



Australian Energy Market Commission

RULE DETERMINATION

NATIONAL ELECTRICITY AMENDMENT (APPLICATION PERIOD FOR CONTINGENT PROJECT REVENUE) RULE 2019

PROPONENT

Dr Kerry Schott AO

26 APRIL 2019

RULE

Rule determination

Application period for contingent project revenue
26 April 2019

INQUIRIES

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E aemc@aemc.gov.au
T (02) 8296 7800
F (02) 8296 7899

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ABOUT THE AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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SUMMARY

- 1 The Australian Energy Market Commission (AEMC or Commission) has made a rule that allows transmission and distribution network businesses to submit a contingent project application at any time during a regulatory control period up until the last 90 business days of the penultimate year of the regulatory control period. Any incremental revenues approved by the Australian Energy Regulator (AER) in respect of a contingent project application submitted within the last 90 business days of a regulatory year (where this is permitted) cannot start to be recovered by the relevant network service provider until the second regulatory year that commences after the application is submitted.
- 2 The current restriction in the National Electricity Rules (NER) that prevents network businesses from submitting a contingent project application within 90 business days prior to the end of a regulatory year is maintained for the penultimate year of a regulatory control period, as is the current implicit restriction that network businesses cannot submit a contingent project application at any time in the final year of a regulatory control period.
- 3 The Commission considers that the final rule may allow the regulatory processes associated with contingent projects to be achieved earlier in the regulatory control period, potentially resulting in earlier implementation of transmission and distribution projects, including time-critical projects. The Commission also considers that the final rule maintains the intent of the contingent project framework in the NER. This is to achieve efficient outcomes for consumers through investment in network projects for which there is uncertainty about exactly when they will be needed at the time a network revenue proposal is submitted for a regulatory control period, and which, if the events do occur, are to result in the amendment of the *existing* revenue determination.
- 4 The final rule has been made in response to a rule change request submitted by Dr Kerry Schott AO, Chair of the Energy Security Board, on 20 February 2019. The rule change request sought to amend the relevant clauses of the NER so that they no longer prevent transmission and distribution network businesses from submitting a contingent project application to the AER in the 90 business days before the end of a regulatory year, except where that regulatory year is the last year of a regulatory control period.
- 5 The Commission determined that it should make a more preferable rule to what was proposed in the rule change request in order to ensure the rule changes are consistent with the contingent project framework in the NER, as well as the operation of network service providers' regulatory and revenue determinations. The contingent project framework requires that there is at least one remaining regulatory year in a regulatory control period for an amended determination to take effect after the AER has approved a contingent project application.
- 6 The more preferable rule maintains the ability for a network business's amended determination, following a contingent project application, to operate within the regulatory control period, providing certainty to the business that it will be able to recover the costs of the project. Therefore, the more preferable rule promotes investment in transmission and distribution projects that will improve reliability and security in the NEM, supporting the

efficiency of the power system for the benefit of consumers.

- 7 The expedited rule change process was used for this rule change. The final rule commences on 2 May 2019.

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1 DR KERRY SCHOTT AO'S RULE CHANGE REQUEST

1.1 The rule change request

On 20 February 2019, Dr Kerry Schott AO (proponent), Chair of the Energy Security Board, made a request to the Australian Energy Market Commission (AEMC or Commission). The rule change request sought to amend the relevant clauses of the National Electricity Rules (NER) so that they no longer prevent transmission and distribution network businesses from submitting a contingent project application to the Australian Energy Regulator (AER) in the 90 business days before the end of a regulatory year, except where that regulatory year is the last year of a regulatory control period (rule change request).

The rule change request proposed that any incremental revenues approved by the AER in respect of a contingent project application submitted during the 90 business day window could not start to be recovered by the relevant network service provider until the second regulatory year that commences after the application is submitted.

Dr Kerry Schott AO also requested that the rule change request be considered a non-controversial¹ rule change request and, as a result, be assessed under an expedited rule change process. The Commission adopted this approach.

1.2 Background

1.2.1 Revenue approval - contingent project application

The economic regulatory regime in the NER allows for limited circumstances in which a network service provider's (NSP's) revenue allowance can be adjusted during a regulatory control period (generally, a period of five years). One way in which this can happen is through the contingent project mechanism, as set out in rules 6.6A and 6A.8 of the NER.²

The contingent project mechanism can be used where large discrete projects have already been identified as part of a distribution network service provider's (DNSP's) distribution determination or transmission network service provider's (TNSP's) revenue determination process that may or may not be required during the upcoming regulatory control period.

Contingent projects are not included in the ex-ante revenue allowance. However, the definition of the contingent projects and their accompanying trigger events form part of a DNSP's distribution determination and a TNSP's revenue determination by the AER. Trigger events usually include the successful completion of a regulatory investment test (for transmission or distribution as relevant).

Potential contingent projects can be identified by TNSPs in their revenue proposals and by DNSPs in their regulatory proposals. The AER then reviews those proposals and determines whether to allow for the inclusion of the contingent projects in the respective determinations. For example, projects identified must:³

¹ Section 96 of the NEL.

