AUSTRALIAN ENERGY REGULATOR

Our Ref: 17907117
Your Ref: ERC0391
Contact Officer: David Monk
Contact Phone: [redacted]

4 February 2025

Ms Anna Collyer
Chair
Australian Energy Market Commission
GPO Box 2603
Sydney NSW 2001

Dear Ms Collyer

Re: Improving the cost recovery arrangements for transmission non-network options – draft determination

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) draft determination on the *Improving the cost recovery arrangements for transmission non-network options* rule change.

The AER supports the intention of the rule change to reduce barriers to implementing transmission non-network options (NNOs) by:

- addressing real or perceived cost recovery uncertainty experienced by Transmission Network Service Providers (TNSPs) seeking to implement NNO projects
- improving the timeliness of cost recovery by providing a mechanism for the ex-ante assessment and approval of forecast network support costs for NNOs within a regulatory control period
- seeking to achieve greater alignment between the cost recovery framework for NNOs and the recovery of costs for capital expenditure projects required to meet similar network needs.

While we support the overall purpose and intention of the draft rule change, we provide the following feedback on the specific approaches and rule drafting set out in the draft determination for consideration by the AEMC in making a final determination.

Amendments to the opex criteria

The draft rule adds a fourth criterion to the operating expenditure (opex) criteria in clause 6A.6.6(c) of the National Electricity Rules (NER). This additional criterion would effectively require that the AER <u>must</u> accept a forecast of required operating expenditure if satisfied it reasonably reflects a methodology for a *network alternative support payment* previously approved by the AER. The draft determination does not explain a specific rationale for amending the opex criteria in this way.

In our view, this amendment to the opex criteria is not required to achieve the intended purpose of the rule change, and may lead to unintended consequences including placing limitations on the AER's scope to review the efficiency of forecast expenditure for NNO projects. The draft determination states that the intention of the rule change is that the AER would 'have regard' to an approved methodology, but that approval of a methodology does not constitute approval of future costs and does not bind the AER to automatically approve costs in the future if any forecast and/or actual costs were consistent with the methodology. The new opex criterion is inconsistent with this intention, as it may lead to circumstances where the AER must accept forecast costs if consistent with a previously approved methodology including, for example, where circumstances may have changed such that the efficiency of specific payments or costs is in question.

More generally, we also note that the existing opex and capex criteria are generally applicable to all categories of network expenditure, and form the central basis of all AER determinations on prudent and efficient expenditure. The introduction of a new opex criterion that relates solely to a small, specific category of opex is incongruous, creates inconsistency between the opex and capex criteria in the NER, and is likely to cause uncertainty as to its interpretation and application. We also consider that, as noted in the draft determination, the current rules already provide a high degree of cost recovery certainty to TNSPs for relevant ongoing NNO agreements from one regulatory period to the next.

For these reasons, we submit that the AEMC reconsider this proposed amendment to the opex criteria in the NER in making the final rule.

Approval of a 'methodology' for contract payments

The draft rule establishes a process for TNSPs to seek an ex ante determination from the AER on a 'methodology' for how costs under an agreement between a TNSP and NNO provider would be incurred and adjusted over time. We understand the draft rule allows TNSPs to submit a 'methodology' only at the same time the TNSP seeks a network support payment allowance: either at the 5 yearly revenue determination stage, or in seeking a mid-period adjustment to the network support payment allowance.

We support the approach of linking the timing of 'methodology' reviews with the process of setting or amending revenue forecasts. We consider the AER would necessarily need to consider the methodology and contract terms that give rise to forecast network support costs in approving a network support payment allowance. That is, making a determination on forecast network support costs requires assessment of the underlying payment methodology, assumptions and forecasts. It is also not clear what the eligibility criteria or thresholds could be for review of a 'methodology' as opposed to review of a forecast of required revenue. We would not support the introduction of a 'methodology' approval which is not tied to a related revenue determination.

