

**Draft rule determination**

National Electricity Amendment  
(Managing ISP project uncertainty  
through targeted ex post reviews)  
Rule 2024

**Proponent**

The Honourable Chris Bowen, Minister for Climate Change and Energy

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**Reference: ERC0381**

## About the AEMC

The AEMC reports to the energy ministers. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the energy ministers.

## Acknowledgement of Country

The AEMC acknowledges and shows respect for the traditional custodians of the many different lands across Australia on which we all live and work. We pay respect to all Elders past and present and the continuing connection of Aboriginal and Torres Strait Islander peoples to Country. The AEMC office is located on the land traditionally owned by the Gadigal people of the Eora nation.

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## Summary

- 1 The Commission has made a draft rule to enable the Australian Energy Regulator (AER) to undertake separate, targeted ex post reviews of capital expenditure for Integrated System Plan (ISP) projects and non-ISP projects. The AER would undertake an ex post review when a transmission network service provider (TNSP) overspends its capital expenditure (capex) allowance for an ISP project or for non-ISP projects. Our draft rule is in response to the rule change request submitted by the Minister for Climate Change and Energy.
- 2 The draft rule would promote better outcomes for consumers by improving the existing ex post review mechanism to:
  - encourage efficient investment in ISP projects and better enable the AER to prevent TNSPs from charging consumers for inefficient capex overspend, and
  - provide certainty for TNSPs on how capex overspends for ISP and non-ISP projects would be treated under the ex post review mechanism.
- 3 The Commission acknowledges the significant cost to consumers for the new transmission needed to achieve a net zero system and meet Australia's emissions reduction targets. This rule change is an important piece of reform that helps ensure consumers are not paying for more than the efficient cost of transmission.
- 4 If made, the rule would commence in August 2025.
- 5 We are seeking feedback on our draft determination and draft rule by **20 June 2024**.

## The Commission's draft decision is based on stakeholder support for the TPIR recommendations

- 6 Our draft determination and draft rule is consistent with the Commission's *Transmission planning and investment review* (TPIR) recommendation to enable the AER to undertake separate, targeted ex post reviews for ISP project capex and capex on non-ISP projects.
- 7 The recommendation was broadly supported by stakeholders during the Commission's extensive consultation on TPIR.
- 8 TPIR found that the existing ex post review mechanism is not fit for purpose because it does not account for the bespoke nature of ISP projects and does not enable the AER to appropriately assess the efficiency of ISP project capex.
- 9 ISP projects carry greater risk of overspends relative to non-ISP projects. Stakeholders considered that there is uncertainty in how the AER would review and adjust capex under the existing ex post review mechanism, particularly in cases where capex overspends are clearly attributable to ISP projects only. This uncertainty exposes TNSPs to risks that may be out of its control and lead to poorer forecasting outcomes.
- 10 Stakeholders supported changes to the NER that would enable the AER to undertake separate, targeted ex post reviews for ISP project capex and non-ISP capex. This would improve certainty and better enable the AER to assess ISP capex overspends to prevent consumers from paying for inefficient capex.

## We assessed our draft rule against three assessment criteria using regulatory impact analysis and stakeholder feedback

- 11 The Commission has considered the NEO<sup>1</sup> and the issues raised in the rule change request and assessed the draft rule against three assessment criteria outlined below. We gathered stakeholder feedback from TPIR and undertook regulatory impact analysis in relation to these criteria.
- 12 The draft would contribute to achieving the NEO by:
- **Supporting efficient outcomes for consumers** - the draft rule would improve the ex post review framework by better enabling the AER to assess ISP project capex. This supports better outcomes for consumers because it would give the AER the appropriate tools to prevent consumers from paying for inefficient capex. An improved ex post review mechanism better encourages TNSPs to undertake capex efficiently.
  - **Creating regulatory certainty** - the draft rule would improve regulatory certainty around the treatment of ISP and non-ISP capex under the ex post review mechanism. This supports TNSPs to better forecast cost estimates which helps ensure consumers only pay for efficient capex.
  - **Facilitating simple, low cost implementation** - the draft rule would be simple to implement because it does not fundamentally change the ex post review mechanism or its process, and will only impose low costs to the AER to update its Guideline.