² As there are not many contingent projects for distribution, the final determination focuses on the relevant provisions for TNSPs in Chapter 6A to illustrate how the contingent project mechanism works.

³ See clause 6.6A.1(b) and 6A.8.1(b) of the NER.

- Be reasonably required to be undertaken to meet the capital expenditure objectives.
- Not be otherwise provided for in the forecast capital expenditure allowance under the revenue determination.
- Exceed the larger of either \$30 million or five per cent of the value of the maximum allowed revenue for the relevant TNSP (or annual revenue requirement for the DNSP) for the first year of the regulatory control period.

Following the occurrence of the trigger event during the regulatory period, the NSP may apply to the AER to amend its regulatory or revenue determination for an adjustment to its allowed revenue. The AER must then make a decision as to whether the trigger event for the contingent project has occurred. The AER must also determine the amount of capital and operating expenditure reasonably required to undertake the project and the impact of allowing such expenditure as part of the allowed revenue. The NER sets out the requirements on TNSPs and DNSPs in lodging applications and the obligations on the AER in assessing applications. Once the AER determines that the trigger event has been met and determines the amount of incremental revenue required for the project, then the NSP's determination is adjusted for the remaining regulatory years of the regulatory control period to reflect the project.

While the contingent project mechanism exists for TNSPs and DNSPs, it is relatively unusual for DNSPs to have many contingent projects (if at all). In contrast, TNSPs typically have a number of contingent projects identified in their revenue determinations. In particular, many of the group 1 and group 2 projects identified in the Australian Energy Market Operator's (AEMO's) inaugural Integrated System Plan (ISP) are already identified in TNSPs' revenue determinations as contingent projects.

For the contingent project trigger event to be satisfied for most transmission contingent projects that the AER has approved in recent revenue determinations, the AER will need to be satisfied that the RIT-T has been successfully completed before a TNSP submits a contingent project application. The AER determines this using the approach laid out in clause 5.16.6 of the NER.⁴

1.2.2

Clauses 6A.8.2(b)(1) and 6.6A.2(b)(1)

As noted above, when the pre-determined trigger event is met during the regulatory control period, the NSP must then apply to the AER for assessment of the contingent project for the purposes of revenue adjustment.

The NER includes a framework that describes how the contingent project mechanism operates, including when applications can be made to the AER, what needs to be in them and how the AER will make a determination on the contingent project for the relevant regulatory control period. Clauses 6.6A.2(b)(1) and 6A.8.2(b)(1) prohibit the DNSP and TNSP, respectively, from submitting a contingent project application within 90 business days prior to the end of a regulatory year.⁵

⁴ This process does not apply in distribution.

⁵ The regulatory year ends on 30 June for Queensland, NSW, ACT, Tasmania and South Australia, and 31 December for Victoria.

The Commission understands that the rationale for the existence of these clauses is linked to charging. Transmission and distribution charges are set on a year by year basis, and are informed by the maximum allowed revenue (for TNSPs) and the annual revenue requirement (for DNSPs). There are a number of steps that must be undertaken after contingent project revenues are approved and included in the allowed revenue before the associated transmission and distribution charges can be recovered in retail prices. For example, transmission charges must be included within distribution charges, and these must be notified to retailers before the end of the regulatory year. These steps take some time. The relevant clauses are intended to reduce the likelihood that a contingent project application is submitted after a point when it would be no longer possible to recover any incremental revenue in the following regulatory year.

1.2.3

ESB work on actioning the ISP and related rule changes

At the COAG Energy Council meeting on 10 August 2018, the Energy Security Board (ESB) was requested to report in December 2018 on:

- how the group 1 projects in the ISP could be delivered as soon as practicable
- how group 2 and 3 projects should be progressed
- how the ISP would be converted into an actionable strategic plan⁶

On 19 December 2018, the ESB provided a report to the COAG Energy Council outlining how the points listed above should be addressed.⁷ Responding to the report, the COAG Energy Council agreed on an approach, set out by the ESB, to deliver group 1 projects as soon as possible including rule changes to streamline regulatory processes. Ministers also tasked ESB to consider how these reforms could be applied to other priority projects such as the South Australia to New South Wales interconnector.⁸ Ministers noted that a rigorous cost benefit analysis will be an essential part of the process to ensure costs to consumers are minimised, and agreed that the ESB do more work on further measures to operationalise the ISP including regular updates and re-assessments of group 2 and 3 projects.⁹ This work is currently underway by the ESB.

In response to two rule change requests submitted by Dr Kerry Schott AO, Chair of the Energy Security Board, that were consolidated by the AEMC, on 4 April 2019 the Commission made a final rule to streamline the regulatory processes for several of the projects identified in the ISP.¹⁰ The final rule for speeding up ISP projects allows:¹¹

6 COAG Energy Council, Meeting Communique, 10 August 2018.

7 Energy Security Board, Integrated System Plan - Action Plan, 20 December 2018. See: <http://www.coagenergycouncil.gov.au/publications/integrated-system-plan-action-plan>

8 Dr Kerry Schott AO submitted a rule change request to the AEMC on 21 February 2019 to address this request from the COAG Energy Council, and the AEMC made the final rule as proposed - see below.

