

Public forum, 17 May 2022

Revenue determination guideline for NSW contestable network projects

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AER presentation



AER AUSTRALIAN ENERGY REGULATOR

Public forum

Revenue determination guideline for NSW contestable network projects

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AER AUSTRALIAN ENERGY REGULATOR

Tuesday, 17 May 2022

Welcome

Kami Kaur



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Agenda


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| 1 | Introduction of AER role | 5 minutes |
| 2 | OECC overview of contestable framework | 15 minutes |
| 3 | AER overview of draft guideline | 20 minutes |
| 4 | Questions | 40 minutes |
| 5 | Next steps & close | 5 minutes |

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AER AUSTRALIAN ENERGY REGULATOR Tuesday, 17 May 2022

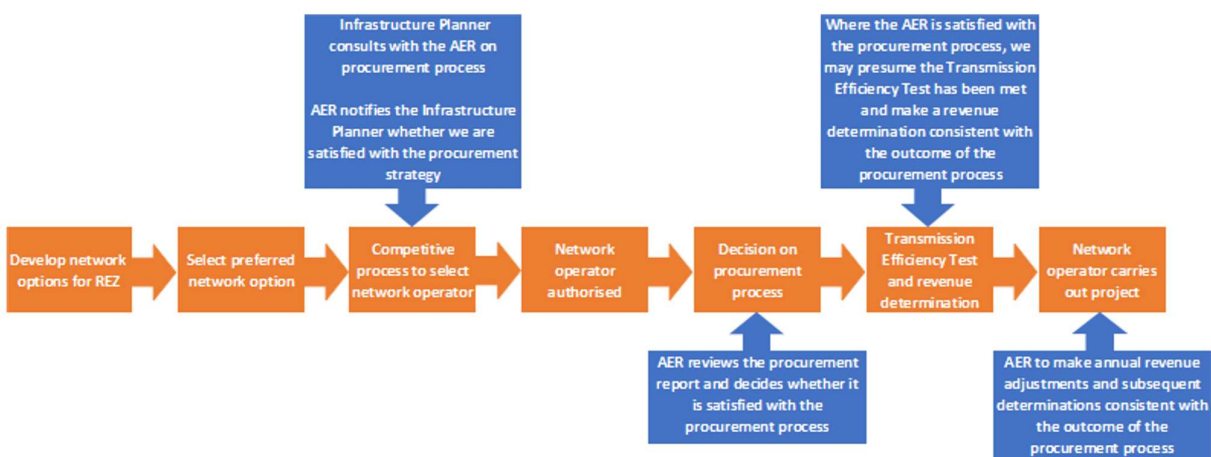
AER overview of the draft guideline

Scott Haig



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Contestable procurement process



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Review of a procurement strategy

- Infrastructure Planner is required to consult with the AER in developing its procurement strategy and throughout the procurement process.
- We will review the procurement strategy prior to the process commencing and advise the Infrastructure Planner whether we are satisfied with it.
- We will notify the Infrastructure Planner of our satisfaction with a strategy if we consider it is likely to result in submissions that:
 - represent the prudent, efficient, and reasonable costs for carrying out the project, and
 - will provide the information the AER requires to make a revenue determination.
- Our draft guideline sets out the:
 - the criteria by which we will assess a procurement strategy
 - information we expect a procurement strategy to contain.

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Monitoring the procurement process

- We expect the Infrastructure Planner will conduct the procurement process consistent with its procurement strategy.
- The regulations will permit the AER to request information from the Infrastructure Planner about the progress of the procurement and its compliance with the procurement strategy.
- We will monitor the process through regular consultation with the Infrastructure Planner and seek updates at key milestones.
- We may also request to be an observer at the Infrastructure Planner's procurement evaluation meetings.

Decision on the contestable process

- Following authorisation of a Network Operator, we will review the procurement process and decide whether it is likely to have produced an outcome that reflects prudent, efficient and reasonable costs.
 - We require the Infrastructure Planner to provide us with a report at the conclusion of the procurement process.
- In making our assessment, we will consider whether the process:
 - was undertaken in accordance with the EII Act;
 - was undertaken consistent with the procurement strategy;
 - reflects our procurement evaluation criteria.
- We are also required to take into account the Infrastructure Planner's view on the adequacy of the competitive procurement process.
- Our guideline sets out the information we expect to be included in a procurement report.