## The draft would clearly enable the AER to undertake separate, targeted ex post reviews

- 13 Our draft rule would enable the AER to undertake a targeted ex post review on ISP project specific capex by introducing the following concepts:
- **ISP overspending requirement** - this new definition enables separate treatment of capex overspend on ISP projects, to capex overspend on non-ISP projects (which remain under the definition of 'overspending requirement'). This enables an ex post review to be triggered when actual ISP project capex exceeds the capex allowance for the ISP project. This allows the AER to assess the efficiency of the ISP project overspend separately from any non-ISP capex.
  - **ISP review period** - this new definition enables the AER to review all capex for an ISP project, including where the capex has been incurred over multiple regulatory years of multiple regulatory control periods.
  - **Reviewable ISP project** - this new definition determines the point at which ISP capex becomes reviewable, which is when the ISP project or project stage is completed.
- 14 Our draft rule would also enable the AER to exclude capex up to the amount that was overspent on an ISP project from a TNSP's RAB if the AER considers part or all of the overspend is inefficient. This prevents TNSPs from charging consumers for inefficient overspend on ISP projects.

## The rule would commence on 1 August 2025 after the AER updates the Capital Expenditure Incentive Guideline

- 15 Transitional rules are included in the draft rule to:

<sup>1</sup> Section 7 of the NEL.

- require the AER to update its *Capital expenditure incentive guideline* (Guideline) by 1 August 2025 to set out how it will make determinations if the ISP overspending requirement is satisfied
- allow the AER to commence consultation on the amended guideline before the final rule is made, if desirable

## How to make a submission

### We encourage you to make a submission

Stakeholders can help shape the solution by participating in the rule change process. Engaging with stakeholders helps us understand the potential impacts of our decisions and contributes to well-informed, high quality rule changes.

### How to make a written submission

**Due date:** Written submissions responding to this draft determination and rule must be lodged with the Commission by 20 June 2024.

**How to make a submission:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0381.<sup>2</sup>

Tips for making submissions on rule change requests are available on our website.<sup>3</sup>

**Publication:** The Commission publishes submissions on its website. However, we will not publish parts of a submission that we agree are confidential, or that we consider inappropriate (for example offensive or defamatory content, or content that is likely to infringe intellectual property rights).<sup>4</sup>

### Next steps and opportunities for engagement

We will hold a virtual public forum on 29 May 2024. The forum will provide an overview of the draft determination. Stakeholders will have the opportunity to ask questions. To register for this forum please visit [our registrations page](#).

There are other opportunities for you to engage with us, such as one-on-one discussions or industry briefing sessions.

You can also request the Commission to hold a public hearing in relation to this draft rule determination.<sup>5</sup>

**Due date:** Requests for a hearing must be lodged with the Commission by 16 May 2024.

**How to request a hearing:** Go to the Commission's website, [www.aemc.gov.au](http://www.aemc.gov.au), find the "lodge a submission" function under the "Contact Us" tab, and select the project reference code ERC0381. Specify in the comment field that you are requesting a hearing rather than making a submission.<sup>6</sup>

### For more information, you can contact us

Please contact the project leader with questions or feedback at any stage.

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Telephone: [02 8296 7800](tel:0282967800)

<sup>2</sup> If you are not able to lodge a submission online, please contact us and we will provide instructions for alternative methods to lodge the submission

<sup>3</sup> See: <https://www.aemc.gov.au/our-work/changing-energy-rules-unique-process/making-rule-change-request/our-work-3>

<sup>4</sup> Further information about publication of submissions and our privacy policy can be found here: <https://www.aemc.gov.au/contact-us/lodge-submission>

<sup>5</sup> Section 101(1a) of the NEL.