9 COAG Energy Council, Meeting Communique, 19 December 2018, p.2.

10 The final rule made on 4 April 2019 relates to processes for specific transmission contingent projects. To note, there is no clause 5.16.6 determination equivalent for distribution.

11 The final rule is expressed to apply to specific contingent projects identified in the relevant transmission network service providers' revenue determinations, and does not remove or change any steps in the regulatory process for the identified projects, but simply allows the AER to consider several processes concurrently.

- the RIT-T dispute process, RIT-T preferred option assessment and the contingent project revenue assessment to be conducted concurrently for upgrades to the Victoria-New South Wales interconnector (VNI) and Queensland-New South Wales interconnector (QNI) that are currently being considered¹²
- the RIT-T preferred option assessment and the contingent project revenue assessment to be conducted concurrently for Project EnergyConnect (proposed new interconnector between South Australia and New South Wales).

The final rule for speeding up ISP projects does not allow the AER to complete a step before the previous step has also been completed. It only allows a step to be commenced before the previous step has been completed.¹³ These changes will save time in the regulatory process for these projects.

1.3 Rationale for the rule change request

The rule change request stated that, at the COAG Energy Council meeting on 19 December 2018, Ministers discussed and agreed on an approach to deliver ISP group 1 transmission projects identified in the ISP as soon as possible, including rule changes to streamline regulatory processes.¹⁴ Subsequent to that meeting, the potential for clause 6A.8.2(b)(1) to delay implementation of some of the ISP group 1 projects has been identified.

Through submissions to the *Early implementation of ISP priority projects* rule change request, as well as through informal discussions, TNSPs as well as Energy Networks Australia identified that clauses 6.6A.2(b)(1) and 6A.8.2(b)(1) of the NER, which prohibit the DNSP and TNSP, respectively, from submitting a contingent project application within 90 business days prior to the end of a regulatory year, may delay time critical projects more generally. That is, they may delay the time at which network businesses get certainty as to revenue recovery for those projects.

1.4 Solution proposed in the rule change request

The proponent sought to resolve the issue discussed above by proposing a rule (proposed rule) that would amend clauses 6.6A.2(b)(1) and 6A.8.2(b)(1) of the NER such that they:

- Would no longer prevent a contingent project application from being submitted in the 90 business days before the end of a regulatory year, except where that regulatory year is the last year of a regulatory control period, but
- Would recognise that any incremental revenues approved by the AER in respect of a contingent project application submitted during the last 90 business day window could

12 For QNI, see: <https://www.transgrid.com.au/what-we-do/projects/current-projects/ExpandingNSWQLDTransmissionTransferCapacity>; for VNI, see: <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Planning-and-forecasting/Victorian-transmission-network-service-provider-role/Regulatory-investment-tests-for-transmission>

13 The NER require that these steps be undertaken one after the other for transmission projects more broadly.

14 As noted in section 1.2.3, the AEMC published a final rule on 4 April 2019 that streamlines the post RIT-T regulatory process for three ISP projects: upgrades to QNI and VNI (group 1 projects) and the proposed new interconnector between South Australia and New South Wales - Project EnergyConnect (group 2 projects). See: <https://www.aemc.gov.au/rule-changes/early-implementation-isp-priority-projects>

not start to be recovered by the relevant NSP until the second regulatory year that commences after the application is submitted.

The rule change request stated that the proposed rule would not affect the timing of recovery of network charges.¹⁵ Therefore, even though the proposed rule would not affect when the network business could recover incremental revenues approved in respect of a contingent project, it would potentially bring the AER consideration and approval of a contingent project forward three to four months. Dr Kerry Schott AO considered that this could be of benefit for a time critical project because it would give the relevant TNSP or DNSP greater certainty regarding the recovery of costs such that it could commence works on the project at an earlier stage.¹⁶

The rule change request stated that while this concern has arisen in relation to transmission contingent projects, given that this clause applies equally to both TNSPs and DNSPs, it would be desirable for the same arrangements to apply to both transmission and distribution in order to minimise the differences between the regimes.¹⁷

The rule change request stated that the proposed rule change would be expected to allow the regulatory processes associated with contingent projects to be achieved faster, potentially resulting in quicker delivery of transmission or distribution projects. Where these projects are time critical, this would promote reliability and security of supply in the NEM as it would assist the TNSP or DNSP in starting (and therefore completing) a project in a more timely manner.¹⁸

The rule change request noted that the proposed changes would have the benefit of allowing applications for contingent projects to be submitted earlier. Therefore, they would enable a TNSP or DNSP to submit a contingent project revenue application to the AER in all of the remainder of the 2018-2019 regulatory year, potentially allowing any currently time-critical projects to be implemented in a more timely manner.¹⁹

Application to the end of the regulatory control period

The rule change request sought to still maintain the restriction of a contingent project application not being submitted in the 90 business days before the end of a regulatory year, where that regulatory year is the last year of a regulatory control period. The rule change request stated that this is because in this instance there are no remaining years of the regulatory control period in relation to which revenue can be adjusted. Given that contingent projects are for those projects that are uncertain in timing within a current regulatory period, the rule change request stated that this appears inappropriate. In addition, in practical terms, the rule change request stated it is likely that the contingent project would be included in the revenue proposal for the first year of the upcoming regulatory control period. This would allow the NSP to start recovering the revenue straight away (from 1 July of the new regulatory control period).

