construction capex extends beyond the initial regulatory period).

Our assessment process for the Transmission Efficiency Test and forecast capital expenditure is set out at clause 6A.6.7 of EII Chapter 6A.

### 5.2.2 Staging development and construction capex beyond the initial regulatory control period

We expect that a Network Operator will incur most development and construction capex within the first five years. However, we note that depending on the size and nature of the network infrastructure project, some building of the infrastructure may be staged beyond the initial regulatory control period, meaning development and construction capex would form part of the Network Operator's subsequent revenue proposals.

If development and construction capex is to be staged over more than one regulatory control period, we expect that the Consumer Trustee's authorisation or Minister's direction will state the timing, and if so, how this is reflected in any maximum capital cost the Consumer Trustee sets.

A Network Operator must provide a forecast of its development and construction capex necessary to carry out the network infrastructure project as required under the Consumer Trustee's authorisation (as detailed in section 4.1).

### 5.2.3 Prudent, efficient and reasonable

In applying the Transmission Efficiency Test, we must determine that the capital costs for development and construction for the network infrastructure project are prudent, efficient and reasonable.<sup>72</sup>

Where practicable, we intend to ensure consistency between the NER Chapter 6A framework and the EII framework. In calculating the capital costs, we will calculate costs that are prudent and efficient as per our current *Expenditure Forecast Assessment Guideline for*

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<sup>71</sup> EII Regulation, cl. 51(4) permits us to adopt, without recalculation, the existing capital costs calculated using the transmission efficiency test for the previous determination.

<sup>72</sup> EII Act, s. 38(4).

*Electricity Transmission (Expenditure Assessment Guideline)*. In our Expenditure Assessment Guideline, we state:

*“We consider that the notion of efficient costs complements the costs that a prudent operator would require to achieve the expenditure objectives. Prudent expenditure is that which reflects the best course of action, considering available alternatives. Efficient expenditure results in the lowest cost to consumers over the long term. That is, prudent and efficient expenditure reflects the lowest long-term cost to consumers for the most appropriate investment or activity required to achieve the expenditure objectives.”<sup>73</sup>*

In assessing whether the capital costs are reasonable, we will assess whether the costs, and the calculation of those costs, are based on reason or reasonably open based on the facts before us.

Accordingly, in calculating prudent, efficient and reasonable capital costs, we will calculate costs that are prudent and efficient as per our current Expenditure Assessment Guideline, whilst ensuring that the calculations are reasonably open based on the facts before us.

#### **5.2.4 Our approach to assessing forecast capex (other than development and construction capex)**

The transmission networks we regulate under the NER are established ‘brownfield’ networks. That is, extensive infrastructure already exists. Therefore, our assessments examine the following additional categories of forecast capex:

- a) augmentations to the existing network (augmentation expenditure or augex)
- b) replacement of the existing network (replacement expenditure or repex)
- c) non-network capital expenditure
- d) connections and customer-initiated works capital expenditure.

In subsequent regulatory control periods and depending on the nature of the network infrastructure project, we expect to receive revenue proposals that include capex other than development and construction capex. Our approach to assess forecast capex is consistent with our Transmission Efficiency Test for assessing prudent, efficient and reasonable development and construction capex.

Some differences between the NER and EII regulatory frameworks may require us to modify the assessment techniques described in our expenditure forecast assessment guideline.<sup>74</sup> Potential modifications might include:

- a) Limited trend analysis in our initial determination but will be used for subsequent determinations.

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<sup>73</sup> AER, [Expenditure Forecast assessment guideline for transmission](#), 2013, p. 9. The Expenditure Assessment Guideline is framed around an assessment against the National Electricity Objective. In applying the guideline, we will have reference to the objectives of the EII Act.

<sup>74</sup> Our assessment techniques are summarised in cl. 2.4 of the *AER’s Expenditure Forecast Assessment Guideline – Transmission*.

- b) Predictive modelling for replacement expenditure and augmentation expenditure will be more relevant for subsequent determinations, where this category of capex is included in a Network Operator's revenue proposal.
- c) No cost benefit analysis as the assessment of different project options is done by the Infrastructure Planner in making recommendations to the Consumer Trustee.
- d) In considering the need for material replacement and augmentation expenditure in subsequent determinations, we will have regard to any instructions from the Consumer Trustee or Minister.<sup>75</sup>
- e) We expect that applicable demand forecasts will be developed by the Infrastructure Planner, forming part of the basis of the Consumer Trustee's authorisation or Minister's authorisation or direction. Therefore, we will only assess a Network Operator's demand forecasts to the extent that they relate to any investment that is left to the discretion of the Network Operator.