TET and revenue determination

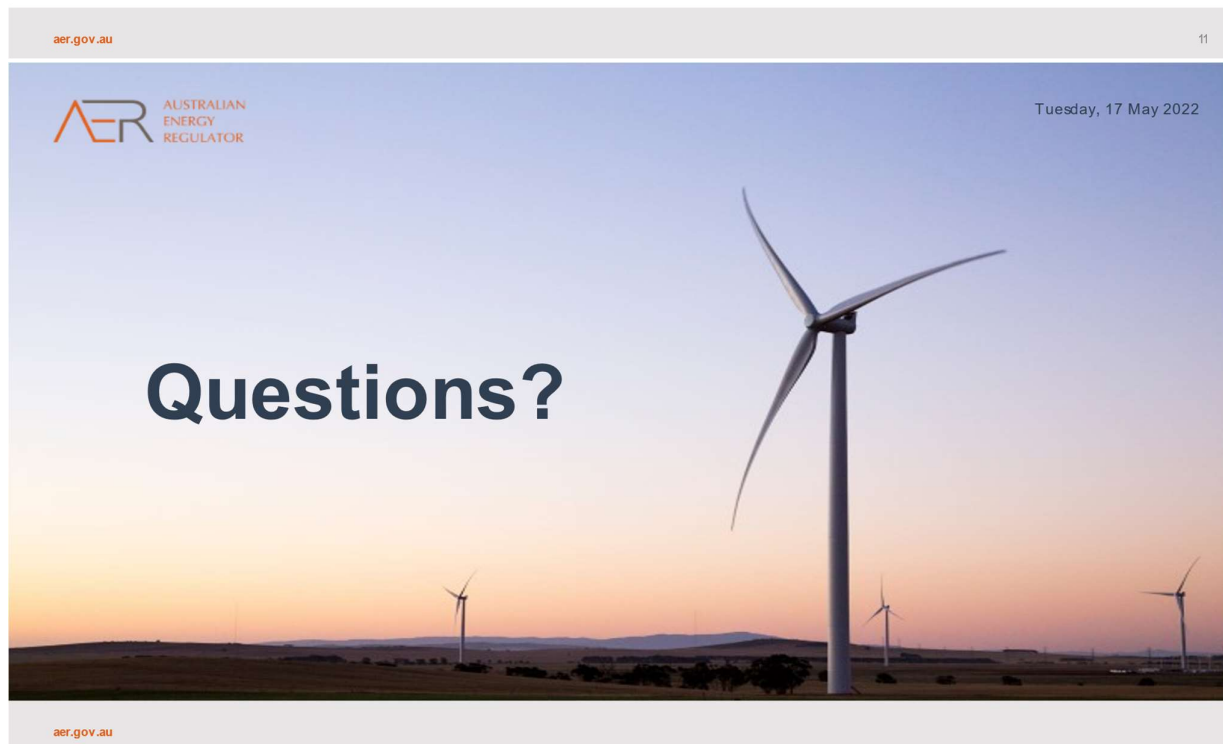
- There are two major components of the AER's role under the framework:
 - applying the Transmission Efficiency Test to determine prudent, efficient and reasonable capital costs for the project
 - determining the amounts payable to network operators for the concession period
- Under the proposed regulations we can consider that the capital costs bid by the successful network operator satisfy the Transmission Efficiency Test.
 - If we are satisfied with the procurement process, we do not intend to independently calculate prudent, efficient and reasonable capital costs.
- For REZ Network Infrastructure Projects, the proposed capital costs must not exceed the maximum capital cost set by the Consumer Trustee.
- Where we are satisfied with the competitive procurement process we would expect to adopt the amounts payable from the project deed in our revenue determination.
- Our draft guideline also sets out:
 - the information a network operator must include in its revenue proposal
 - the information that will be contained in our revenue determination
 - how we expect other AER guidelines to apply.

Subsequent determinations and revenue adjustments

- Subsequent determinations within the concession period are required to be consistent with the outcome of the procurement process.
- Approaches to cost variations and risk allocation are matters that potential network operators will compete on as part of a contestable process.
- A project deed may therefore contain a mechanism providing for annual revenue adjustments.
 - Where we are satisfied with the competitive process, our revenue determination will include that mechanism.
- Network operators will be required to provide us information annually on:
 - any proposed adjustments;
 - the adjusted revenue and payment schedule; and
 - supporting evidence for our review of compliance with the mechanism.
- A project deed may also provide for more significant revenue adjustments, that the AER would review outside of the annual revenue adjustment process.