¹⁵ Dr Kerry Schott AO, *Application period for contingent project revenue* rule change request, 20 February 2019, p.3.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Provided the 2018-2019 regulatory year is not the last year of the regulatory control period.

The consultation paper published by the AEMC on 7 March 2019 to seek stakeholder submissions on the rule change request also raised the issue of whether it would be appropriate for the restriction of a contingent project application not being submitted in the 90 business days before the end of a regulatory year to also apply to the *penultimate* year of the regulatory control period.

The rule change request did not include a proposed rule.

1.5 The rule making process

On 7 March 2019, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.²⁰ A consultation paper identifying specific issues for consultation was also published. Submissions closed on 4 April 2019.

The Commission accepted that the rule change request was a request for a non-controversial rule as defined in s. 96 of the NEL. Accordingly, the Commission commenced an expedited rule change process, subject to any written requests not to do so. The closing date for receipt of written requests was 21 March 2019.

No requests to not carry out an expedited rule change process were received. Accordingly, the rule change request was considered under an expedited process.²¹

The Commission received four submissions. Issues raised by stakeholders are discussed and responded to in the relevant sections of this final rule determination.

²⁰ This notice was published under s. 95 of the National Electricity Law (NEL).

²¹ Section 96 of the NEL.

2 FINAL RULE DETERMINATION

2.1 The Commission's final rule determination

The Commission's final rule determination is to make a final rule that allows transmission and distribution network businesses to submit a contingent project application to the AER up until 90 business days before the end of the penultimate year of a regulatory control period.²² However, any incremental revenues approved by the AER in respect of a contingent project application submitted during the 90 business day window of a regulatory year where this is permitted (i.e. in a regulatory year that is not the penultimate or final year) cannot start to be recovered by the relevant NSP until the second regulatory year that commences after the application is submitted.²³

The final rule maintains the 90 business day restriction for submitting a contingent project application to the AER in the penultimate year of a regulatory control period, and explicitly states that a contingent project application cannot be submitted at any time during the final regulatory year of a regulatory control period,²⁴ which is currently implicit in the NER.

The final rule is a more preferable rule. The Commission's reasons for making this final rule determination are set out in section 2.4.

In relation to the rule's application in the Northern Territory, the final rule relates to parts of the NER that apply in the Northern Territory. In making the final rule, the Commission has considered whether a uniform or differential rule should apply to the Northern Territory, and the Commission has determined to make a uniform rule. See section 2.2.3 for the definition of a differential rule and the Commission's ability to make a differential rule.

This chapter outlines:

- the rule making test for changes to the NER
- the more preferable rule test
- the assessment framework for considering the rule change request
- the Commission's consideration of the more preferable final rule against the national electricity objective
- the Commission's consideration in deciding whether to make a uniform or differential rule in accordance with the Northern Territory legislation adopting the NEL.²⁵

Further information on the legal requirements for making this final rule determination is set out in Appendix A.

²² See clause 6.6A.2(a1) and clause 6A.8.2(a1) of the final rule.

²³ See clause 6.6A.2(p) and clause 6A.8.2(m) of the final rule.

²⁴ See clause 6.6A.2(a1) and clause 6A.8.2(a1) of the final rule.

²⁵ National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

2.2 Rule making test

2.2.1 Achieving the NEO

Under the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO).²⁶ This is the decision-making framework that the Commission must apply.

The NEO is:²⁷

to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

(a) price, quality, safety, reliability and security of supply of electricity; and

(b) the reliability, safety and security of the national electricity system.

2.2.2 Making a more preferable rule

Under s. 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO.

In this instance, the Commission has made a more preferable rule. The reasons are summarised below in section 2.4.

2.2.3 Northern Territory legislative considerations

Under the Northern Territory legislation adopting the NEL, the Commission must regard the reference in the national electricity objective to the “national electricity system” as a reference to whichever of the following the Commission considers appropriate in the circumstances having regard to the nature, scope or operation of the proposed rule:²⁸

(a) the national electricity system

(b) one or more, or all, of the local electricity systems

(c) all the electricity systems referred to above.

The Commission considers it appropriate in the context of the proposed rule to regard the reference in the national electricity objective to the “national electricity system” as a reference to (c) above.

The Commission may make a differential rule if, having regard to any relevant Ministerial Council on Energy (MCE) statement of policy principles, a different rule will, or is likely to,

²⁶ Section 88 of the NEL.

²⁷ Section 7 of the NEL.

²⁸ Section 14A of Schedule 1 to the National Electricity (Northern Territory) (National Uniform Legislation) Act 2015, inserting section 88(2a) into the NEL as it applies in the Northern Territory.

better contribute to the achievement of the NEO than a uniform rule.²⁹ A differential rule is a rule that:

- varies in its term as between:
 - the national electricity system, and
 - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

As the proposed rule related to parts of the NER that apply in the Northern Territory, the Commission has considered whether a uniform or differential rule should apply to the Northern Territory and assessed the rule against additional elements required by the Northern Territory legislation.³⁰ The Commission has decided that a differential rule is not required, and the final determination is therefore to make a uniform rule because the same rule is able to be applied in the Northern Territory without any modifications to take account of the differences in that jurisdiction.