### 5.2.5 Pre-period costs

It is possible that a Network Operator may incur costs related to the carrying out of a network infrastructure project prior to the first regulatory period commencing. As there will not be an existing determination or RAB for the Network Operator, these costs (if validly incurred) will need to be included in the post-tax revenue model as an opening RAB (together with appropriate financing costs). In order for these pre-period costs to be factored into amounts payable to a Network Operator they must be included in a Network Operator's revenue proposal for the initial regulatory period. The Network Operator will need to provide justification that the costs are:

- consistent with the relevant authorisation or Ministerial direction;
- related to the carrying out of the infrastructure project; and
- prudent, efficient and reasonable.

We will review the information provided by the Network Operator on the pre-period costs before deciding whether or not to include them in our determination. We expect most pre-period costs to be capital expenditures but will review any operating expenditures proposed to be recovered.

## 5.3 Depreciation

The approach to calculating depreciation is captured in the EII Regulation and EII Chapter 6A (**Appendix A**).

Under the EII Regulation we must calculate the depreciation using the depreciation schedules prepared in accordance with NER Chapter 6A.<sup>76</sup>

Our standard assessment approach, consistent with NER Chapter 6A.6.3 and the equivalent EII clause 6A.6.3, is set out in our assessment approaches for regulatory depreciation as in

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<sup>75</sup> However, we expect any material augmentation will be covered by a separate authorisation or direction and separate revenue determination rather than being assessed as part of broader capex in a subsequent revenue determination under the original authorisation or direction.

<sup>76</sup> EII Regulation, cl. 47D(2). Where there is consistency between the NER Chapter 6A and EII Chapter 6A, for the purposes of determining depreciation in accordance with this EII Regulation, we will refer to EII Chapter 6A in this guideline.

our regulatory determinations.<sup>77</sup> One of the key considerations behind determining a depreciation schedule is ensuring it is calculated using a profile that reflects the nature of the asset (or category of assets) over its economic life.<sup>78</sup>

### 5.3.1 Amending the depreciation schedule for financeability

The EII Regulation and EII Chapter 6A allow us to modify a depreciation schedule if a Network Operator is unable to efficiently obtain finance to carry out the infrastructure project (a financeability issue).<sup>79</sup> Specifically, we may depreciate the asset (or group of assets) using a profile that differs from the nature of the assets that we consider is appropriate to address a financeability issue.<sup>80</sup>

To modify a depreciation schedule for a financeability issue, we must be satisfied that it is reasonably necessary to ensure:

- a) the non-contestable revenue determination is consistent with the objects of the EII Act, specified in section 3(1)(a)–(c), and
- b) the Network Operator is capable of efficiently obtaining finance to carry out the network infrastructure project.<sup>81</sup>

The process under which we will assess an application to amend the depreciation for a financeability issue is outlined in EII Chapter 6A.6.3A. Under EII Chapter 6A, a Network Operator can submit a financeability request to us,<sup>82</sup> in which they can propose adjustments to the asset (or group of assets) to be depreciated on a basis other than on a straight-line depreciation approach.<sup>83</sup>

EII Chapter 6A.6.3A sets out certain conditions under which a Network Operator may submit a financeability request to the AER. These conditions relate to:

- whether the relevant project (that is, the project the Network Operator is submitting a financeability request for) is an actionable ISP project<sup>84</sup>
- whether it has obtained concessional financing in relation to this project or any other ISP project and whether any benefits are being retained by the Network Operator.<sup>85</sup>

Following the Network Operator submitting a financeability request, we will apply the financeability test set out in EII Chapter 6A, to determine whether or not a financeability issue

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<sup>77</sup> See for example our recent regulatory determination for Transgrid's 2023–28 regulatory control period under the NER and our determination for Transgrid's WSB augmentation project under the EII Framework. AER, Transgrid 2023–28 – Draft Decision – Attachment 4 – Regulatory depreciation, September 2022, pp. 3–7; AER, Transgrid 2024–29 – Draft Decision – Waratah Super Battery project (non-contestable) – Appendix A – Assessment approaches, September 2023, pp. 13–17.

