

Revenue determination guideline for NSW contestable network projects – Draft

May 2022

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Inquiries about this publication should be addressed to:

Australian Energy Regulator

GPO Box 3131

Canberra ACT 2601

Tel: 1300 585 165

AER Reference: 13601915.3

Amendment Record

Version	Date	Pages
Revenue determination guideline for NSW contestable network projects – Draft	6 May 2022	27

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Glossary

Term	Definition or extended form
AER	Australian Energy Regulator.
Concession period	Refers to the term of the Project Deed between the Infrastructure Planner and a Network Operator selected to carry out (which may include owning (or leasing), constructing, financing, operating and/or maintaining) a network infrastructure project under the EII Act in accordance with a Consumer Trustee authorisation or Ministerial authorisation or direction. It is expected that a concession period may include options for extensions.
Consumer Trustee	A person or body authorised under section 60 of the EII Act to exercise the functions of the Consumer Trustee. 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 to undertake this role.
OECC	Office of Energy and Climate Change within the NSW Department of Treasury.
EII Act, the Act	<i>Electricity Infrastructure Investment Act 2020</i> (NSW).
EII framework	The EII Act and any regulations made under it.
Regulations	Any regulations 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 this role for the five REZs specified in the EII Act.
Network Operator	Means a person who owns, controls or operates, or proposes to own, control or operate, network infrastructure under the EII Act.
NEL	National Electricity Law
NER	National Electricity Rules
NGR	National Gas Rules
Project, network infrastructure project	A REZ Network Infrastructure Project or Priority Transmission Infrastructure Project as defined under the EII Act.
Project Deed	The contractual arrangement between the Infrastructure Planner and a Network Operator for carrying out a network infrastructure project under section 63(4)(a) of the EII Act. At the time of making an initial revenue determination, this may include a Commitment Deed signed by the Infrastructure Planner and the Network Operator as well as a substantially negotiated (but not executed) Project Deed.
Regulator	A person or body authorised under section 64 of the EII Act to exercise the functions of a regulator. The AER has been appointed as a Regulator for the purposes of Part 5 of the EII Act.
REZ	Renewable Energy Zone, being the geographical area of NSW and the infrastructure specified in a declaration by the Minister under section 19 of the EII Act.

Regulated Network Service	Intended to be defined in the regulations as the carrying out of a network infrastructure project in accordance with: an authorisation under section 31(1)(b) or 36(2) of the EII Act or a direction under section 32(1) of the EII Act; and all applicable laws, regulations and rules.
Procurement process	The contestable process undertaken by the Infrastructure Planner to select a Network Operator for a Project.
Procurement rules	Rules set out in the Infrastructure Planner's procurement strategy for undertaking a contestable process to select a Network Operator for a Project.
Procurement strategy	A strategy for undertaking a contestable procurement process to select a Network Operator for a Project.
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.

Invitation to make submissions

We invite interested parties to make written submissions in response to this draft Guideline by close of business **27 May 2022**.

Please contact us if you would like to meet with AER staff during this consultation period.

Submissions should be sent electronically to REZ@aer.gov.au with the title 'Submission – Revenue determination guideline for NSW contestable network projects'. We ask that all submissions sent in an electronic format are in Microsoft Word or other text-readable document form.

Alternatively, submissions may be sent to:

Kami Kaur
Acting General Manager, NSW REZ Branch
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Enquiries about this paper, or about lodging submissions, should be directed to REZ@aer.gov.au.

Confidentiality

The AER prefers that all submissions be publicly available to facilitate informed and transparent consultation. Submissions will be treated as public documents unless otherwise requested.

Parties wishing to submit confidential information are requested to:

- clearly identify the information that is the subject of the confidentiality claim, and
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on the [AER's website](#). For further information regarding the AER's use and disclosure of information provided to it, see the [ACCC/AER Information Policy](#) available on our website.

Questions on this guideline

We welcome questions on the operation of any aspect of this guideline. Where a question is from a party in an upcoming or ongoing competitive procurement process, we will share any response provided to that party with the Infrastructure Planner so that the information can be provided to other parties in the competitive procurement process. However, any questions relating specifically to the competitive procurement process should be directed to the Infrastructure Planner.

Public forum

The AER will host an online public forum to allow stakeholders the opportunity to ask questions about our draft Guideline before submissions close.

The public forum will be held from **11.00 am to 12.30 pm (AEST) on 17 May 2022**. To register your interest in the public forum, please email REZ@aer.gov.au by close of business on 16 May 2022.

Next steps

We will consider submissions received and feedback from the public forum before we publish a final Guideline in **July 2022**.

1 Introduction

1.1 Purpose of this Guideline

The AER will make revenue determinations for Network Operators selected to carry out¹ network infrastructure projects under the *NSW Electricity Infrastructure Investment Act 2020* (EII Act) and regulations.

A Network Operator may be selected to carry out a network infrastructure project in one of two ways:

1. Under a contestable process, a Network Operator is selected through a competitive procurement process conducted by the Infrastructure Planner.
2. Under a non-contestable process, a Network Operator is selected directly by the Infrastructure Planner.

In both cases, the Network Operator must be authorised by the Consumer Trustee, or authorised or directed by the Minister, before carrying out the network infrastructure project.

This Guideline focuses on how we will undertake our regulatory role under the contestable process. It discusses our assessment of the Infrastructure Planner's procurement strategy and procurement process, and our approach to making a revenue determination for Network Operators based on the outcomes of the competitive procurement process (including how the Transmission Efficiency Test is applied under the contestable framework).

A separate guideline will be developed by us on our role under the non-contestable process. We intend to consult on that guideline in the second half of 2022.

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

Under the EII Act, network infrastructure projects can be Renewable Energy Zone (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 regulations specify differences in processes for these types of network infrastructure projects, these differences are noted in this Guideline.²

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 National Electricity Rules (NER) and natural gas pipelines under the National Gas Law and the National Gas Rules (NGR).

¹ Carrying out a network infrastructure project may include owning or leasing, constructing, financing, operating and/or maintaining assets.

² The key differences are that REZ Network Infrastructure Projects are authorised by the Consumer Trustee while Priority Transmission Infrastructure Projects are authorised or directed by the Minister; and the Consumer Trustee does not calculate a maximum capital amount for Priority Transmission Infrastructure Projects.

On 12 November 2021 we were appointed as a Regulator³ under the EII Act. 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 (under Part 5 of the EII Act). This function is the subject of this Guideline. 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).

1.3 Authority for this Guideline

Section 38(5) of the EII Act requires the Regulator to publish guidelines on its website about the Transmission Efficiency Test to be used to calculate the prudent, efficient and reasonable capital costs of network infrastructure projects (Transmission Efficiency Test guidelines). The NSW Office of Energy and Climate Change (OECC) intends to recommend a regulation that will also require the AER to publish on its website a guideline setting out how we intend to make (and remake) a revenue determination under the EII Act (revenue determination guidelines). We have combined these two aspects into a guideline relating to contestable network infrastructure projects (this Guideline) and a separate guideline relating to non-contestable network infrastructure projects (that is being developed).

Any references in the EII Act or regulations to ‘transmission efficiency test guidelines’ and ‘revenue determination guidelines’ (or equivalent) should be taken to refer to this Guideline and our guideline relating to non-contestable network infrastructure projects.

The AER may amend this Guideline from time to time. Should we amend the Guideline, we will consult on any proposed amendments, other than minor administrative amendments.