2.3 Assessment framework

In assessing the rule change request against the NEO the Commission has considered the following principles:

- **Making transmission and distribution investments at the right time:** A process which promotes making transmission and distribution investment in order to address system limitations in a timely way reduces the risk of price, reliability and/or security issues arising from investments that are too late in meeting the identified needs.
- **Minimising inefficient increases in regulatory cost:** Increased regulatory costs are ultimately borne by consumers in the form of higher prices. The benefit of any increased regulatory activity needs to outweigh the costs in order for the change to be efficient.
- **Promoting certainty for the national electricity market about project status:** A process that minimises uncertainty, or provides certainty earlier, promotes efficient outcomes designed to meet the reliability needs of the national electricity system.

The Commission considered whether the benefits of the proposed rule and the more preferable final rule outweigh the costs or risks of such changes.

²⁹ Section 14B of Schedule 1 to the National Electricity (Northern Territory) (National Uniform Legislation) Act 2015, inserting section 88AA into the NEL as it applies in the Northern Territory. Section 14 of Schedule 1 to the National Electricity (Northern Territory) (National Uniform Legislation) Act 2015, inserts definitions for differential Rule and uniform Rule into section 87 of the NEL as it applies in the Northern Territory.

³⁰ From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. (See the AEMC website for the NER that applies in the NT.) National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

2.4 Summary of reasons

The more preferable final rule made by the Commission is published with this final rule determination. The key features of the more preferable final rule are discussed below, along with the Commission's reasons.

2.4.1 Application

An application may be submitted up until 90 business days prior to the end of the penultimate regulatory year of a regulatory control period:

- Transmission and distribution network businesses are permitted to submit a contingent project application any time up until 90 business days prior to the end of the penultimate regulatory year of a regulatory control period.³¹
- Any incremental revenue approved by the AER in respect of a contingent project application that is submitted within the last 90 business days of a regulatory year could not start to be recovered by the relevant network service provider until the second regulatory year that commences after the application is submitted.³² This is because the amendment to the network's revenue determination does not take effect until the second regulatory year that commences after the application is submitted.

In its submission to the consultation paper published to seek stakeholder feedback on the rule change request, Energy Networks Australia stated that there is no need for additional regulation limiting the commencement of revenue recovery for contingent projects. Energy Networks Australia stated that revenue could not practically be recovered in the following regulatory year given that network businesses have to finalise annual prices several months before the end of a regulatory year.³³

While agreeing that this practical limitation exists, for clarity, the Commission determined the NER should state that revenue should not start to be recovered by the relevant network service provider until the second regulatory year that commences after the application is submitted, if it is submitted within 90 business days prior to the end of a regulatory year where this is allowed to occur (i.e. in regulatory years that are not the penultimate regulatory year or final regulatory year). This is to make sure that sufficient time is provided for the necessary charging regime to be determined before the costs are passed on to consumers.

2.4.2 Application in the final year of a regulatory control period

An application may not be submitted at all in the final regulatory year of a regulatory control period:

31 The final rule does not refer to specific years within a regulatory control period, such as "year one" or "year two," etc. because the length of regulatory control periods can vary. See clauses 6.12.1(2)(ii) and 6A.14.3(e), for example. However, in a five year regulatory control period, this would allow an application to be submitted at any time during years one to three and up until 90 business days prior to the end of year four.

32 For example, approved revenue from an application submitted 80 business days prior to the end of regulatory year three would not be recovered until regulatory year five.

33 Energy Networks Australia, submission to the consultation paper, *Application period for contingent project revenue rule change request*, 4 April 2019, pp.3-4.

- Transmission and distribution network businesses are not permitted to submit a contingent project application at any time during the final regulatory year of a regulatory control period.

The rule change request proposed that the NER be amended to remove the restriction that prevents a network business from submitting a contingent project application within the final 90 business days of a regulatory year, except where that year is the last year in a regulatory control period. The AER supported this position in its submission to the consultation paper as there would be no remaining years in the regulatory period in which revenue could be adjusted if the restriction was not in place for the last year, and the AER's decision on the contingent project application would come after the regulatory or revenue determination for the next regulatory control period. Additionally, the AER noted that clauses 6A.6.7(h) and 6.5.7(g), which require the revenue proposal for the next regulatory control period to include the amount of unspent capital expenditure from the previous regulatory control period, would be inoperable.³⁴

In its submission to the consultation paper, Energy Networks Australia stated that a contingent project application should be allowed at any time in the regulatory control period subject to threshold triggers being met, with revenue recovery which may span across regulatory control periods.³⁵ Energy Networks Australia suggested that, rather than prevent a contingent project application in the final year of a regulatory control period, the final rule should implement a similar approach to that adopted through the *Cost pass through arrangements for network service providers rule* published in 2012. This rule amended the NER to allow network service providers to recover costs for a pass through event that occurred in the previous regulatory control period.³⁶