<sup>6</sup> If you are not able to lodge a request online, please contact us and we will provide instructions for alternative methods to lodge the request.

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# 1 The Commission has made a draft determination

This draft determination is to make a draft rule in response to a rule change request submitted by The Honourable Chris Bowen, Minister for Climate Change and Energy, about managing Integrated system plan (ISP) project uncertainty through targeted ex post reviews. We are seeking feedback on this draft rule.

## 1.1 Our draft rule would improve the ex post review mechanism to encourage efficient capex on ISP projects

Our draft determination is to enable the Australian Energy Regulator (AER) to undertake separate, targeted ex post reviews on capex for ISP and non-ISP projects, instead of undertaking a single review of total capex for all projects.

The ex post review is part of a package of incentive mechanisms which encourage transmission network service providers (TNSPs) to undertake efficient capital expenditure (capex). The ex post review is a mechanism of last resort that enables the AER to prevent TNSPs from charging consumers for any inefficient capex overspends, where a TNSP has materially overspent its capex allowance.<sup>7</sup>

Separate, targeted ex post reviews would support better outcomes for consumers by:<sup>8</sup>

- encouraging TNSPs to undertake efficient capex on ISP projects, and
- better enabling the AER to prevent TNSPs from charging consumers for inefficient and imprudent capex overspends.<sup>9</sup>

Our draft rule would improve certainty for TNSPs that the AER would only consider adjusting the amounts that would be recovered from consumers for:

- non-ISP capex, where there has been an overspend on non-ISP projects, and
- ISP capex, where there has been an overspend on an ISP project. The AER would review the total capex incurred for a completed ISP project.

Improving certainty for TNSPs would help to limit TNSPs' exposure to risks that are not in TNSPs' control and support better cost forecasting. As noted by the AER, improved project cost estimates would help ensure consumers do not pay for inefficient capex on ISP projects.<sup>10</sup>

Our draft rule would not change the AER's existing process for conducting an ex post review. As shown in Figure 1.1, we expect the AER would continue to undertake an ex post review based on the existing process. However, our draft rule would limit the scope of a review to either capex on an ISP project or non-ISP project capex, depending on where the overspend occurs. Chapter 3 describes specific draft changes to the NER which would facilitate separate, targeted ex post reviews.

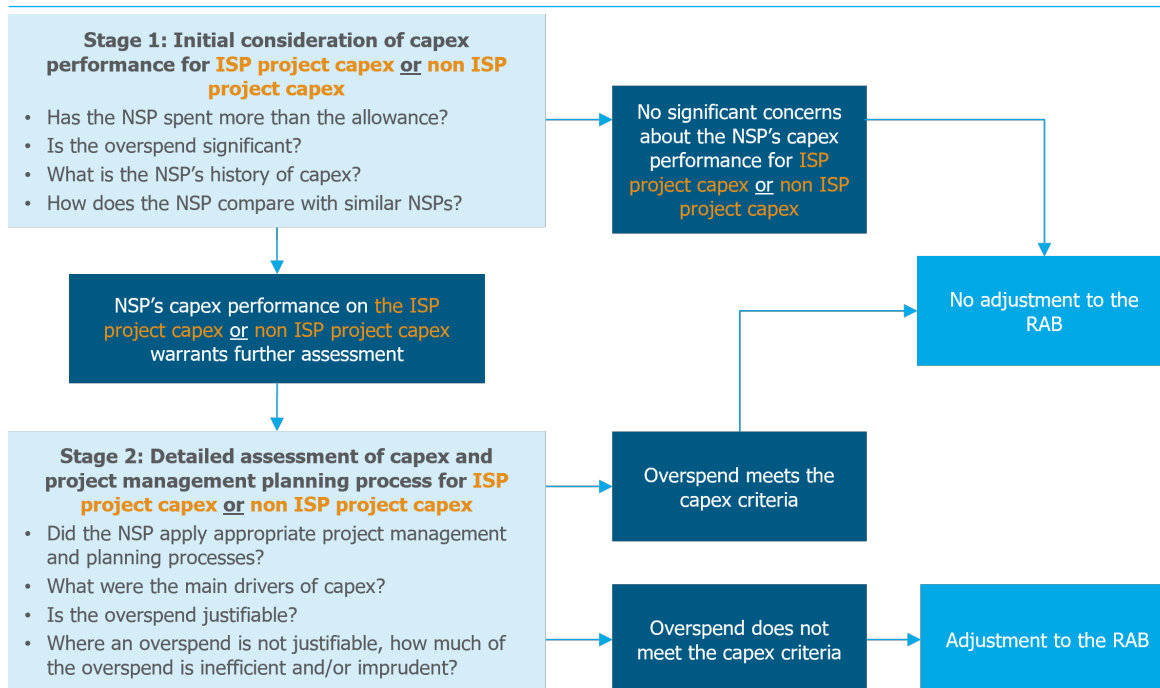
7 An ex post review is a review of TNSPs capex overspend. When a transmission network service provider (TNSPs) spends more than its total capital expenditure (capex) allowance, the Australian Energy Regulator (AER) reviews the capex and can prevent TNSPs from charging consumers for any overspend that the AER considers inefficient by removing capex from a TNSP's regulatory asset base (RAB). Appendix C explains the existing ex post review mechanism in more detail.