This Guideline has been produced on the basis of policy positions that have been developed by the OECC and have been published at the same time as our draft Guideline.⁴ The OECC is in the process of converting its policy positions into regulations to recommend to the NSW Executive Council.⁵ Throughout this Guideline where we refer to regulations we are referring to the regulations we expect to be made under the EII Act, based on the OECC’s stated policy positions. We note that any changes to the policy positions (and expected regulations) will need to be reflected in changes to this Guideline before it is finalised in July 2022. Regulations on the contestable framework are expected to be made in May 2022.

1.4 Interaction with the National Electricity Rules

Chapter 6A of the NER sets the framework for economic regulation of transmission network service providers in the National Electricity Market, including the making of revenue determinations.⁶ The

³ IPART has also been appointed as a Regulator to undertake certain functions under the EII Act.

⁴ OECC, *Regulatory framework for the Transmission Efficiency Test and Regulator’s determinations for network infrastructure projects*, May 2022: <https://www.energy.nsw.gov.au/media/3541>

⁵ The Constitution of New South Wales provides for an Executive Council as the official arm of government to give legal authority to such things as proclamations and regulations under the Acts authorised by the NSW Parliament.

⁶ The NEL and NER do not regulate the carrying out of a network infrastructure project by a Network Operator.

non-contestable framework under the EII Act is intended to substantially replicate Chapter 6A of the NER. However, under the contestable framework, the OECC intends to recommend regulations that replicate only a small number of Chapter 6A rules. This reflects the significant differences between the Chapter 6A framework and the competitive procurement process contained in the EII framework, including:

- The focus for the Regulator in the EII framework is on reviewing the potential of the competitive procurement process to produce an outcome that reflects prudent, efficient and reasonable costs rather than a detailed review of the components of a proposed revenue allowance.
- Where we are satisfied with the procurement process, the AER's determinations in the EII framework will reflect the amounts payable in the Project Deed that has been negotiated and agreed to by the Infrastructure Planner and the successful proponent, until the end of the concession period.
- Network Operators in the EII framework are paid by the Scheme Financial Vehicle using monies collected through a Jurisdictional Scheme Obligation⁷ on the NSW distributors rather than through the NER pricing arrangements.

The OECC intends to recommend regulations that allow the AER to develop guidelines to be applied to Network Operators under the EII framework. To the extent possible, these guidelines will be consistent with equivalent guidelines made under Chapter 6A of the NER. Only a handful of AER guidelines made under Chapter 6A of the NER will be relevant to Network Operators authorised through the contestable framework. Section 6 of this Guideline indicates which guidelines the AER intends to develop and apply to Network Operators. No existing AER schemes or models will apply under the contestable framework.

⁷ AER, *Determination on jurisdictional scheme application in relation to NSW EII Act*, December 2021.

2 Overview of the contestable framework

Under the EII framework the Infrastructure Planner may undertake a competitive procurement process to select a Network Operator for network infrastructure projects.⁸ The Infrastructure Planner identifies the project options and the preferred network project, sets the procurement strategy, conducts the procurement process, evaluates the submissions, and selects a successful proponent. The AER has no direct role in these aspects. However, if the Infrastructure Planner intends to undertake a competitive procurement process, it must consult with the AER on its intended approach and throughout the process.

The AER has an important but discrete role in making a determination on the amounts to be paid to a Network Operator for carrying out a network infrastructure project. Where 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, our determination may adopt the relevant amounts payable to the Network Operator as agreed between the Infrastructure Planner and Network Operator through that process.

In deciding whether we are satisfied with the procurement process, we will undertake reviews at two points in the process:

1. At the start of the procurement process, we will review whether the procurement strategy developed by the Infrastructure Planner is likely to result in submissions that represent the prudent, efficient and reasonable costs for carrying out the network infrastructure project and provide the information the AER requires to make a revenue determination. We have developed evaluation criteria to guide our review of the Infrastructure Planner's procurement strategy and set out information we would expect to see contained in it (section 3 of this Guideline).
2. After the procurement process has been completed and a Network Operator selected, we will decide whether we are satisfied that the process is likely to have produced an outcome that reflects prudent, efficient and reasonable costs and is otherwise consistent with the EII Act.⁹ Section 4 of this Guideline sets out the information we expect to be provided to us by the Infrastructure Planner in its report at the conclusion of the procurement process, and how we intend to assess the process.

In addition to these reviews, the AER will monitor the procurement process through consultation with the Infrastructure Planner and seek updates from it at key project milestones. We may also request to be an observer at the Infrastructure Planner's procurement evaluation meetings at both the Expression of Interest and Request for Proposal stages.

The successful proponent from the procurement process will submit a revenue proposal to the AER consistent with the terms of the Project Deed it has entered into (or will enter into) with the Infrastructure Planner.¹⁰ Section 5 of this Guideline sets out our information requirements for a revenue proposal, our approach to assessing a revenue proposal (including the application of the Transmission Efficiency Test), our determination timeline and the information our determination will contain.

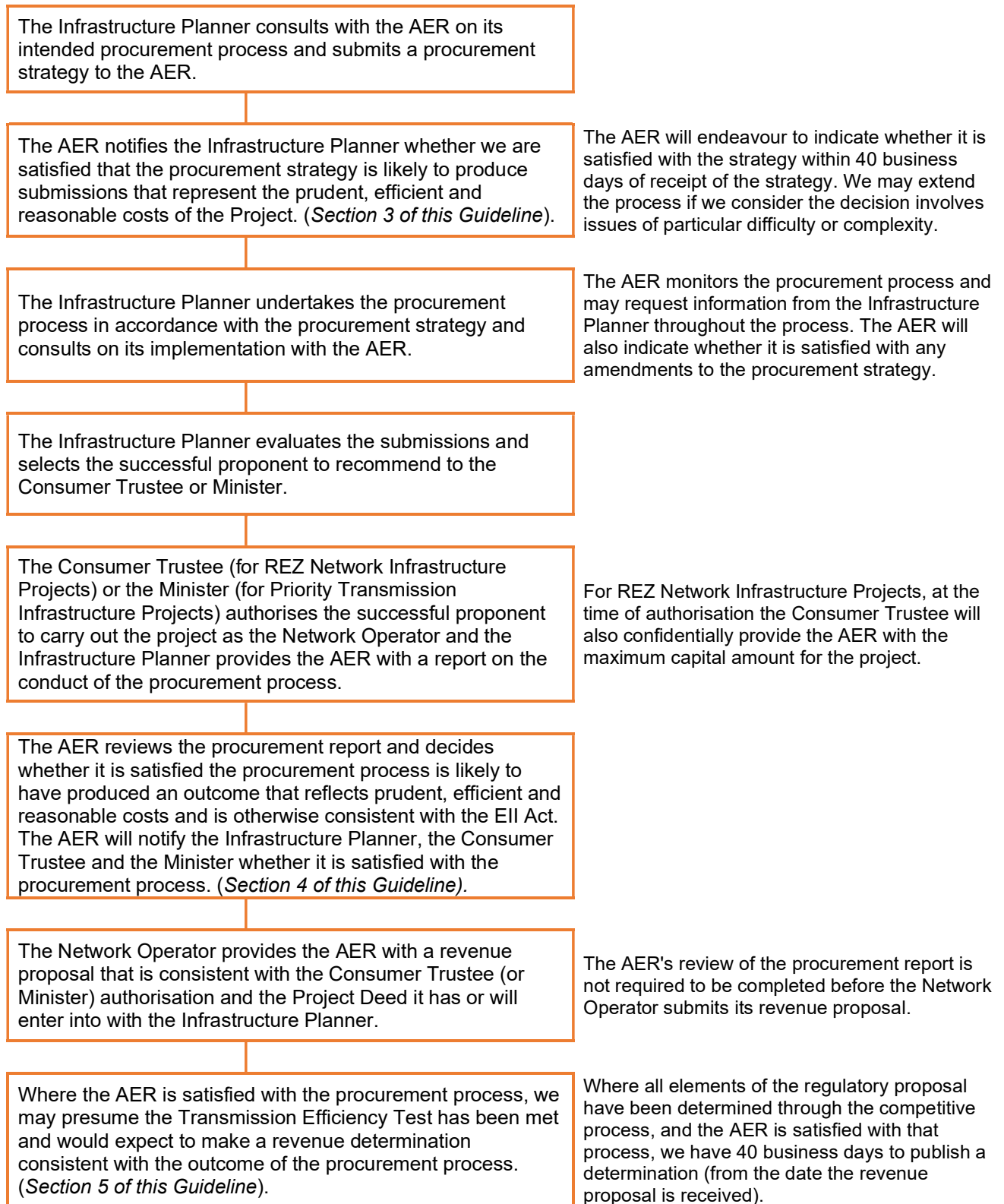
Figure 1 illustrates the key processes under the contestable framework.