The cost pass through mechanism is needed because of the inability of NSPs, and the AER, to forecast all possible events that could affect the ability of NSPs to provide network services at the time of setting the revenue or regulatory determinations. The inability of network businesses to recover the costs of these unexpected events, such as tax, insurance and regulatory changes, would otherwise have a significant financial effect on the ability of the businesses to invest in and operate their networks.³⁷

The contingent project mechanism was designed for a different purpose. A contingent project is a large discrete project that is identified as part of the regulatory or revenue determination process that may or may not be required during the upcoming regulatory control period - it is not the result of an unforeseen event. Additionally, the cost threshold for a contingent projects is much higher than a pass through event.³⁸ Further, cost pass through events do not result in a revenue adjustment, but rather, TNSPs are able to directly recover actual costs from consumers. This is a different mechanism to contingent projects, where cost recovery

34 AER, submission to the consultation paper, *Application period for contingent project revenue rule change request*, 4 April 2019, p.2.

35 Energy Networks Australia, submission to the consultation paper, *Application period for contingent project revenue rule change request*, 4 April 2019, pp.2-3.

36 AEMC, final determination, *Cost pass through arrangements for network service providers rule*, 2012, p.9.

37 Ibid.

38 The threshold is 1 per cent for cost pass through and 5 per cent for contingent projects.

occurs through an amendment to the revenue determination, which requires TNSPs to consider how projects can be delivered efficiently for consumers.

It is not appropriate to make changes to the NER in line with Energy Network Australia's proposal to apply the cost pass through provisions to contingent projects such that a contingent project application could be submitted at the end of a regulatory control period, and to allow the recovery of costs in the next regulatory control period. The Commission's reasoning is explained further below.

The NER regulating contingent project applications are clearly intended to operate only where, following the amendment to the regulatory or revenue determination in response to the application, there is at least one remaining year of the regulatory control period. In other words, clause 6A.8.2 (for transmission) does not contemplate the amendment of the revenue determination during the last regulatory year of the regulatory control period even if it is made earlier than 90 business days prior to the end of that last regulatory year:

- Clause 6A.8.2(l) currently provides that "amendments to a revenue determination take effect from the commencement of the next regulatory year." As a revenue determination only applies during a regulatory control period, then an amendment made to that revenue determination made during the last regulatory year of the regulatory control period will have no effect as, from the commencement of the next regulatory year after the determination is made (being the first regulatory year of the next regulatory control period) a new revenue determination will regulate what revenue may be earned in the regulatory years of that next regulatory control period.
- Clause 6A.8.2(b)(3)(iii) requires the contingent project application to include a forecast of the capital and incremental operating expenditure, for each remaining regulatory year which the transmission network service provider considers is reasonably required for the purpose of undertaking the contingent project.
- Clause 6A.8.2(b)(3)(vii) requires the contingent project application include "an estimate of the incremental revenue which the transmission network service provider considers is likely to be required to be earned in each remaining regulatory year of the regulatory control period as a result of the contingent project being undertaken as described in clause 6A.8.2(b)(3)(iii)."
- Clause 6A.8.2(b)(3)(v) requires the application for a contingent project revenue adjustment to include "the intended date for commencing the contingent project (which must be during the regulatory control period)." This means that transmission network service providers cannot use the contingent project mechanism for projects they won't start until the next regulatory control period.

As described above, the NER relating to contingent projects place an implicit limit on a contingent project application being submitted in the final regulatory year of a regulatory control period. In its submission to the consultation paper, TransGrid suggested that this restriction should be removed but didn't provide any further detail about how the removal

could operate within the existing framework.³⁹ The contingent project mechanism is structured throughout the NER such that network businesses must have at least one remaining year of the regulatory control period following the amendment to the regulatory or revenue determination in response to the application, and as such the Commission determined that the more preferable final rule make the current implicit limitation that a contingent project application cannot be submitted in the final year of a regulatory control period more explicit.

2.4.3 Application in the penultimate regulatory year of a regulatory control period

The rule maintains that an application cannot be made within 90 business days prior to the end of the penultimate regulatory year of a regulatory control period.

In its submission to the consultation paper, the AER supported the rule change request's proposal to remove the 90 business day restriction on submitting a contingent project application in the penultimate year of a regulatory control period.⁴⁰

As described above, network businesses must have at least one remaining year of the regulatory control period following an amendment to a regulatory or revenue determination in response to a contingent project application. In order for the network business to be able to submit an application and for the AER to make a determination in time for there to be one remaining year of the regulatory control period, the Commission determined that there needs to be some time available in the penultimate year for these steps to occur. Therefore, the final rule maintains the 90 business day restriction for submitting a contingent project application in the penultimate regulatory year of a regulatory control period. If this restriction were not retained and a network business was to submit a contingent project application within the last 90 business days of the penultimate year of a regulatory control period, the AER would not have enough time to make its decision before the commencement of the next regulatory year, meaning that the amended regulatory or revenue determination would be unable to operate as intended by the existing framework in the NER, as there would be no remaining regulatory years in the regulatory control period for the amended determination to take effect.