8 Section 2.3 discusses how our rule promotes the long term interest of consumers in more detail.

9 Inefficient and imprudent capex means capex the AER considers does not reasonably reflect the capital expenditure criteria. Appendix C.2.2 provides a detailed overview of how the AER assesses capex and decides how much capex should not be included in a TNSP's RAB to prevent consumers from paying for the capex.

10 AER, Submission to the AEMC, *Transmission planning and investment review - stage 3 draft report*, p. 8.

Figure 1.1: Ex post review process under our draft rule



Source: AEMC. Based on the AER's current approach to conducting an ex post review, set out in the *Capital expenditure incentive guideline*.  
Note: Changes to the existing ex post review mechanism outlined in appendix C, that would be made by our draft rule, are shown in orange.

## 1.2 Stakeholder views from TPIR relating to existing uncertainty shaped our determination

Our draft determination and draft rule is consistent with the *Transmission planning and investment review* (TPIR) recommendation to enable the AER to undertake separate, targeted ex post reviews for ISP and non-ISP project capex. Our draft determination reflects broad stakeholder support for the recommendation expressed by stakeholders during the Commission's extensive consultation on TPIR.

During TPIR, the Commission noted that the ex post review mechanism encourages TNSPs to spend capex efficiently.<sup>11</sup> This is especially important for capex on ISP projects because, as discussed in TPIR, there is a higher risk of ISP project cost overruns, relative to non-ISP projects.<sup>12</sup>

TNSPs considered that the existing ex post review mechanism is not fit for purpose given the bespoke risk profile and scale of ISP projects. This is because an ex post review is currently triggered where a TNSP's actual capex exceeds its total capex allowance. As there is a greater risk of overspending capex on large ISP projects relative to smaller BAU projects, TNSPs expressed a concern that an ex post review may be triggered more frequently.

Because the existing ex post review is a review of total capex, non-ISP capex would also be subject to review where an overspend is clearly attributable to an ISP project only. TNSPs consider that this creates uncertainty around the treatment of non-ISP capex where a capex overspend has occurred only on a specific ISP project.<sup>13</sup> Specifically, TNSPs are uncertain whether non-ISP capex

11 AEMC, *Transmission planning and investment review - stage 3 draft report*, 21 September 2022, p. 97.

12 Ibid, pp. 93-94.

13 Submissions to the *Transmission planning and investment review - stage 3 draft report*: ENA p. 12; Transgrid, p. 8.

could be subject to exclusion from the regulated asset base (RAB) if a TNSP has overspent on ISP project capex only. This uncertainty in the regulatory framework could result in inefficient outcomes for consumers if it creates material risks that are outside a TNSP's control.<sup>14</sup>