<sup>78</sup> EII Chapter 6A, cl. 6A.6.3(b)(1).

<sup>79</sup> EII Chapter 6A.6.3A(n)(1); EII Regulation, cl. 47D(3).

<sup>80</sup> EII Chapter 6A, cl.6A.6.3A(n)(1). Any amendments for financeability must still conform with EII 6A.6.3(b)(2)–(3).

<sup>81</sup> EII Regulation, cl. 47D(3).

<sup>82</sup> EII Chapter 6A, cl. 6A.6.3A(b).

<sup>83</sup> EII Chapter 6A, cl. 6A.6.3A(b)(4).

<sup>84</sup> EII Chapter 6A, cl. 6A.6.3A(d).

<sup>85</sup> EII Chapter 6A, cl. 6A.6.3A(e).

exists.<sup>86</sup> The financeability test assesses whether there is a financeability issue on a whole of regulated business basis—that is, if the Network Operator is also a Service Provider under the National Electricity and Gas Rules, we will take a view on financeability inclusive of any regulated assets.<sup>87</sup> As part of this test, we must determine the Network Operator’s financeability position<sup>88</sup> prior to and after the inclusion of the ISP project, in relation to a financeability threshold.<sup>89</sup>

If the financeability test demonstrates that there is a financeability issue, we must, as part of our final decision, address the financeability issue by:<sup>90</sup>

- a) preventing the Network Operator’s financeability position (as determined through the financeability test) from deteriorating below a particular threshold (also determined through the financeability test); or
- b) preventing the Network Operator’s financeability position from deteriorating from its initial position prior to the ISP project.

### 5.3.2 Financeability guideline

We are required to publish a financeability guideline under the NER Chapter 6A.<sup>91</sup> The guideline will set out, among other considerations, how we will determine the financeability position of a Network Operator submitting a financeability request,<sup>92</sup> the financeability threshold at which a financeability issue is identified,<sup>93</sup> and how modifications to the depreciation schedule will be made in the AER’s PTRM.<sup>94</sup> We will publish this financeability guideline under the NER by 31 December 2024.<sup>95</sup> To ensure regulatory consistency for the treatment of financeability across the two frameworks, once this financeability guideline is published, we will apply it to the EII framework when considering any financeability request submitted by a Network Operator.

In the event we receive a financeability request from a Network Operator prior to the final financeability guideline being published, we will use our reasonable endeavours to:

- assess whether there is a financeability issue through a financeability test,<sup>96</sup> and
- address a financeability issue (if found).<sup>97</sup>

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<sup>86</sup> EII Chapter 6A, cl. 6A.6.3A(i) to (l).

<sup>87</sup> EII Chapter 6A, cl. 6A.6.3A(j).

<sup>88</sup> The Network Operator’s financeability position is calculated using the Maximum Allowable Revenue (MAR) derived from the prevailing Post Tax Revenue Model (PTRM). That is, the assessment is based on a Network Operator’s regulated business only and will use the benchmark gearing ratio set out in the applicable RORI, or the benchmark gearing ratio as adjusted for the increased equity component in that ratio in accordance with any relevant concessional finance agreement.

<sup>89</sup> The financeability threshold is equivalent to the benchmark credit rating in the applicable RORI.

<sup>90</sup> EII Chapter 6A, cl.6A.6.3A(m).

<sup>91</sup> NER Chapter 6A, cl. 6A.6.3A(p).

<sup>92</sup> NER Chapter 6A, cl. 6A.6.3A(p).

<sup>93</sup> NER Chapter 6A, cl. 6A.6.3A(r)(3).

<sup>94</sup> NER Chapter 6A, cl. 6A.6.3A(s).

<sup>95</sup> AEMC, *Rule determination –Accommodating financeability in the regulatory framework*, March 2024, p. 26.

<sup>96</sup> EII Chapter 6A, cl. 6A.6.3A(i)–(l).

<sup>97</sup> EII Chapter 6A, cl. 6A.6.3A(m)–(n).

To the extent that a draft financeability guideline has been published under the NER,<sup>98</sup> we would look to apply the outcomes of the draft guideline where appropriate.

## 5.4 Forecast operating expenditure

Consistent with our approach to assessing forecast capex, we will apply our current expenditure forecast assessment guideline to assess Network Operators' revenue proposals and determine an opex allowance under the EII Act. We may modify our assessment approach to reflect differences between the EII framework and the NER framework where we identify the need to do so. Should we materially modify our approach, we will set these modifications out in our determination.