The AEMC has had informal conversations with AER staff who agreed that there was a practical limitation with the proposal but do not consider that there are any practical limitations in implementing the approach/position taken in the final rule and determination.

There is still a risk that, if a network business submitted a contingent project application on the 91st business day before the end of the penultimate year, or close to it, the AER may not have enough time to make a decision in the remainder of the regulatory year, which would be required in order for the amended regulatory or revenue determination to be able to take effect in the following regulatory year (in this case, the final year of the regulatory control period). Under the NER, the AER is provided with 100 business days to assess and make a decision on a contingent project application (40 business days plus an optional 60 business

³⁹ TransGrid, submission to the consultation paper, *Application period for contingent project revenue* rule change request, 2 April 2019, p.2.

⁴⁰ AER, submission to consultation paper, *Application period for contingent project revenue* rule change request, 4 April 2019, p.2.

day extension). A network business would have to consider the risk that the AER may not be able to make a decision in time if it is seeking to submit a contingent project application close to when the 90 business day restriction commences in the penultimate year of a regulatory control period. This is not a new scenario introduced by the more preferable final rule, but is a situation that network businesses must currently consider under the existing framework.

BOX 1: EXAMPLE AND IMPLICATIONS OF MORE PREFERABLE FINAL RULE

If a network service provider has a regulatory control period of 1 July 2019 to 30 June 2024, the more preferable final rule allows for a contingent project application to be submitted any time between 1 July 2019 and 20 February 2023 (noting the existing requirement to submit an application as soon as practicable following the occurrence of the trigger event).

For a contingent project application submitted within the last 90 business days of the 2019-2020 regulatory year (i.e. the first year), the network business would not be able to commence cost recovery for the contingent project until 1 July 2021 (i.e. within the third year). Similarly, for an application submitted within the last 90 business days of the 2020-2021 regulatory year (the second year), cost recovery could commence from 1 July 2022 (the penultimate year). For an application submitted within the last 90 business days of the 2021-2022 regulatory year (the third year), cost recovery could commence from 1 July 2023 (the final year of the regulatory control period).

In the 2022-2023 regulatory year (the penultimate year), the network business would not be able to submit a contingent project application after 20 February or at any time in the 2023-2024 regulatory year (the final regulatory year).

Some comments made by stakeholders in response to the rule change request raise broader questions about the contingent project framework within the NER. These broader questions are being looked at in the context of the AEMC's *Electricity network economic regulatory framework review 2019*, which is examining whether the economic regulatory framework is sufficiently robust and flexible, and continues to support the efficient operation of the energy market in the long term interests of consumers.⁴¹

Having regard to the issues raised in the rule change request and during consultation, the Commission is satisfied that the more preferable final rule will, or is likely to, better contribute to the achievement of the NEO, as detailed in the remainder of this section.

2.4.4

Assessment against the National Electricity Objective

Making transmission and distribution investments at the right time

The Commission considered whether the more preferable final rule would promote making investments at the right time to reduce the risk of price, reliability and/or security issues

⁴¹ See: <https://www.aemc.gov.au/market-reviews-advice/electricity-network-economic-regulatory-framework-review-2019>

arising from investments that are too late. Any delay to the projects past their optimal implementation times will cause a delay to the projects' benefits being realised.

The more preferable final rule will provide the opportunity for network businesses to be able to obtain revenue certainty earlier than they would otherwise be able to up until the penultimate year of a regulatory control period. This will potentially allow contingent projects to be implemented in a more timely manner.⁴²

The more preferable final rule supports investment in transmission projects that will improve reliability and security in the NEM, thus supporting the efficiency of the power system for the benefit of consumers.

Minimising inefficient increases in regulatory cost

The Commission considered whether there would be an increase in regulatory costs associated with the more preferable final rule, and if so, whether such an increase would be efficient. That is, whether the benefit of any increased regulatory costs outweighs those costs.

The more preferable final rule does not require the AER to undertake any work in addition to what it would be required to do under the current rules.⁴³ The more preferable final rule should therefore not result in increased regulatory costs, and any that might eventuate are considered to be minimal. It is worth noting in relation to this that the AER supported the proposed rule in its submission to the consultation paper.

There are benefits associated with network businesses being able to obtain revenue certainty for contingent projects earlier, as described above. Therefore, the benefits of the more preferable final rule outweigh any associated increase in regulatory costs, which can reasonably be expected to be minor, if they eventuate at all.

Promoting certainty for the national electricity market about project status

The Commission considered whether the proposed rule would promote certainty for the market about the status of transmission and distribution network projects. A process that minimises uncertainty in the market, or provides certainty earlier, promotes efficient outcomes designed to meet the reliability needs of the national electricity system.