To address stakeholder concerns with the existing ex post review mechanism, stakeholders supported changes to the NER that would enable the AER to undertake separate targeted ex post reviews for ISP project capex and non ISP capex.<sup>15</sup>

The AER considered that targeted ex post reviews may appropriately balance ISP project risk between TNSPs and consumers.<sup>16</sup> PIAC noted that a targeted ex post review process would improve cost forecasts and CEIG acknowledged that it would ensure robust protections for consumers.<sup>17</sup>

CEIG considered that a targeted ex post review mechanism should not create any delays associated with additional review stages.<sup>18</sup> Our draft rule does not create additional review stages. The existing two staged process in Figure 1.1 would be maintained, but the scope of the review would be restricted to projects where the overspend has occurred. Our draft rule would improve the timeliness of the ex post review process because it would clearly enable the AER to focus on ISP capex if there is an overspend instead of having to additionally review non-ISP capex where there has been no material overspend on non-ISP projects.

AEMO noted that targeted ex post reviews may create the risk that TNSPs will increase their project risk estimates to indirectly mitigate the increased risks associated with these ex-post reviews.<sup>19</sup> The Commission considers that our draft rule would not increase the risk that TNSPs inflate project cost estimates. Instead, as noted by the AER and PIAC, our draft rule would support TNSPs to better forecast costs.

### 1.3 Our determination would support the efficient delivery of the transmission needed to achieve a net zero power system

Transmission is a critical enabler for the transition to net zero, both in the national electricity market (NEM) and for the Australian economy more broadly. This transition will require an unprecedented level of investment in, and build of, transmission infrastructure to deliver power from renewable generation and energy storage to consumers.

TPIR recommended improvements to the regulatory frameworks for transmission planning and investment to support efficient investment in and timely delivery of major transmission projects.

This rule change is a recommendation from TPIR and forms part of a set of reforms that support the efficient delivery of major transmission investment.

The Commission acknowledges the significant cost to consumers for the new transmission, needed to achieve a net zero system and meet Australia's emissions reduction targets. This rule change is an important piece of reform that helps ensure consumers are not paying for more than the efficient cost of transmission.

14 Ibid.

15 Submissions to the *Transmission planning and investment review - stage 3 draft report*: ENA p. 12; Transgrid, p. 8; CEIG, pp. 3,12; AER, p. 8; Marinus Link, pp. 5-6; PIAC, p. 10; TasNetworks, p. 3.

16 AER, submission to the *Transmission planning and investment review - stage 3 draft report*, p. 8.

17 Submissions to the *Transmission planning and investment review - stage 3 draft report*: CEIG, p. 3 & PIAC, p. 10.

18 CEIG, submission to the *Transmission planning and investment review - stage 3 draft report*, p. 12.

19 AEMO, submission to the *Transmission planning and investment review - stage 3 draft report*, p. 20.

## 2 The rule would contribute to the energy objectives

Our draft rule would promote the national electricity objective (NEO) because it would support better outcomes for consumers by helping ensure that consumers do not pay for inefficient capex for ISP projects. Our draft rule would also improve certainty on how the regulatory framework for ex post reviews operates, which helps improve TNSPs cost forecasts for ISP projects.

### 2.1 The Commission must act in the long-term interests of energy consumers

The Commission can only make a rule if it is satisfied that the rule will or is likely to contribute to the achievement of the relevant energy objectives.<sup>20</sup>

For this rule change, the relevant energy objective is the NEO.

The NEO is:<sup>21</sup>

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; and
- (c) the achievement of targets set by a participating jurisdiction—
  - (i) for reducing Australia’s greenhouse gas emissions; or
  - (ii) that are likely to contribute to reducing Australia’s greenhouse gas emissions.