### 5.4.1 Establishing base opex for the initial revenue determination

In our initial determination for a network infrastructure project, we will have no base year from a preceding regulatory control period on which to assess revealed opex. In establishing a base from which to assess a Network Operator's proposed opex allowance we will consider the following factors in addition to our usual assessment approach:

- a) Input costs, metrics and benchmarks associated with any other NEM networks that the Network Operator or other similar businesses may own and operate (if applicable).
- b) Any elements of a contestable project that may impact the relevant non contestable project's opex costs.
- c) The outcome of any detailed project review if required.
- d) Our approach to setting regulated opex for other network projects with similar characteristics (e.g. growth projects undertaken by TNSPs).

We expect that a Network Operator's initial proposed opex allowance should at a minimum adopt the general expectations set out in our expenditure forecast assessment guideline and be in accordance with the approved cost allocation methodology, and should identify and quantify:

- a) the number and cost of permanent and casual staff engaged to operate and/or maintain EII regulated network assets either exclusively or on a pro rata basis as appropriate
- b) the cost of external contractors, consultants and other service providers providing operating and/or maintenance services in relation to the regulated network assets
- c) the cost-of-service contracts, insurance and other ongoing expenses exclusively associated with the regulated network assets.

## 5.5 Adjustment of a revenue determination

A network operator may include in its revenue proposal mechanism/s to adjust any amount provided for in our revenue determination. However, Regulation 51 of the EII Regulations provides the AER with discretion as to whether or not to include an adjustment mechanism in its determination. The Regulations also state that a provision in our determination may specify that a particular adjustment:

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<sup>98</sup> NER Chapter 6A, cl. 6A.6.3A(p)–(s).

- a) must be carried out at particular times or in particular circumstances
- b) may or may not require the revenue determination to be revised and remade.

### 5.5.1 Assessment of adjustment mechanisms

We note that the EII contestable framework is largely consistent with the NER Chapter 6A framework and therefore provides for a number of adjustment mechanisms including pass through events and nominated pass through events. In assessing any proposed adjustment mechanisms, the AER is likely to have regard to the nominated pass-through event considerations referenced in the EII Chapter 6A Rules.

The ability of a network operator to propose adjustment mechanisms under the EII framework should not be interpreted as a retreat from incentive-based regulation. Incentive regulation is fundamental to promoting efficiency in both Chapter 6A of the NER and the EII Act.<sup>99</sup> For example, we note that we continue to expect expenditure forecasts proposed by a network operator and any adjustment mechanisms to be respectively unbiased estimates and symmetrical in their application.

### 5.5.2 Process for adjusting a Network Operator's revenues

The following sets out our process for adjusting a Network Operator's revenues as set out in our revenue determination.<sup>100</sup>

1. *Network Operator submits to the AER proposed revenue adjustments, adjusted revenue and an adjusted payment schedule for the regulatory control period* – The information must be submitted by a specified date prior to the date the adjusted revenue will apply.
2. *Network Operator's revenue adjustment proposal must include evidence supporting the proposed adjustments* – This evidence would include details of inputs into the revenue adjustment mechanism and any supporting information.
3. *AER undertakes a compliance check and notifies the Network Operator whether we agree with the proposed revenue adjustments, adjusted revenue and an adjusted payment schedule for the regulatory control period* – We would review the Network Operator's proposal and undertake a compliance check against the relevant revenue adjustment provisions contained in our determination. We would advise the Network Operator whether we agree with the proposed revenue adjustments, require further information or require the Network Operator to amend and resubmit its proposal. We may amend the proposal if the Network Operator fails to submit an amended proposal that meets our requirements. Once we have approved the revenue adjustment proposal, we would advise the Network Operator and publish the adjusted revenue and payment schedule for the regulatory control period.

We expect to make revenue adjustments annually from the second year of the regulatory control period. For annual adjustments, we expect Network Operators to provide all relevant information required for us to assess the proposed adjustment at least 63 business days prior to the start of the annual period in which the adjusted revenue will first apply.

Our revenue determination may specify a trigger event which requires us to assess a proposed adjustment event outside of the annual process.<sup>101</sup> A Network Operator must

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<sup>99</sup> EII Act 37(1)(b).