⁸ The AER understands that the competitive procurement process will generally be used for 'greenfield' projects that are separable from the existing transmission network.

⁹ The EII Act and the regulations that the OECC intends to recommend require the Network Operator to provide the AER with the annual amounts payable, the components that comprise those annual amounts and a schedule of quarterly payments.

¹⁰ The Project Deed may not be finalised at the time the Network Operator submits its revenue proposal. In these circumstances, the AER would expect to receive a signed Commitment Deed between the Infrastructure Planner and Network Operator, and a draft Project Deed.

Figure 1: Key processes under the contestable framework



3 Review of a procurement strategy

Where the Infrastructure Planner decides to undertake a competitive procurement process to select a Network Operator to carry out a Project, the OECC intends to recommend regulations that require the Infrastructure Planner to consult with us and provide information to enable us to make a determination under section 38 of the EII Act. This section discusses our approach to reviewing the procurement strategy and our information requirements.

3.1 Procurement strategy

We expect the Infrastructure Planner to submit its procurement strategy to us before undertaking the procurement process. We will notify the Infrastructure Planner of our satisfaction with a procurement strategy if we consider that the strategy is likely to result in submissions that:

- represent the prudent, efficient, and reasonable costs for carrying out the Project in accordance with the EII Act
- will provide the information the AER requires to make a determination under section 38 of the EII Act.

We will endeavour to notify the Infrastructure Planner as to whether we are satisfied with the procurement strategy within 40 business days after we receive it. However, we may extend the process if we consider issues of particular difficulty or complexity are involved. We will inform the Infrastructure Planner if we expect to take longer than 40 business days to reach a position.

3.2 Procurement evaluation criteria

We will be satisfied with the procurement strategy if we consider it meets the following evaluation criteria:

1. A sufficient level of competitive¹¹ tension exists, such that a competitive outcome will likely be achieved.
2. Pre-qualification and participant registration processes are undertaken to:
 - a) encourage market participants to make a submission and identify those potential participants who can genuinely undertake the Project; and
 - b) identify whether any incumbent supplier has or is perceived to have any unfair advantage in the new procurement (and if so, steps are taken to address this).
3. The Project scope is identified and is sufficiently clear.
4. Procurement rules, processes and procedures (including submission evaluation criteria) provide transparency to potential proponents and reflect good industry practice.
5. Analysis has been undertaken on the likely prudent, efficient and reasonable costs to carry out the Project to inform the evaluation process.
6. Minimum requirements with which submissions must comply have been identified and are reasonable.
7. The timeframes for the process are reasonable and allow both incumbents and non-incumbents the opportunity to respond.

¹¹ The OECC intends to recommend regulations clarifying the meaning of 'competitive' in relation to a competitive procurement strategy.

8. Governance arrangements are clear and robust.
9. The procurement strategy is consistent with the EII Act and regulations.
10. All participants are treated fairly (including through the management of any potential conflicts) in accordance with a probity plan implemented by an independent probity advisor.

3.3 Contents of a procurement strategy

Based on our procurement evaluation criteria described above, we would expect the Infrastructure Planner's procurement strategy to include the following:

1. a description of the Project that is the subject of the procurement process
2. an overview of market sounding and analysis undertaken, identifying the number of potential qualified proponents, including those not already participants in the market
3. an overview of the pre-qualification and participant registration processes undertaken (or planned to be undertaken) and the outcome of those processes
4. a summary of analysis undertaken of the likely range of efficient, prudent and reasonable costs for carrying out the Project (for example, through use of industry benchmarks)
5. an overview of the proposed evaluation process to select the preferred proponent, including:
 - a) the procurement rules
 - b) the process the evaluation panel will follow to assess participants' submissions
 - c) the evaluation criteria to be applied in selecting the successful proponent
 - d) the process that is to occur to negotiate any variations to the proponents' final submissions
 - e) the qualifications and experience of the evaluation panel members, decision-makers and the independent probity adviser
 - f) the process to be followed if a successful proponent is not able to be identified through the contestable procurement process
6. a summary of the minimum requirements with which participants must comply, which may include requirements for the successful proponent to:
 - a) set out the overall cost to carry out the Project for the concession period
 - b) provide a breakdown of the annual amounts to be paid to the Network Operator in accordance with a Project Deed, including a breakdown of these annual amounts into the components identified in section 38(2) of the EII Act.¹²
 - c) provide a schedule of quarterly amounts to be paid by the Scheme Financial Vehicle to the Network Operator for the duration of the concession period
 - d) include a mechanism that will be used to adjust the annual revenue to be paid to the Network Operator over the regulatory period
 - e) submit a Project Deed in a form approved by the Infrastructure Planner and to enter into that Project Deed if successful
 - f) where a Network Operator may carry out the Project beyond the period priced in the Project Deed (through an extension of the concession period), include the closing asset

¹² The EII Act states that the components include return of capital, return on capital, operating costs and other components prescribed by the regulations.

value at the end of the priced period, or the methodology by which that value is to be calculated.¹³ The value or methodology should be based on the principle that capital costs should only be recovered once from consumers

- g) enter into any other contractual and regulatory arrangements required by the Infrastructure Planner
- 7. an overview of information provision procedures and the approach to the treatment of confidential information
- 8. a probity plan which includes processes to address:
 - a) known or potential conflict of interest issues and how they will be mitigated;
 - b) information asymmetries; and
 - c) any probity concerns raised by participants throughout the process.
- 9. an overview of the governance arrangements for the procurement process, identifying:
 - a) the processes for approval of the public procurement documents;
 - b) the process for the development of the evaluation report and recommendation; and
 - c) those accountable for ensuring the procurement process is followed.
- 10. a statement as to how the Infrastructure Planner considers the proposed procurement strategy complies with the requirements of the EII Act
- 11. the timeline for the procurement process showing the key milestones in the process.

In addition to the above information requirements, we would expect to be provided with an opportunity to comment on the Expression of Interest and Request for Proposal documents prior to them being issued to participants.

The AER will engage with the Infrastructure Planner prior to the submission of the procurement strategy to discuss any issues or provide any clarifications regarding the AER's information requirements. We intend to apply the procurement evaluation criteria flexibly to reflect differences in project and procurement circumstances over time.

To support our review of a procurement strategy, we may engage an expert adviser to assist us. We may also seek additional information from the Infrastructure Planner to enable us to decide whether we are satisfied with the proposed procurement strategy.