The targets statement, available on the AEMC website, lists the emissions reduction targets to be considered, as a minimum, in having regard to the NEO.<sup>22</sup>

### 2.2 We must also take these factors into account

#### 2.2.1 We have considered the revenue and pricing principles for this rule change

We also have to take into account the revenue and pricing principles when making a rule for or with respect to transmission system revenue and pricing.<sup>23</sup>

In making this draft determination, the Commission has considered the following aspects of transmission system revenue and pricing to be most relevant:

- the regulation of revenues earned, or prices charged, by owners, controllers or operators of transmission systems, for the provision by them of services that are the subject of a transmission determination.<sup>24</sup>
- the economic framework, mechanisms or methodologies to be applied or determined by the AER for that purpose.<sup>25</sup>

20 Section 88(1) of the NEL.

21 Section 7 of the NEL.

22 Section 32A(5) of the NEL.

23 The revenue and pricing principles are set out in section 7A of the NEL.

24 Schedule 1 item 15 of the NEL.

25 Schedule 1 item 19 of the NEL.

- the RAB, for the purposes of making a transmission determination, of assets forming part of a transmission system owned, controlled or operated by a regulated transmission system operator, and of proposed new assets to form part of that transmission system that are, or are to be, used in the provision of services that are the subject of a transmission determination.<sup>26</sup>

As the draft rule relates to such matters, the Commission must take into account the revenue and pricing principles. The Commission considers the following principles are most relevant to the draft rule:

- a regulated network service provider should be provided with a reasonable opportunity to recover at least the efficient costs the operator incurs in complying with a regulatory obligation or requirement, or making a regulatory payment.<sup>27</sup>
- a regulated network service provider should be provided with effective incentives in order to promote economic efficiency with respect to services the operator provides. The economic efficiency that should be promoted includes efficient investment in a transmission system.<sup>28</sup>
- regard should be had to the economic costs and risks of the potential for under and over investment by a regulated service provider in a transmission system.<sup>29</sup>

The Commission has taken into account these principles in making this draft determination and rule. The draft rule promotes these principles because our draft rule:

- considers that some capex overspend may be prudent and efficient which we consider TNSPs should have the opportunity to recover. Under the draft rule, the AER would only be able to prevent TNSPs from recovering what the AER considers is inefficient overspend.
- would enable the ex post review mechanism to be an effective incentive for TNSPs to undertake capex efficiently.
- acknowledges the increased risk of overspend associated with ISP projects and would improve certainty over how an overspend would be treated, under the ex post review mechanism, to help TNSPs manage risk.

### 2.2.2 We have considered how the rule would apply in the Northern Territory

In developing the draft rule, the Commission has considered how it should apply to the Northern Territory according to the following questions:

- Should the NEO test include the Northern Territory electricity systems? For this rule change request, the Commission has determined that the reference to the “national electricity system” in the NEO includes only the national electricity system.
- Should the rule be different in the Northern Territory? The Commission has determined that a uniform rule should apply to the Northern Territory.

See Appendix D for more detail on the legal requirements for our decision.

## 2.3 How we have applied the legal framework to our decision

The Commission must consider how to address uncertainty with the existing ex post review mechanism and encourage efficient investment in ISP projects against the legal framework.

<sup>26</sup> Schedule 1 item 21 of the NEL.

<sup>27</sup> Section 7A(2) of the NEL.

<sup>28</sup> Section 7A(3) of the NEL.

<sup>29</sup> Section 7A(6) of the NEL.

We identified the following criteria to assess whether the proposed rule change, no change to the rules (business-as-usual), or other viable, rule-based options are likely to better contribute to achieving the NEO:

- Outcomes for consumers: would the draft rule help ensure consumers only pay for the efficient costs of transmission infrastructure?
- Principles of good regulatory practice: would the draft rule improve certainty over how the AER would undertake an ex post review?
- Implementation considerations: would the draft rule be relatively simple and low cost to implement?