Opportunities for stakeholder engagement

- Under the competitive framework, all elements of the network project are expected to be settled through the competitive procurement process.
- There will generally be no scope for engagement by the network operator in developing its revenue proposal or by the AER in making its revenue determination.
 - However, we would expect a network operator to consult with stakeholders on any components of a proposal that have not been established through a contestable procurement process, and we also intend to consult on those components.
- We intend to be as transparent as possible in undertaking our role, and our guideline sets out information we intend to publish in our revenue determination.
- We note that there are opportunities for stakeholder engagement at earlier stages of the process:
 - The Infrastructure Planner intends to seek local community and stakeholder feedback in developing network options and selecting the preferred option.
 - The Consumer Trustee may undertake targeted consultation to inform its consideration of the Infrastructure Planner's recommendation.



Policy Paper: Regulatory Framework for the TET and Regulator's Determination for Network Infrastructure Projects

Melanie Koerner
General Manager – System Planning and REZ Authorisations
AEMO Services Limited

17 May 2022



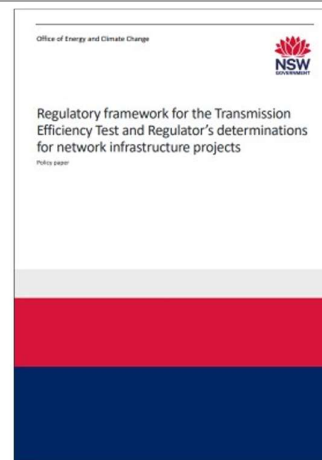
Regulatory framework for network infrastructure projects – Part 5 of the EII Act

The EII Act introduces a new framework to:

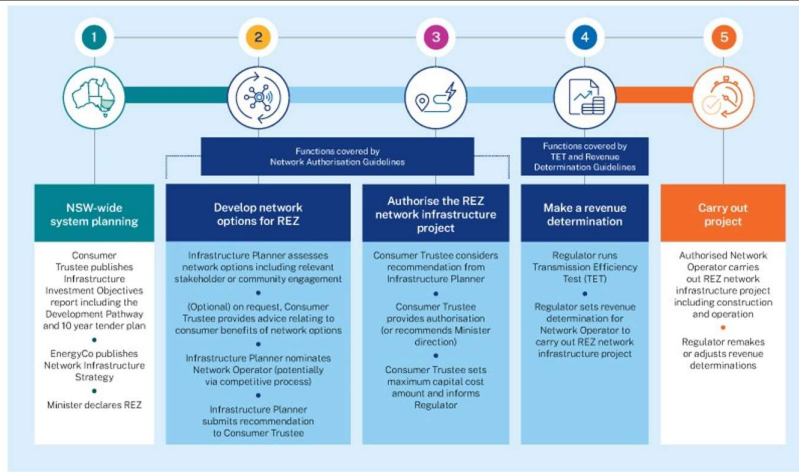
- identify, develop and deliver network infrastructure projects in NSW
- determine costs to be recovered from electricity consumers

Intent of the policy:

- Address 'chicken and egg' problem of new REZ network and generation investment
- Bring forward replacement generation and supporting REZ network investment to avoid price shocks
- Enable the faster development of important network projects