If, following our review, we are satisfied with the procurement strategy we will notify the Infrastructure Planner. If we are not satisfied with the procurement strategy, we will inform the Infrastructure Planner as to what aspects of the proposed strategy we are not satisfied with.

3.4 Subsequent amendments to a procurement strategy

Our expectation is that the Infrastructure Planner will seek confirmation from us as to whether we are satisfied with any subsequent amendments it makes to its procurement strategy. We will assess any amendments proposed by the Infrastructure Planner against the procurement evaluation criteria and procurement strategy information requirements in sections 3.2 and 3.3 of this Guideline.

The AER will endeavour to review any proposed amendments within a period of 10 business days from receiving the proposed amendment and indicate whether it is satisfied with them. We will inform the Infrastructure Planner if we expect to take longer than 10 business days to undertake our assessment.

¹³ In these circumstances, regulation of the Project would continue under the AER's approach for non-contestable projects.

4 Review of the procurement process

To make a determination on the amounts to be paid to a Network Operator under the contestable framework, we will need to be satisfied that the procurement process is likely to have produced an outcome that reflects prudent, efficient and reasonable costs and is otherwise consistent with the EII Act. This section sets out how we intend to monitor the procurement process, what information we expect to be included in a procurement report from the Infrastructure Planner and how we intend to assess whether we are satisfied with the procurement process and the implications of that assessment for our determination.

4.1 Monitoring the procurement process

We expect the Infrastructure Planner will conduct the procurement process consistent with its procurement strategy. The procurement process, which may vary across projects, broadly includes the following stages:

1. Market sounding;
2. Pre-qualification and participant registration;
3. Expression of Interest;
4. Request for Proposal; and
5. Selection of the preferred proponent.

The AER may request information from the Infrastructure Planner about the progress of the procurement process and the Infrastructure Planner's compliance with the procurement strategy. We intend to monitor the procurement process for a project through regular consultation with the Infrastructure Planner, including through seeking updates from it at key project milestones. We may also request to observe the Infrastructure Planner's evaluation process at both the Expression of Interest and Request for Proposal stages.

As a general principle, the AER respects the commercially sensitive nature of the procurement process. Accordingly, any disclosure of information provided to the AER about the competitive procurement process on a confidential basis is likely to be limited and will only occur as provided for by section 75 of the EII Act.

4.2 Information to be contained in the procurement report

To assist our review of the procurement process, the Infrastructure Planner is required to provide the AER with a report at the conclusion of the procurement process. We would expect to receive the procurement report prior to the Network Operator submitting its revenue proposal, and for the report to contain:

1. a summary description of the Project to be constructed
2. identification of the successful proponent
3. a summary of the approach to market, including any market sounding and expression of interest stages and the outcomes of those stages
4. a summary of each submission received in response to the Request for Proposal, including details of any late or non-conforming submissions
5. a description of the submission evaluation process followed, including:
 - a) the evaluation team and the use of any subject matter experts
 - b) the evaluation criteria

- c) details of any conflicts identified and how such conflicts were managed
 - d) any identified breaches of the conditions of the procurement rules by the respondents and a summary of any action taken
6. assessment and scoring, including completed scoring for each submission against each evaluation criterion
 7. the outcome of the evaluation process, including the ranking of submissions, a summary of the strengths and weaknesses of each submission, results of any reference checks and identification of any substantial risks
 8. a statement of reasons why the successful proponent was preferred with reference to the evaluation criteria, including any significant matters that required resolution
 9. a value for money analysis, which compares pricing in the successful proponent's submission against other offers from the market and against previously developed estimates (if the lowest priced submission is not recommended, the rationale must be clearly stated)
 10. a statement identifying any material amendments that have been made to the procurement strategy and whether the AER confirmed its satisfaction with each amendment
 11. a summary of any material variations to be included in the Project Deed negotiated with the successful proponent compared to their final submission that was accepted and an explanation why each variation was adopted
 12. the final submission documentation for the successful proponent
 13. the Project Deed that has or will be entered into between the Infrastructure Planner and the successful proponent
 14. a probity report, prepared by an independent probity advisor, that includes:
 - a) a summary statement confirming whether the probity plan was adhered to throughout the process by the Infrastructure Planner and that a fair and transparent process was conducted
 - b) a summary of the documents and evidence reviewed
 - c) an overview of the probity advisor's attendance at submission evaluation meetings and any other engagement in the procurement process
 - d) detailed probity conclusions (with reference to evidence) regarding:
 - i) the approach to market
 - ii) communication with the market while the procurement process was open and with participants during the evaluation
 - iii) evaluation of submissions
 - iv) negotiation processes
 - v) conflict of interest and confidentiality outcomes
 - vi) any complaints from the market or any probity breaches.

The AER may also request additional information from the Infrastructure Planner regarding the conduct of the procurement process or to more fully understand the outcome of the process.

4.3 Assessment of the procurement process

To make a determination on the amounts payable to the Network Operator under the contestable framework, we must be satisfied that the procurement process is likely to have produced an outcome that reflects prudent, efficient and reasonable costs and is otherwise consistent with the EII Act. In making this assessment, we will consider whether the procurement process:

1. was in accordance with any regulations made under section 31(4) of the EII Act;
2. was undertaken consistent with the Infrastructure Planner's procurement strategy; and
3. reflects our procurement evaluation criteria.

The OECC intends to recommend regulations that also require us to take into account any opinion expressed by the Infrastructure Planner as to the adequacy of the competitive procurement process.

If, following our review, we are satisfied with the procurement process, we would expect to make our revenue determination for the Network Operator consistent with the outcome of that process as reflected in the Project Deed. We will advise the Infrastructure Planner and Consumer Trustee (or the Minister, where applicable) whether we are satisfied with the procurement process.

Should we not be satisfied with the competitive procurement process, we will give written notice to the Infrastructure Planner stating the reasons why and give them the opportunity to respond. If, following the Infrastructure Planner's response, we are still not satisfied, we may decline to make a determination on the basis of the outcome of the competitive procurement process. Instead, we would consider making a revenue determination using our approach for non-contestable processes.

We may engage a consultant to assist us in our assessment of the procurement process, including reviewing the procurement report and advising whether the procurement strategy has been followed.

5 Revenue determination

Under the EII Act, the AER must determine the amount payable to Network Operators for network infrastructure projects. This section sets out the revenue determination process we intend to undertake (including what a revenue proposal must contain, the timeline for our determination and the contents of our determination). It also sets out our intended approach to assessing a regulatory proposal, including application of the Transmission Efficiency Test and the determination of the amounts payable to the Network Operator.

5.1 Revenue determination process

The OECC intends to recommend regulations that require a Network Operator to provide a revenue proposal to the AER once the Consumer Trustee has authorised the Network Operator to undertake the Project. The authorisation will indicate the date by which a revenue proposal is required to be provided to the AER.

We do not expect Network Operators for contestable network infrastructure projects to undertake pre-lodgement stakeholder consultation on their revenue proposal where all components of revenue have been established through a contestable procurement process. This is because the policy intent of the contestable framework is that the competitive market for network services is being relied upon to produce an outcome that reflects prudent, efficient and reasonable costs for NSW electricity consumers. However, where any components of revenue have not been established through a contestable procurement process, we would expect that there has been consultation with stakeholders on those components. In such cases, the Network Operator should discuss in its revenue proposal what consultation was undertaken with stakeholders, what feedback was provided and how that feedback has been taken into account in developing the proposed revenue component.