These assessment criteria reflect the key potential impacts – costs and benefits – of the rule change request, for impacts within the scope of the NEO.

The Commission has undertaken regulatory impact analysis to evaluate the impacts of the various policy options against the assessment criteria. Appendix B.1 outlines the methodology of the regulatory impact analysis.

The rest of this section explains why the draft rule best promotes the long-term interest of consumers when compared to other options and assessed against the criteria.

### 2.3.1 A fit-for-purpose ex post review mechanism supports efficient outcomes for consumers

Our draft rule would help ensure consumers do not pay for inefficient expenditure on ISP projects. It does so by improving the existing ex post review mechanism to enable the AER to consider capex on an ISP project separately from non-ISP capex.

A separate ex post review of capex on an ISP project would enable the AER to better focus on ISP project capex. As discussed in section 3.1.2, our draft rule would introduce a definition for ‘ISP project review period’ to enable the AER to review all years in which ISP project capex is incurred. This may be a longer time period than what the current definition of ‘review period’ allows.<sup>30</sup> This would enable the AER to take a more holistic view of the efficiency of ISP project capex which better supports the AER’s assessment on capex efficiency. Improving the ex post review framework to better enable the AER to assess ISP project capex supports better outcomes for consumers because it would give the AER the appropriate tools to prevent consumers from paying for inefficient capex.

The ex post review mechanism encourages TNSPs to spend capex efficiently because it enables the AER to exclude any inefficient capex from a TNSP’s RAB. By improving the existing ex post review mechanism our draft rule would further encourage TNSPs to spend capex more efficiently.

### 2.3.2 Separating the existing ex post review mechanism into targeted ex post reviews improves certainty

As discussed in section 1.2, the existing mechanism creates uncertainty over the treatment of non-ISP capex, where TNSPs have overspent their capex allowance for a specific ISP project only. This uncertainty in the regulatory framework may create material risks that are outside a TNSP’s control.

Under the draft rule, the ex post review provisions in Chapter 6A of the NER would no longer be applied to a TNSP’s total capex. Instead, the AER would consider overspends of capex incurred on each ISP project, separate to capex incurred for BAU projects. The draft rule facilitates this by

<sup>30</sup> See clause S6A.2.2A(a1) of the draft rule.

defining ISP capex overspends as the 'ISP overspending requirement' and other non-ISP capex overspends as the 'overspending requirement'.<sup>31</sup> This improves certainty for TNSPs that the AER would not review, and potentially exclude, the non-ISP capex from the TNSP's RAB, if the TNSP only overspent its ISP project capex allowance, and vice versa. This certainty supports TNSPs to better forecast capex which helps ensure TNSPs only recover efficient capex from consumers.

During TPIR, the Commission considered whether to retain flexibility for the AER to initially review a TNSP's total capex before considering whether to undertake a more targeted review. The Commission considers that this would not appropriately address the existing uncertainty with the ex post review mechanism because there would still be initial uncertainty over whether the AER may undertake a detailed review of non-ISP capex where there has only been a material overspend on ISP capex.

### 2.3.3 Separate, targeted ex post reviews are relatively simple and low cost to implement

Our draft rule would impose some costs on the AER because the AER would be required to update its existing *Capital expenditure incentive guideline* (Guideline) to describe how the AER would undertake ex post reviews for ISP and non-ISP capex overspends.<sup>32</sup> As discussed in appendix B.1, we consider these costs to be low and consider that the draft rule does not impose significant costs on any other stakeholder.

Our draft rule would be simple to implement because the draft rule does not fundamentally change the ex post review mechanism or its process. Our draft rule would only reduce the scope of what the AER can review to where a capex overspend has occurred.

There would be no significant barriers to implement our rule because we consider the AER can clearly isolate ISP project capex from non-ISP capex from a cost allocation perspective and, as discussed in section 3.1.4, our draft rule would be compatible with the AER's capital expenditure sharing scheme (CESS).