We note the draft rule determination states that the AER would determine the required content for 'methodologies' in the new *network alternative support payment guideline*. We consider the content of methodologies and payment terms included in draft contracts for network support services should not be prescribed by the AER, but rather negotiated between TNSPs and NNO providers in the specific circumstances of each NNO project. We therefore anticipate that taking a high level, principles based approach to this guidance would best achieve efficient outcomes for consumers, and we support the rule change providing the AER with flexibility in this regard.

New process to adjust the network support payment allowance

As discussed above, the draft rule would create a new process under new clauses 6A.6.6A and 6A.7.2A whereby a TNSP could apply to the AER to adjust the network support payment allowance within the regulatory control period if the application meets certain eligibility criteria and thresholds.

We note that the NER already provides for multiple mechanisms by which a TNSP's forecast revenue allowance may be adjusted within a regulatory control period. These include through a prescribed or nominated pass through event, a contingent project, and a capex reopener. The network support payment allowance included in a revenue determination may already be adjusted under the existing framework if the cause of the change in costs relates to an existing category of cost pass through event, such as a regulatory change event or service standard event.

While we understand the proposed new mechanism reflected in the draft rule aligns somewhat with the system security NNO framework established under the *Improving security frameworks for the energy transition* rule change, it is not clear from the draft determination whether the AEMC has considered alternative options including making use of an existing revenue adjustment mechanism available under the NER (such as an appropriately defined prescribed cost pass through event) without the need to establish a new mechanism with associated new guidelines and eligibility criteria. The final rule determination may benefit from further discussion on this point.

Timing for publication of new guideline

We note that the draft determination states the new *Network alternative support payment guideline* is to be published within 9 months of commencement of the rule change, and is to be developed following the transmission consultation procedures.

The transmission consultation procedures allow for the AER to extend processes due to reasons of unusual complexity or difficulty, or circumstances beyond the AER's control. Requiring the new guideline to be published within 9 months of commencement of the rule change therefore appears potentially inconsistent with the transmission consultation procedures.

Further, we consider that the transitional rule allowing for application of the new process prior to the AER finalising the new *Network alternative support payment guideline* reduces the urgency to publish the guideline. We therefore submit that the AEMC consider providing a longer period of time for the AER to publish the new guideline, for example 12 months, to better enable the AER to manage resource constraints and prepare a guideline which is fit for purpose and reflects a robust consultation process.

AER resourcing

The draft determination creates a new regulatory function for the AER to make ex-ante determinations on a specific sub-category of opex, and obliges the AER to publish and maintain a new guideline relating to this process. We note that the AER will need to reallocate existing resources or apply additional resources to implement this new function.

Alignment of opex and capex frameworks

As noted above, we support the intention of this rule change to seek to achieve greater alignment between the cost recovery framework for NNOs and the recovery of costs for capital expenditure projects required to meet similar network needs.

However, the draft rule change only partially achieves the purpose of alignment with the capex framework. The draft rule retains the ex-post true up of actual and forecast network support costs with no materiality threshold, such that TNSPs may recover incurred costs on a dollar for dollar direct pass through basis. This is not consistent with the framework for capital expenditure on equivalent network augmentation projects. Network support payments would continue to fall outside the ex-ante incentive framework, as they currently do. Again, this is inconsistent with the framework for capital expenditure.

While we understand the intended limited scope of this rule change at the current time, we suggest that in future the AEMC further consider whether NNO costs are likely to be largely recurrent in nature, and therefore should be included in base opex and subject to the standard NER incentive framework without ex post true up, similar to capital expenditure. Material unforeseen changes to expected costs could still be dealt with through the cost pass through framework, similar to other categories of opex. We consider that greater alignment between the opex and capex frameworks in this regard, and consistent application of the standard 'base-trend-step' opex forecasting approach and related efficiency incentives, are likely to be in the long term interests of consumers.

Please feel free to contact David Monk at [redacted] if you wish to discuss any of the above matters.

Yours sincerely

[redacted]

Arek Gulbenkoglu
General Manager
Network Expenditure

Sent by email on: 04.02.2025