42 The rule change request referred to the implementation of ISP group 1 projects as a driver for the rule change request. The Commission notes that ElectraNet's current regulatory control period is 2018-23. This means that the more preferable final rule will benefit the South Australia system strength project identified in the ISP group 1 projects. Similarly, TransGrid's current regulatory control period is 2018-23, which will mean that, provided the RIT-Ts for the QNI and VNI upgrades are completed before February 2021, the more preferable rule will benefit the NSW components of these projects. Powerlink's current regulatory control period is 2017-2022. If the RIT-T for the QNI upgrade is completed before February 2020, the more preferable final rule will benefit any QLD component of the project. The remainder of the group 1 projects involve works in Victoria where the transmission planning framework means that AEMO is not subject to the AER revenue determination process in order to recover funds from consumers. Further streamlining the regulatory process for some of the ISP group 1 projects, as noted in section 1.2.3, on 4 April 2019, the Commission made a final rule to allow the relevant network businesses to submit a RIT-T preferred option assessment application during the 30 day RIT-T dispute notification period, and to be able to submit a contingent project application before the AER makes a determination on the RIT-T preferred option for the QNI and VNI upgrade projects. See: <https://www.aemc.gov.au/rule-changes/early-implementation-isp-priority-projects>

43 Altering the period during which network businesses are permitted to submit a contingent project application may impact when the AER undertakes its assessment of the applications, and may more evenly spread the AER's work load associated with contingent project applications over the regulatory control period.

In the present circumstances, uncertainty in the market can lead to inefficient decisions being made with regard to investment in transmission infrastructure and new generation. The availability of information to market participants about planned investments by transmission businesses assists in efficient investment decisions being made by other transmission businesses, as well as generator developers and consumers.

The more preferable final rule may therefore result in network businesses being able to make investment decisions several months earlier than they otherwise would be able to given that they will have certainty about the revenue associated with a contingent project earlier than they might otherwise have. The final rule does not, however, change anything in the regulatory process that is designed to protect consumers from inefficient investment. This improves the quality of information available to other market participants to make efficient investment decisions, which ultimately benefits consumers.

2.4.5

The more preferable final rule, the proposed rule and the NEO

The more preferable final rule better meets the NEO than the proposed rule because it is consistent with the way the contingent project mechanism is designed to operate within the NER framework. The contingent project mechanism seeks to achieve efficient outcomes for consumers through investment in transmission projects for which there is uncertainty about exactly when they will be needed at the time a network revenue proposal is submitted. The more preferable final rule maintains the ability for a network business's amended regulatory or revenue determination, following a contingent project application, to be able to apply within the relevant regulatory control period, providing certainty to the businesses that they will be able to recover the costs of the project.

The proposed rule sought to allow a contingent project application to be submitted any time during the penultimate year, and up until the last 90 business days of the final regulatory year of a regulatory control period. However, if a contingent project application is submitted within the last 90 business days of the penultimate year, the AER would not have time to assess the application and make an amendment to the regulatory or revenue determination prior to the commencement of the final regulatory year. As the NER require an amendment to a regulatory or revenue determination to take effect from the commencement of the next regulatory year after the AER makes a decision, such an exercise would be pointless where there is no regulatory year remaining. An application submitted at any time in the final regulatory year of a regulatory control period would similarly not make sense as there is no remaining regulatory year in which to amend the regulatory or revenue determination.⁴⁴ This would create revenue uncertainty for a network business in relation to the contingent project and would not encourage the implementation of transmission and distribution network projects.

⁴⁴ As noted at the beginning of this section, the contingent project framework in the NER requires that there is at least one remaining year of the regulatory control period after the AER amends a network business's regulatory or revenue determination as an amended determination does not take effect until the following regulatory year, and a regulatory or revenue determination applies only to a single regulatory control period.

Therefore, the more preferable final rule better meets the NEO as it will support investment in network projects that will improve reliability and security in the NEM, thus supporting the efficiency of the power system for the benefit of consumers.

ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
DNSP	Distribution network service provider
ESB	Energy Security Board
ISP	Integrated system plan
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National electricity market
NEO	National electricity objective
NER	National Electricity Rules
NSP	Network service provider
TNSP	Transmission network service provider

A LEGAL REQUIREMENTS UNDER THE NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this final rule determination.

A.1 Final rule determination

In accordance with s. 103 of the NEL the Commission has made a final rule in relation to the rule proposed by Dr Kerry Schott AO.

The Commission's reasons for making this final rule determination are set out in section 2.4.

A copy of the more preferable final rule is published with this final rule determination. Its key features are described in section 2.4.

A.2 Power to make the rule

The Commission is satisfied that the more preferable final rule falls within the subject matter about which the Commission may make rules. The more preferable final rule falls within s. 34(2) of the NEL as it relates to regulating the activities of persons involved in the operation of the national electricity system.

A.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during consultation
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO.

There is no relevant MCE statement of policy principles for this rule change request.⁴⁵

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of AEMO's declared network and system functions.⁴⁶ The more preferable final rule is compatible with AEMO's declared network and system functions because it does not affect the performance of the functions at all.

⁴⁵ Under s. 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

⁴⁶ Section 91(8) of the NEL.

A.4 Civil penalties

The Commission cannot create new civil penalty provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NER be classified as civil penalty provisions.

The final rule does not amend any clauses that are currently classified as civil penalty provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the final rule be classified as civil penalty provisions.

A.5 Conduct provisions

The Commission cannot create new conduct provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NER be classified as conduct provisions.

The final rule does not amend any rules that are currently classified as conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the COAG Energy Council that any of the proposed amendments made by the final rule be classified as conduct provisions.