<sup>100</sup> EII Regulation, cl. 51.

<sup>101</sup> EII Regulation, cl. 51(2)(b).

provide us with the relevant information to assess proposed adjustment as soon as practicable following the trigger event. Where the AER approves a revenue adjustment, the adjusted revenue will apply from the start of the next full quarter (unless otherwise specified in the revenue determination).

We will endeavour to make revenue adjustment decisions within 42 business days of receipt of the revenue adjustment proposal.

## **5.6 Payments to be made by the Network Operator to the Infrastructure Planner**

The EII Regulation sets out a range of costs a Network Operator is entitled to recover.<sup>102</sup> We will determine these costs as part of our non-contestable revenue determination process. However, where a Network Operator is required to make payments to the Infrastructure Planner under a contractual arrangement as part of a relevant authorisation,<sup>103</sup> we will pass them through as part of our non-contestable revenue determination. That is, we do not review the efficiency, prudence or reasonableness of these costs but must still include them in our non-contestable revenue determination.

## **5.7 Transferring REZ network infrastructure to the NER**

The EII Act provides for a network operator who is subject to a non-contestable revenue determination (and is also subject to an existing determination under the NER) to have its REZ network infrastructure assets transferred to the NER.<sup>104</sup> Since releasing our draft Guideline in November 2022, Regulations 54A–D have been made that set out the process and Ministerial Direction required for a Network Operator’s REZ network infrastructure to be transferred to a revenue determination made under the NER.

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<sup>102</sup> EII Regulation, cl. 46(1)(b).

<sup>103</sup> EII Regulation, cls. 46(1)(b)(ii) and 50A; EII Act, s. 38(2).

<sup>104</sup> EII Act, s. 42.

## 6 Non-contestable components of contestable augmentation determination

This section sets out the process for assessing a non-contestable cost component of a contestable augmentation revenue determination.

### 6.1 Framework for contestable augmentations

The EII Regulation contains a framework for the AER to make revenue determinations for contestable augmentations.<sup>105</sup> A contestable augmentation is a network infrastructure project carried out by a network operator to augment an existing network infrastructure project that is subject to a contestable revenue determination.<sup>106</sup> The contestable augmentation would be a separate network infrastructure project, subject to its own authorisation and revenue determination.<sup>107</sup>

Under the EII Regulation, cost components of a contestable augmentation are determined through one of three methods:

1. as a result of a competitive assessment process (contestable costs)<sup>108</sup>; or
2. using an appropriate referenced costs process contained in the contractual arrangements for the existing network infrastructure project (referenced costs)<sup>109</sup>; or
3. by an AER assessment of the prudent, efficient and reasonable cost based on the application of our non-contestable Guideline (non-contestable costs)<sup>110</sup>.

After establishing an amount for each cost component, the AER must then combine the amounts into a revenue determination for the Network Operator.<sup>111</sup>

Our process for assessing non-contestable cost components as part of a contestable augmentation must be set out in this Guideline.<sup>112</sup>

The broader process we will undertake in making a contestable augmentation determination, including information requirements and consultation with the Network Operator, will be set out in our contestable guideline. Any updated contestable guideline will also set out our approach to assessing contestable and referenced costs.

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<sup>105</sup> EII Regulation, cl. 47E.

<sup>106</sup> EII Regulation, cl. 3.

<sup>107</sup> EII Regulation cls. 47E(1) & 48(1A).

<sup>108</sup> EII Regulation, cl. 47E(2).

<sup>109</sup> EII Regulation, cl. 47E(3).

<sup>110</sup> EII Regulation, cl. 47E(4).

<sup>111</sup> EII Regulation, cl. 47E(6).

<sup>112</sup> EII Regulation, cl. 47E(6).

## 6.2 Assessment of non-contestable cost components

Our assessment of non-contestable cost components is only one component of a broader contestable augmentation determination. Most process elements of this Guideline will, therefore, not be relevant to that assessment. Relevant sections of the Guideline are set out below.

In proposing non-contestable costs, a Network Operator should have regard to the consultation expectations set out in section 3.5.1 of this Guideline.

Our assessment of proposed non-contestable costs will largely reflect the process set out in section 5 (AER's assessment approach) of this Guideline. However, the EII Regulation requires us to also take into account the contractual arrangements for the related network infrastructure project, and any other contract entered into by the network operator under an authorisation in relation to the contestable augmentation.<sup>113</sup> These requirements reflect the expectation that the structure of our determination, including adjustments and incentive schemes, will reflect the structure of the contestable determination for the related network infrastructure project.