5.1.1 Contents of a revenue proposal

A revenue proposal from a Network Operator must:

1. include a statement of whether the Network Operator's revenue proposal is consistent with the Project Deed¹⁴ and the Consumer Trustee's (or Minister's) authorisation and, if it is inconsistent, identify and provide reasons for the inconsistency
2. identify any parts of the revenue proposal the Network Operator claims to be confidential and the grounds for the confidentiality claims in accordance with the AER's Confidentiality Guideline (see section 6.2.1 of this Guideline)
3. include the revenue (in total and annually) to be paid to the Network Operator for carrying out the Project for the regulatory period, including a break-down of the total and annual amounts into their components (as set out under section 38 of the EII Act and any regulations)¹⁵
4. include the costs of any regulatory obligations imposed on the Network Operator and how those costs have been treated in calculating the total and annual revenue amounts. These costs should include the costs of early development works, preparatory activities and project management undertaken by the Infrastructure Planner (including land, easements, project development work, client delivery and related costs) that are being passed through to the Network Operator.

¹⁴ The Project Deed may not be finalised at the time the Network Operator submits its revenue proposal. In these circumstances, the AER would expect a Commitment Deed to be in place between the Infrastructure Planner and Network Operator, and a draft Project Deed to have been developed.

¹⁵ See s38(2) of the EII Act.

5. include a formulaic description of any mechanism that will be used to adjust the annual revenue to be paid to the Network Operator for each year of the regulatory period. For each component of the mechanism, provide:
 - a) a description of the component
 - b) a detailed explanation of the proposed method of indexation, escalation or adjustment
 - c) identification of the authoritative source (or sources) of indices or data to be used for any indexation, escalation or adjustment
6. include for all financial values the dollar terms in which the amounts are presented
7. include the methodology by which quarterly amounts payable to the Network Operator from the Scheme Financial Vehicle are to be calculated from the annual maximum allowed revenue. The methodology should be consistent with that contained in the Project Deed.
8. 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 plain language to electricity consumers
 - b) a summary of the scope and terms of the Consumer Trustee's (or the Minister's) authorisation and the network infrastructure project the authorisation requires the Network Operator to carry out
 - c) a statement identifying any elements of the revenue proposal that are to be set on a non-contestable basis
 - d) for each determination after the initial determination, a comparison of the Network Operator's proposed revenues with its approved revenues for the preceding regulatory period (by total and by component).

A revenue proposal must also comply with the requirements of and contain or be accompanied by such information as is required by an information notice issued by us under the EII Act.¹⁶

The Network Operator must also provide a public version of its revenue proposal and any supporting information (including a response to an information notice) for publication on the AER's website.

5.1.2 Treatment of confidential information

A Network Operator may include commercially sensitive information as part of its regulatory proposal. However, it must submit information in compliance with the AER's Confidentiality Guideline. Consistent with that guideline, a Network Operator should:

- discuss its approach to confidential information with the AER prior to lodging the revenue proposal so that any issues can be addressed prior to submission
- submit a confidentiality template together with public and confidential versions of documents and a notice setting out the proportion of material claimed to be confidential and the reasons for that claim.

Notwithstanding the above, the AER will not accept the information listed in section 5.1.4 as being confidential. This information forms the basis of our determination and will be published on our website.

¹⁶ See s38(7) of the EII Act.

5.1.3 Timeline for our determination

A determination process commences when the Network Operator submits a revenue proposal to the AER.¹⁷ The OECC intends to recommend regulations providing that, where all aspects of a revenue determination have been established through a contestable procurement process, we will have a period of 40 business days to publish our determination.

A contestable procurement process is generally expected to establish all elements of our revenue determination, but, in limited circumstances, it may not do so. If we identify any element of the proposal that has not been set by the contestable process, we will assess that component in accordance with our standard assessment approaches, as set out in our guideline dealing with non-contestable network infrastructure projects. For these determinations, if we consider there are issues of complexity and difficulty in assessing a non-contestable component, we may, at our discretion, extend the timeframe by an additional 40 business days.

5.1.4 Contents of our revenue determination

Given the differences between the NER framework and the EII contestable framework, our revenue determination will be shorter and address a much narrower range of issues. Our determination will include as a minimum:

- 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
- the length of the regulatory period
- the capital costs associated with development and construction of the Project
- the annual revenue for each financial year of the regulatory period and broken down into its components (as set out under section 38 of the EII Act and any regulations)
- the costs of any regulatory obligations imposed on the Network Operator and how those costs have been treated in calculating the total and annual revenue amounts. These costs will include the costs of early development works, preparatory activities and project management undertaken by the Infrastructure Planner that are being passed through to the Network Operator
- the payments (including their timing) to be made by the Scheme Financial Vehicle to the Network Operator and the methodology to calculate the payments
- any mechanism which is to apply to adjust the allowed revenue for each year of the regulatory period
- the length of the concession period.

5.1.5 Subsequent determinations

Where we have made a previous revenue determination in accordance with the outcomes of a contestable procurement process, the OECC intends to recommend a regulation that we must act consistently with the outcome of that procurement process in making subsequent determinations for the duration of the concession period. For clarity, in making subsequent determinations, we would expect to include in those determinations the amounts (and the components those amounts are comprised of) payable to a Network Operator for each year of a regulatory period consistent with

¹⁷ A revenue proposal must be submitted to the AER by the date specified by the Consumer Trustee in its authorisation (or by the Minister in their authorisation).

those contained in the Project Deed. We expect revenue proposals for subsequent determinations (based on a fully contestable procurement process) to be provided to the AER at least 80 business days prior to the expiry of an existing determination. The OECC intends to recommend regulations providing that we will have a period of 40 business days to publish subsequent determinations.

5.1.6 End of priced concession period

At the end of the concession period priced in the Project Deed, regulatory arrangements for a network infrastructure project may transition from the contestable framework to the non-contestable framework (assuming the Network Operator continues to operate the network infrastructure project). The non-contestable framework will be based on a modified version of Chapter 6A of the National Electricity Rules, which governs the economic regulation of prescribed transmission services. The non-contestable EII framework will require the AER to assess each component of a revenue proposal (for example, return of capital, return on capital and operating expenditure) and make a determination on the revenue requirement for each financial year of the five-year regulatory period. The regulatory arrangements for non-contestable network infrastructure projects will be set out in a separate guideline to be published by the AER later in 2022.

A key aspect in transitioning a Network Operator to the non-contestable framework is to establish a closing asset base at the end of the priced period in the Project Deed so that the return on and return of capital elements of the annual revenue requirement can be calculated. We understand that the Project Deed will include the value of the closing asset base at the end of the concession period or a methodology for establishing it. The AER will take this value or methodology into account in establishing the opening asset base for its first determination where a network infrastructure project has transitioned from the contestable regulatory framework to the non-contestable framework. We expect that this value or methodology will be based on the principle that capital costs can only be recovered once from consumers.

5.2 AER's assessment approach

5.2.1 Compliance review of the revenue proposal

Upon receipt of a revenue proposal from the Network Operator we will:

- undertake a compliance check of the proposal to ensure that it complies with the requirements set out in section 5.1.1.
- check whether the Network Operator has submitted information in compliance with the AER's Confidentiality Guideline.
- examine whether the Network Operator's revenue proposal is consistent with the Project Deed and the relevant Consumer Trustee's (or Minister's) authorisation. We will consult with the Infrastructure Planner and Consumer Trustee in making this assessment.
- review whether the proposed timing of payments complies with the EII Act and regulations and is consistent with the outcomes of the procurement process.