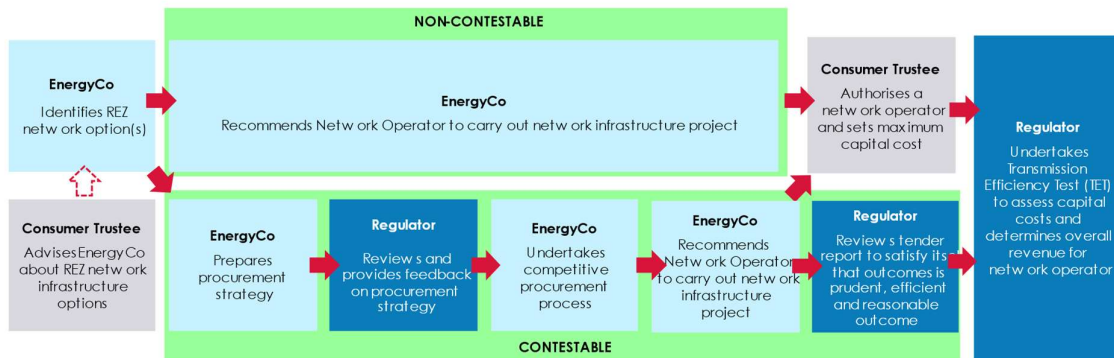


Regulatory process for REZ infrastructure projects



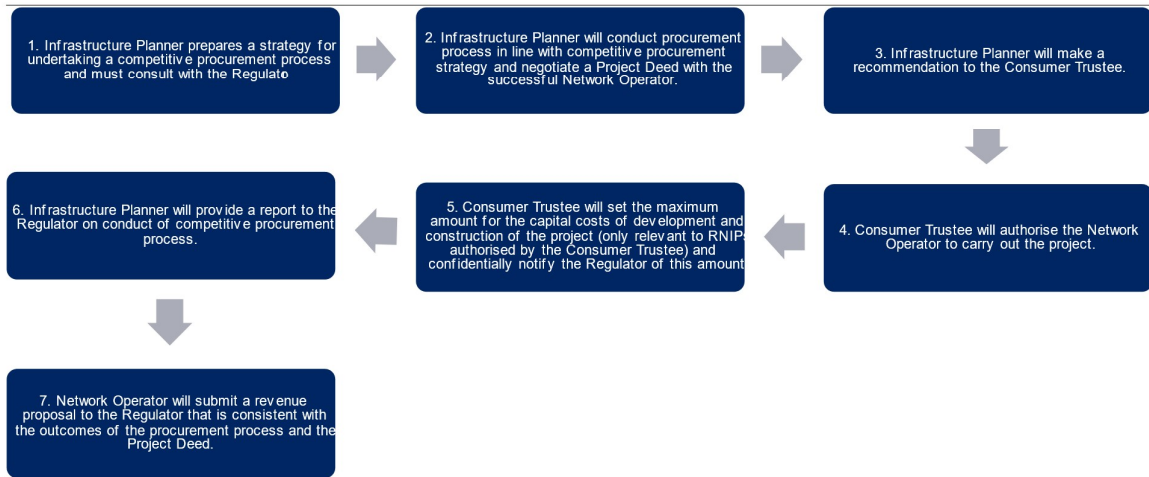
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REZ Network Regulatory and Authorisation Process



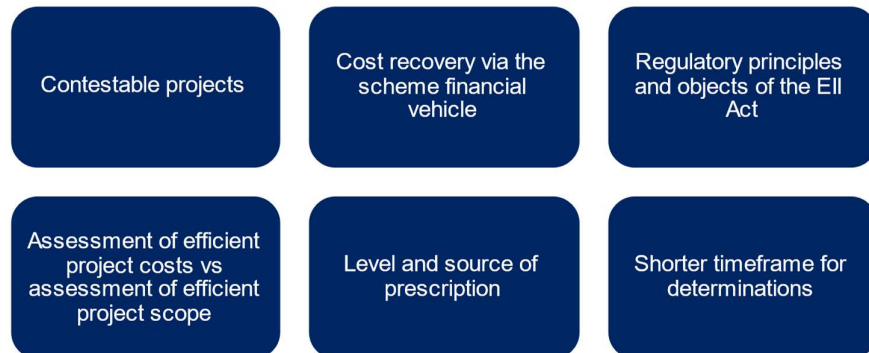
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Steps for contestable process



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Key differences between the EII Act and NER



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Status of the regulations

The OECC is intending to propose regulations related to:

- competitive procurement strategy and certain issues related to the Regulator's initial TET and revenue determination for contestable projects (Q2 2022).
- other matters for contestable and non -contestable projects (Q4 2022).

Questions/comments and responses

1. *What happens if the network operator's revenue proposal exceeds the maximum capital cost?*

OECC response: We would like to avoid this situation and there are two steps that mitigate this risk. First, the Consumer Trustee can provide advice to the Infrastructure Planner at the commencement of a project as to whether the estimated project cost is likely to be in the long-term financial interests of NSW consumers. Second, the Consumer Trustee must authorise the network operator before it submits a revenue proposal to the AER. If the project cost is above the maximum capital cost, the network operator will not be authorised.

If an AER determination finds the capital costs exceed the maximum capital cost, it will not be able to make a revenue determination that incorporates capital costs in excess of the maximum set by the Consumer Trustee.