The period for which we must set out the schedule of amounts required to be paid to the network operator for a contestable augmentation must also correspond with the term of the contractual arrangements for the related network infrastructure project.<sup>114</sup> This may be a period of greater than five years. In these circumstances, we consider that bespoke models will need to be used to determine non-contestable cost components for the relevant project term.

## 6.3 Timeframe for our assessment

The timeframe for making a contestable augmentation determination differs from a standard non-contestable determination. The standard timeframe for the AER to make a revenue determination for a contestable augmentation is 84 business days.<sup>115</sup> However, we may, by written notice to the network operator, extend the time period by a further 42 business days if satisfied the extension is reasonably necessary because:

- the revenue determination is complex, and
- we are not satisfied that a cost component should be considered a contestable or referenced cost.<sup>116</sup>

Noting this shorter timeframe, we expect to use a truncated approach to that set out in table 1 (section 2 of this Guideline). We expect to generally undertake a single round of public consultation either on the relevant non-contestable cost components as set out in the

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<sup>113</sup> EII Regulation, cl. 47E(5).

<sup>114</sup> EII Regulation, cl. 52(2)(d).

<sup>115</sup> EII Regulation, cl. 50(a1).

<sup>116</sup> EII Regulation, cl. 50(2A).

revenue proposal, or on an issues paper that we develop.<sup>117</sup> Consistent with our approach to contestable determinations, we will not undertake consultation on contestable or referenced cost components of a contestable augmentation.

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<sup>117</sup> The AER may publish on its website information given to the AER under clause 48 that relates to a determination under clause 47E(4) for a contestable augmentation (EII Regulation, cl. 53(5)(b)).

## Glossary

Term	Definition
AER	Australian Energy Regulator.
Consumer Trustee	A person or body appointed under section 60 of the EII. The Consumer Trustee is required to act independently and in the long-term financial interests of NSW electricity consumers. AEMO Services Ltd has been appointed as consumer trustee.
Contestable augmentation	Has the meaning given to that term in the EII Regulation.
Contractual arrangement	Contracts that the Network Operator enters as required under the Consumer Trustee's authorisation or Minister's authorisation or direction. This includes contracts made between the Infrastructure Planner and the Network Operator for carrying out a network infrastructure project under section 63(4)(a) of the EII Act.
EII Act, the Act	Electricity Infrastructure Investment Act 2020 (NSW).
EII Regulation	Electricity Infrastructure Investment Regulation (NSW) 2021 made under the EII Act.
Infrastructure Planner	A person authorised to exercise the functions of an infrastructure planner under section 63 of the EII Act. The Infrastructure Planner performs a range of planning and contracting functions. The Energy Corporation of NSW has been appointed to undertake the role of Infrastructure Planner for the five renewable energy zones listed in section 23 of the EII Act.
NEL	National Electricity Law as it applies in NSW.
NER	National Electricity Rules.
Network Operator	Has the meaning given to that term in the EII Act.
NSW Government	The NSW Government department or entity responsible for developing and implementing policy and legislative proposals relating to the NSW Infrastructure Roadmap (which is enabled by the EII Act). The relevant department or entity may change from time to time in line with NSW machinery of government changes.
Project, network infrastructure project	A REZ Network Infrastructure Project or Priority Transmission Infrastructure Project as defined in the EII Act.
Priority transmission infrastructure project	Has the meaning given to that term in the EII Act.
RAB	Regulatory asset base
Regulated activities	Activities for which a Network Operator is paid under a revenue determination under section 38(1) of the EII Act.

Transmission Efficiency Test and revenue determination guideline for NSW non-contestable network infrastructure projects - Draft amendments

Term	Definition
Regulator	A person or body appointed as a regulator under section 64 of the EII Act. The AER has been appointed as a Regulator for the purposes of Part 5 of the EII Act.
Renewable Energy Zone (REZ)	Has the meaning given to that term in the EII Act.
REZ network Infrastructure project	Has the meaning given to the term in the EII Act.
Transmission Efficiency Test	The test to be applied to calculate the prudent, efficient and reasonable capital costs for development and construction of a network infrastructure project under section 38(4) of the EII Act.