If the above requirements have been met, we will proceed to review the revenue proposal. However, if we identify any material deficiencies with the above aspects we may reject the revenue proposal and ask the Network Operator to resubmit it after addressing any identified deficiencies. If this occurs, the Network Operator will need to amend its proposal to rectify the deficiency and recommence the determination process afresh. That is, the period for making a determination will recommence from the date the amended revenue proposal is lodged.

5.2.2 Consultation on the revenue proposal

Where all aspects of a revenue proposal have been based on the outcome of a competitive procurement process, we do not intend to undertake consultation on that proposal. This is because the policy intent of the contestable framework is that the competitive market for network services is being relied upon to produce an outcome that reflects prudent, efficient and reasonable costs for NSW electricity consumers. Consequently, we will not publish a draft determination. However, as required by the EII Act the AER will inform a Network Operator of any material issues being considered by the AER before making its determination.¹⁸ This obligation is consistent with the AER's 'no surprises' approach to its regulation of network service providers under the NER. The OECC intends to recommend regulations that will also require the AER to consult with the Infrastructure Planner before making a determination.

Where elements of a revenue proposal have not been determined through a competitive procurement process, the AER intends to undertake targeted consultation on those aspects with stakeholders before making its determination. This would likely involve publishing a preliminary position on those aspects and seeking submissions on them. It is noted that such a consultation would exclude any costs of Network Operators to meet regulatory obligations (including the cost of early development works, preparatory activities and project management undertaken by the Infrastructure Planner). This is because the AER has no role in reviewing these costs and the Network Operator will have a legally binding obligation to pay these costs as set out in the Project Deed.

5.2.3 Application of the Transmission Efficiency Test

Before making our revenue determination under section 38 of the EII Act we are required to apply the Transmission Efficiency Test to assess a Network Operator's proposed capital costs for a Project.¹⁹ In doing so we must be satisfied that the capital costs for development and construction proposed by the Network Operator are 'prudent, efficient and reasonable'.

Under a contestable process it is expected that the capital costs of a Project will be determined through the competitive procurement process. The OECC intends to recommend regulations that permit the AER to presume the outcomes of a competitive procurement process, including capital costs, are prudent, efficient and reasonable. Therefore, where the AER is satisfied with the competitive procurement process (based on an assessment of the procurement strategy and procurement process consistent with sections 3 and 4 of this Guideline), we will consider the capital costs established through a competitive procurement process to have met the requirements of the Transmission Efficiency Test.

For REZ Network Infrastructure Projects, the AER must also ensure the Network Operator's proposed capital costs do not exceed any maximum capital amount for the Project²⁰ as advised by the Consumer Trustee. The Consumer Trustee must notify the AER of the maximum capital amount once it has authorised the Network Operator. If the Network Operator's proposed capital costs exceed the maximum capital amount, we will inform the Consumer Trustee, Infrastructure Planner and Network Operator that we are not able to make a determination on the basis of the outcome of the competitive procurement process.

¹⁸ Section 37(1)(d) of the EII Act.

¹⁹ Section 38(4) of the EII Act.

²⁰ Once the Consumer Trustee has authorised the Network Operator it must provide the Regulator with the maximum amount for the prudent, efficient and reasonable capital costs for development and construction of the REZ Network Infrastructure Project that may be determined by the Regulator. The maximum capital amount does not apply to Priority Transmission Infrastructure Projects in either the contestable or non-contestable frameworks under the EII Act.

5.2.4 Determination of the amount payable to the Network Operator

In determining the amount payable to a Network Operator, we are required to take into account the objectives of the EII Act and the following principles contained in section 37 of the Act:

- A Network Operator is entitled to recover the prudent, efficient, and reasonable costs incurred by the Network Operator for carrying out the network infrastructure project.
- Incentives should be given to Network Operators to promote economic efficiency.
- A Network Operator is entitled to revenue for the ongoing ownership, control and operation of a network infrastructure project that is commensurate with the regulatory and commercial risks to the Network Operator.
- Any other principles set out in the EII Regulations.

In addition to these principles, the OECC intends to recommend regulations that also require that the outcome of the competitive procurement process be the primary matter the regulator takes into account in making a determination.

Under the contestable framework, where 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, we expect to adopt in our revenue determination the amounts payable to the Network Operator consistent with the Project Deed. However, as noted in Section 4 of this Guideline, if we are not satisfied we would not accept a revenue proposal and decline to make a revenue determination on the basis of the outcome of the competitive procurement process. Instead, we would consider making a revenue determination under the non-contestable process.

5.2.5 Remaking a revenue determination

We are required to remake a determination once every five years or as directed by the Consumer Trustee. We may also review and remake a determination at any time, subject to the regulations.²¹ In this latter case, we would generally only expect to revoke or amend our revenue determination where a material error has been identified, consistent with clause 6A.15 of the NER.

5.2.6 Annual adjustment of a revenue determination

The approaches to cost variations and risk allocation are matters that potential Network Operators will compete on as part of the contestable procurement process. Where we are satisfied that the competitive procurement process is likely to have produced an outcome that reflects prudent, efficient and reasonable costs, our revenue determination will include a mechanism to facilitate annual adjustments to the revenues set out in a Project Deed that has been agreed between the Infrastructure Planner and the successful proponent.

The following sets out our process for making annual adjustments to a Network Operator's revenues:

1. *Network Operator submits proposed revenue adjustments, adjusted annual revenue and an adjusted payment schedule for a relevant regulatory year by a specified date each year* – A Network Operator is required to submit to the AER, information required to calculate any proposed annual revenue adjustments and an updated annual revenue and payment schedule for the relevant regulatory year. The information must be submitted by a specified date prior to the start of the relevant regulatory year to which the adjusted revenue will apply. The timing of the annual revenue adjustment proposal will need to reflect that the adjusted

²¹ Section 40 of the EII Act.

revenue will need to be included in the annual contribution determination that informs the amount to be recovered by NSW distributors for the cost of the EII framework.

2. *Network Operator's annual revenue adjustment proposal must include evidence of the proposed adjustments* – The Network Operator's proposal must include evidence supporting the proposed adjustments. This would include details of inputs into the annual revenue adjustment mechanism and any supporting evidence, including notification from the Infrastructure Planner notifying the amounts of any agreed variations and their consistency with the Project Deed. We may also seek independent confirmation from the Infrastructure Planner.
3. *AER undertakes a compliance check and notifies the Network Operator whether we approve the proposed adjustments* – We would review the Network Operator's proposal and undertake a compliance check against the annual revenue adjustment mechanism contained in the Project Deed (and reflected in our determination). We would advise the Network Operator whether we approve the proposal, 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 annual revenue adjustment proposal, we would advise the Network Operator and publish the adjusted annual revenue and payment schedule for the relevant regulatory year.

We would endeavour to make our annual revenue adjustment decision within 30 business days of receipt of the revenue adjustment proposal. However, we may extend the timeframe by a further 10 business days if we require further information or require the Network Operator to amend its proposal.

5.2.7 Other revenue adjustments

We expect revenue variations to be reflected in an annual revenue adjustment mechanism set out in the Project Deed and assessed through the annual revenue adjustment process discussed above. However, there may be other types of revenue variations allowed for in a Project Deed where the AER is required to have a greater role in assessing whether the proposed variation represents prudent, efficient and reasonable costs. For example, if there was an agreed variation to the scope of the network infrastructure project under the Project Deed that materially increased the capital costs and allowed revenues, it may be appropriate for the AER to assess the amount of the variation, including so that we can be satisfied that it complies with the Transmission Efficiency Test.