2. *Is the requirement for the IP to consult with the AER on its procurement strategy before undertaking the procurement a requirement of the EII Act or an AER expectation? Will the AER report on the outcomes of the pre-procurement engagement?*

AER response: It is not a requirement of the EII Act, but we expect there to be a requirement to consult in the regulations. To the extent possible, we will be transparent in how we undertake our role.

Our primary mechanism to provide transparency will be our revenue determination. Our determination will include a statement as to whether we are satisfied that the competitive procurement process is likely to have produced an outcome that reflects prudent, efficient and reasonable costs and is otherwise consistent with the EII Act, and an overview of the AER's process and considerations in reaching that decision.

3. *Presumably most of the cost 'saving' of contestable network investment is where the lowest possible rate of return is procured for the design in question - is this correct (or is the project design itself open for variation too)? If the rate of return is contestable, given the incumbent transmission business will likely be the lowest cost operator, could a contestable bid be made to finance and build the network asset and hand over operation to the incumbent transmission business?*

Can see instances where best outcome is a bid of the rate of return to construct the asset, but they won't be the best party to operate the asset. If the incumbent transmission business is one of the bidders under ring-fencing arrangements, you can imagine they would not go into partnership with the developer bidder. The best outcome might be through a developer bidder bidding initially and then handing over to incumbent transmission business.

OECC response: Project design is a matter for the Infrastructure Planner, not the AER. The model used, including the role of the network operator and the elements subject to a competitive process, may change for each procurement. For example, the CWO REZ network project may have some limited ability for participants to compete on project design.

AER response: The model being used for the initial contestable projects is not one where the network operator builds the asset and then transfers it to the incumbent transmission business. But the EII Act does not preclude a competitive procurement being undertaken on this basis. The aim of the framework is to choose the approach that provides the lowest overall costs, not just lowest rate or return. The EII Act does provide for a project to be transferred to another party at some point in the process.

4. *When finalising the regulations, it's important that regulatory risk is reduced to the extent possible. Regulatory risk (discretion) increases project risk and costs. Some of the language used in the forum may point to regulatory risk in the process (for example, 'AER expects' and 'AER may presume').*

The regulations should be consulted upon with stakeholders before they are finalised.

AER response: We need to balance regulatory risk against the need to be satisfied that the market has turned up and we have had a competitive process. This necessarily requires a decision to be made at the end of the process.

We do not want to get to the end of the process and not be able to implement the outcome, which is why we will take a no surprises approach. If we identify an issue with the process, we will raise it at the time we become aware.

OEEC response: The policy intent regarding the TET and revenue determination has been established via the legislative process and further detail has been developed via the Network Infrastructure Projects (Part 5 of the EII Act) Policy Paper, which was consulted on in October 2021. There is a need to resolve the regulations for the contestable TET and revenue determination process ahead of the procurement for the Central-West Orana REZ, so we appreciate you bringing this to our attention at the public forum.

5. *Given the AER is relying on the rigor of the competitive procurement process, hypothetically speaking, what would happen if some bidders withdrew during the procurement process, would it affect the AER decision in anyway?*

AER response: AER oversight of the procurement process means that we could express our view on the process before it is concluded. In these circumstances, the Infrastructure Planner could potentially adapt the process or take other measures such as moving to the non-contestable process. We would only accept the outcome of the procurement process where we were satisfied it was likely to have produced an good outcome.

The market response so far has been strong, so we are hopeful that the competitive process will produce good outcomes.

6. *Can you clarify the reference to the capital expenditure requirements in chapter 6A of the National Electricity Rules?*

AER response: The reference was in relation to how we will approach the Transmission Efficiency Test under the non-contestable approach. The test will largely reflect the existing capital assessment process contained in chapter 6A of the NER.

However, those chapter 6A requirements are not relevant to the contestable approach, as the regulations will allow us to consider that capital costs agreed through a competitive procurement process meet the Transmission Efficiency Test.

7. *Will there be any provision for public submission on the procurement process (for example, from parties involved in the process)?*

AER response: We have not proposed this in the guideline. Because we are overseeing the process, we should have visibility of any issues. We are not sure whether there is a lot to be gained by further consultation.

OEEC response: The *Network Authorisation Guidelines* are currently being consulted upon and includes the potential for consultation by the Consumer Trustee and the Infrastructure Planner at earlier stages in the process, for example on selection of the preferred network option.