Given the need for the AER to complete a more detailed assessment in these circumstances, it would not be feasible for this assessment to be undertaken as part of an annual revenue adjustment process. Depending on the Project Deed, such an assessment may be required to occur either within a regulatory period or at the time of remaking a determination. If an assessment was required within a regulatory period, a period of 80 business days would be appropriate, with any agreed variation amount being included in the next annual revenue adjustment process or at the next revenue determination. Alternatively, if a Project Deed required the assessment of the variation to be undertaken at the time of the next revenue determination, it is likely the AER would treat the variation as a hybrid determination, thereby extending the determination timeframe from 40 business days to up to 80 business days. As with the annual adjustment process, we would require robust evidence to support any proposed revenue variations.

We appreciate the need to be flexible in relation to our assessment of revenue variations and respond to the arrangements that have been agreed in the Project Deed. However, we expect the number of variations will be limited and predominantly managed through the annual revenue adjustment process.

6 Application of supporting guidelines

This section sets out the supporting guidelines the AER will apply under the contestable framework. To the extent possible, these supporting guidelines will be consistent with the equivalent AER guidelines under the NER framework. The OECC intends to recommend regulations that will require the AER to implement supporting guidelines under the EII framework, but the mechanism by which this will be achieved remains under consideration.

6.1 AER guidelines applied to the EII framework

The contestable framework contained in the EII Act and regulations that the OECC intends to recommend is significantly different to the regulatory framework in the NER. It relies on a competitive procurement process to establish the amounts payable to the Network Operator. Under this framework, we do not undertake a detailed review of individual components of the Network Operator's proposed revenue (for example, capital and operating expenditure), instead we are relying on the competitive procurement process to deliver prudent, efficient and reasonable outcomes. Consequently, only a few AER guidelines developed under the NER framework are relevant to contestable network infrastructure projects.

The following EII framework guidelines, which will be derived from equivalent AER guidelines made under Chapter 6A of the NER, will apply to the contestable framework for network infrastructure projects:

- Confidentiality Guideline
- Ring-fencing Guideline
- Cost Allocation Guideline.

For the avoidance of doubt:

- Guidelines introduced under the EII framework will not alter the application of NER guidelines to network service providers under the NER.
- We will amend or update guidelines that apply to network service providers under the NER in accordance with the NER. Relevant amendments to a guideline made under the NER will also be applied in the equivalent guideline for Network Operators of contestable network infrastructure projects, with any appropriate adaptations to reflect the EII framework.
- Where we amend a guideline, we will allow a reasonable period between publishing those amendments and the time by which a Network Operator must comply.
- A reference to a guideline is to be read to include an associated handbook or guidance note where applicable.

6.1.1 Confidentiality

A Confidentiality Guideline will apply to all Network Operators of contestable network infrastructure projects providing information to the AER under the EII framework. We intend that the EII Confidentiality Guideline will be based on the AER's existing NER Confidentiality Guideline, which applies to network services providers under the NER and the NGR.

We will assess confidentiality claims in a Network Operator's revenue proposal in accordance with relevant requirements in the EII Act and regulations, including any requirements that the OECC intends to recommend regarding publication of the AER's revenue determination.

We note that commercial-in-confidence provisions are likely to apply to substantial portions of a contestable revenue proposal. However, to make and publish a credible determination it is

important that claims of confidentiality can be efficiently dealt with. The Confidentiality Guideline will set out the procedures to be followed to resolve any areas of disagreement.

6.1.2 Cost allocation

A Cost Allocation Guideline will apply to Network Operators of contestable network infrastructure projects under the EII framework. To the extent possible we intend that the Cost Allocation Guidelines will be consistent with the AER's Transmission Cost Allocation Guidelines made under the NER.

Cost allocation and attribution rules ensure that only costs that are attributable to providing a Regulated Network Service for a network infrastructure project are attributed to that network infrastructure project, and any costs shared between different network infrastructure projects are appropriately allocated and are only recovered once from consumers. A Network Operator must prepare and maintain a cost allocation methodology that governs the Network Operator's internal accounting and the way it prepares revenue proposals and any annual reporting that it submits to the AER. Cost allocation and attribution is also used to support the Ring-fencing Guideline (discussed below) to address the risk that a network business may use regulated revenues under the EII framework to cross-subsidise other activities.

Overview of cost allocation requirements

The Cost Allocation Guideline will require a Network Operator to develop detailed policies and principles for attributing and allocating costs between different network infrastructure projects for which the Network Operator provides Regulated Network Services. Principles and policies will be required to comply with the cost allocation principles that the OECC intends to recommend, and the requirements set out in the Cost Allocation Guideline. These requirements will be broadly consistent with the requirements in clause 2.2 of the AER's Transmission Cost Allocation Guidelines, with any changes necessary for the EII framework.

The Cost Allocation Guideline will set out requirements for submitting a proposed cost allocation methodology to the AER, including the format and contents of a proposed cost allocation methodology.

The Cost Allocation Guideline will require a Network Operator to apply an approved cost allocation methodology in preparing a revenue proposal and any other financial information to be provided to the AER in response to a notice issued under section 38(7) of the EII Act. A Network Operator will also be required to:

- be able to demonstrate the application of the cost allocation methodology
- commission an audit of the application of the cost allocation methodology, when required to do so by the AER, and
- publish an approved cost allocation methodology on the Network Operator's website.

A Network Operator will also be required to amend an approved cost allocation methodology if directed to do so by the AER.

Obligation to prepare and maintain a cost allocation methodology

The Cost Allocation Guideline will require a Network Operator to develop a cost allocation methodology for submission to the AER in accordance with the requirements of that guideline. This obligation will differ for Network Operators that are already a transmission or distribution network service provider under the NER, and those that are not:

- A Network Operator that is also a regulated transmission network service provider or a distribution network service provider under the NER must amend its existing NER cost allocation methodology to identify and separately allocate costs for each network infrastructure project for which the Network Operator provides Regulated Network Services.

Amendments to a network service provider's cost allocation methodology must be approved by the AER.

- If the Network Operator does not already maintain a cost allocation methodology under the NER, the Network Operator must prepare a cost allocation methodology consistent with the Cost Allocation Guideline and submit the methodology to the AER for approval. This includes a Network Operator that is also a regulated entity under the National Gas Law or other legislation. For the avoidance of doubt, a Network Operator that provides a Regulated Network Service for only one network infrastructure project under the EII framework must submit a cost allocation methodology detailing how it would attribute and allocate costs between multiple network infrastructure projects.

6.1.3 Ring-fencing

A Ring-fencing Guideline will apply to Network Operators of contestable network infrastructure projects under the EII framework. To the extent possible we intend that the Ring-fencing Guideline will be consistent with the AER's Transmission Ring-fencing Guideline made under the NER.

The purpose of ring-fencing regulated services from unregulated services is to protect the efficiency of regulated services and the competitiveness of markets for unregulated services. Ring-fencing does this by preventing regulated businesses from:

- discriminating in favour of their related parties to disadvantage competitors operating in these markets; and
- using revenue earned from regulated services to cross-subsidise contestable services.

The Ring-fencing Guideline will identify Regulated Network Services (as defined in the glossary) provided by a Network Operator as 'ring-fenced services' that must be separated from other unregulated activities. The Ring-fencing Guideline will adopt all obligations currently set out in the NER Transmission Ring-fencing Guideline, with some modifications to reflect the EII framework. We consider that the risk of cross-subsidisation between provision of 'Regulated Network Services' and other services, and of discrimination in favour of a related party, exists for Network Operators on broadly the same basis that it exists for transmission network service providers under the NER.

We have recently announced we are re-commencing our review of the Transmission Ring-fencing Guideline in two stages. The first stage involves issuing a new interim Guideline, to address a legal issue relating to the introduction of chapter 6A to the NER and updated references to replace obsolete references. In the second stage we will re-commence the comprehensive review of the guideline which was paused in 2020. It is intended that the EII Ring-fencing Guideline will be amended to reflect updates to the NER Transmission Ring-fencing Guideline once the final guideline is published. These updated provisions will apply to all Network Operators, including those with an existing determination. When we make an amendment to the EII Ring-fencing Guideline within a regulatory period we will consult Network Operators on any transitional arrangements that are to apply.

Obligations to prevent cross-subsidy

Obligations to prevent cross-subsidisation between Regulated Network Services and any other services provided by a Network Operator (or an associate²² of a Network Operator) will apply under the EII framework. We consider there are three kinds of risks in respect of cross-subsidy:

1. A Network Operator that is also a registered network service provider under the NER, a regulated gas service provider under the NGR, or that is regulated under other legislation may

²² 'Associate' as defined in cl. 4 of the Transmission Ring-fencing Guideline takes its definition from the Corporations Act 2001 and includes a reference to a director or secretary of the body corporate, a related body corporate and a director or secretary of a related body corporate.

cross-subsidise between regulated services provided under other legislation and Regulated Network Services provided under the EII framework.

2. A Network Operator may use revenue earned from providing Regulated Network Services to cross-subsidise unregulated activities undertaken by the Network Operator or an associate of the Network Operator.
3. A Network Operator that is responsible for more than one network infrastructure project under the EII framework may cross-subsidise one project using revenue earned from providing Regulated Network Services in connection with another project.

We anticipate a risk of misallocation of costs where a network service provider regulated under the NER or a gas service provider regulated under the NGR is selected to be a Network Operator. For example, differences in how underspending or overspending is treated between the NER, NGR, other legislation and the EII framework may provide an incentive for a Network Operator to shift costs between the provision of these different kinds of regulated services.

We consider there is a modest risk that a Network Operator may cross-subsidise unregulated services, for example by mis-allocating costs that are shared between provision of Regulated Network Services and unregulated services. This risk is mitigated by the contestable process undertaken by the Infrastructure Planner to select a Network Operator, because the project deed signed between the two parties will limit the extent to which annual amounts paid to the Network Operator can be varied. Nonetheless, there remains a limited incentive for a Network Operator to cross-subsidise provision of unregulated activities with revenue earned from providing Regulated Network Services.

Contestable REZ Network Infrastructure Projects are also subject to a maximum capital amount which applies for the whole of the concession period. If the Network Operator has more than one infrastructure project, the possibility exists that costs may be misallocated between the projects to avoid exceeding the maximum capital amount for a project.

To mitigate these risks, a Network Operator will be required to comply with the obligations that are broadly equivalent to the AER's Transmission Ring-fencing Guideline made under the NER. These include obligations to develop and maintain separate accounts for ring-fenced services and amalgamated accounts for the entire business, allocate and attribute costs, and to comply with accounting guidelines. We will require a Network Operator to allocate and attribute costs that are shared between provision of Regulated Network Services and any other services in a manner consistent with its AER approved cost allocation methodology. This requirement reflects our updated approach for ring-fencing and cost allocation under the Ring-fencing Guideline for electricity distributors.²³

Obligations to prevent discrimination

Obligations that prevent a Network Operator from discriminating in favour of a related business will apply under the EII framework. However, we will modify the definition of a 'related business' that currently exists in the NER Transmission Ring-fencing Guideline. We intend to redefine a related business²⁴ to mean: the activities of generation that connects directly to a Network Operator's network infrastructure or retail supply or operation of a load within an area directly supplied²⁵ by a Network Operator's network infrastructure. Unlike transmission network service providers, Network Operators are likely to construct and/or operate a limited area of network that is not directly

²³ AER, *Ring-fencing Guideline – Electricity Distribution – Version 3*, November 2021, cl. 3.2.2.

²⁴ Consistent with cl. 7.1(a)(ii) of the AER Transmission Ring-fencing Guideline, ring-fencing obligations apply to any related business carried out by the transmission network service provider itself, or by the transmission network service provider as part of a partnership, joint venture, or other unincorporated association.

²⁵ Note that "connect" and "supplied" are defined terms in Chapter 10 of the NER. We intend to adopt these NER definitions in interpreting the definition of a 'related party' under the EII Ring-fencing Guideline.

connected to the regional reference node for the NSW wholesale market. A broad prohibition on the activities of generation, distribution and retail activities, as exists in the NER Transmission Ring-fencing Guideline, would exceed the scope of potential harms to electricity consumers. However, a Network Operator may discriminate in favour of itself or a related party that provides generation, retail or load activities in an area directly supplied by the Network Operator's network infrastructure project. For example, a Network Operator may restrict network access by competitors or provide information about the network to a related generator on a preferential basis.²⁶

We consider the activities of 'generation' could include dispatch of electricity from non-traditional energy sources (such as a battery). This activity could include the provision of contestable market services such as frequency control ancillary services (FCAS). The Ring-fencing Guideline will address any potential harm that may arise if a Network Operator seeks to use regulated assets to earn revenue from contestable market services.

Under the EII framework Network Operators will be permitted to own, control or operate both transmission and distribution infrastructure. We see no scope for harm to electricity consumers from allowing a Network Operator to provide both types of infrastructure under the EII framework.

Note that a Network Operator that derives regulated revenue from multiple projects or from multiple regulated industries will not be prevented from sharing staff and resources, provided the Network Operator accurately identifies and allocates shared costs in accordance with an approved cost allocation methodology and no material conflicts of interest exist.

²⁶ We note that some aspects of network access will be governed under the REZ access rights scheme currently being developed by the OECC.

7 Information notices

7.1 Information requirements for revenue determinations

The EII Act allows the AER to issue information notices to Network Operators for the purpose of making a revenue determination.²⁷ Those provisions require that Network Operators must comply with any information notice issued by us, unless they have a lawful excuse.²⁸

Before issuing an information notice for a revenue determination, we will engage with the relevant Network Operator. The information notice would, as a minimum, include the information contained in section 5.1.1 of this Guideline but may also include other information requirements. For example, the information notice may also request information to allow the AER to assess any components of a revenue proposal that have not been determined through a competitive procurement process. Where relevant, information provided in response to a notice may be required to be subject to independent assurance (audit or review). Public versions of the revenue proposal and responses to an information notice will be published on the AER's website.

We may also use information notices during our review of a revenue proposal to request additional information where such information is required to assist us in making our revenue determination.

7.2 Information requirements for annual reporting

In addition to requesting information for making its revenue determinations, the OECC intends to recommend regulations that also allow us to issue notices to Network Operators to provide us with information on an annual basis throughout a regulatory period. We are likely to use this information to:

- monitor, report on and enforce a Network Operator's compliance with any requirements imposed on the Network Operator under a revenue determination, including cost allocation and ring-fencing requirements;
- monitor and report on a Network Operator's financial and operational performance.

Before issuing an information notice, we will engage with a Network Operator regarding our annual information requirements. Where relevant, annual information will be required to be subject to independent assurance (audit or review). Public versions of the annual reporting responses will be published on the AER's website.

²⁷ Section 38(7)-(8) of the EII Act.

²⁸ Section 38(9) of the EII Act.