<sup>31</sup> See clause S6A.2.2A(c1) of the draft rule and clause S6A.2.2A(c) of the NER.

<sup>32</sup> See section 3.3 for more information.

### 3 How our rule would operate

Our draft determination is to explicitly separate ex post reviews for ISP project capex and non-ISP capex. This means that the AER would no longer undertake an ex post review of a TNSP’s total capex if a TNSP overspends its total capex allowance. Instead, the AER would undertake separate, targeted ex post reviews for:

- ISP project capex, if a TNSP overspends its capex allowance for an ISP project.
- non-ISP projects capex, if a TNSP overspends its total capex allowance for non-ISP projects.

Table 3.1 summarises the key changes to the current arrangements that would be introduced by our draft rule to enable the AER to undertake separate, targeted ex post reviews. The rest of this chapter discusses each change in more detail.

**Table 3.1: Draft key changes to current arrangements**

Feature	Current arrangement	
Trigger for ex post review (see section 3.1.1)	Ex post review is triggered where total capex incurred over the five-year review period exceeds total forecast capex for that period.	<p><b>ISP project:</b> ex post review is triggered where capex incurred on an ISP project exceeds forecast capex for that project. An ex post review can only be triggered for a completed ISP project.</p> <p><b>Non ISP project:</b> Ex post review is triggered where capex incurred on non-ISP projects exceeds forecast capex for all non-ISP projects during the review period.</p>
Timing of an ex post review (see section 3.1.1)	The AER undertakes an ex post review at the time it prepares a draft decision on a TNSP’s regulatory determination for the next regulatory control period.	No change to current approach.
Review period (see section 3.1.2)	The AER can review TNSP capex from the last five years. As explained in Box 2, this is called the review period which includes the first three years of the previous regulatory control period and the last two years of the immediately previous regulatory control period.	<p><b>ISP project:</b> the ISP project review period includes all the years in which capex is incurred for that ISP project, including where that capex is incurred over multiple regulatory control periods, beyond five years.</p> <p><b>Non-SP project:</b> the existing review period applies.</p>

Feature	Current arrangement	
RAB exclusions (see section 3.1.4)	The amount the AER can exclude from the RAB is limited to the level of overspend above the total capex allowance that the AER determines does not meet the capex criteria.	<p><b>ISP project:</b> the amount of capex the AER can exclude from the RAB would be limited to the level of overspend for that project that the AER determines does not meet the capex criteria.</p> <p><b>Non-ISP project:</b> the amount of capex the AER can exclude from the RAB would be limited to the level of overspend above the capex allowance for non-ISP projects, for the five year review period, the AER determines does not meet the capex criteria.</p>

Note: See section 3.1 for references to the draft rule.

### 3.1 The AER must review ISP project capex if a TNSP exceeds its capex allowance for the ISP project

#### Box 1: Draft determination - Targeted ex post review for ISP project capex

Our draft rule would enable the AER to undertake a targeted ex post review on ISP project specific capex by introducing the following concepts:

- **ISP overspending requirement** - this enables separate treatment of capex overspend on ISP projects, to capex overspend on non-ISP projects (which remain under the definition of 'overspending requirement'). This enables an ex post review to be triggered when actual ISP project capex exceeds the capex allowance for the ISP project. This enables the AER to assess the efficiency of the ISP project overspend separately from any non-ISP capex.
- **ISP review period** - this enables the AER to review all capex for an ISP project, including where the capex has been incurred over multiple regulatory years of multiple regulatory control periods.
- **Reviewable ISP project** - this determines the point at which ISP capex becomes reviewable, which is when the ISP project or project stage is completed.

Our draft rule would also enable the AER to exclude capex up to the amount that was overspent on an ISP project from a TNSP's RAB if the AER considers part or all of the overspend is inefficient. This prevents TNSPs from charging consumers for inefficient overspends on ISP projects.

Our draft rule would enable the AER to undertake a targeted ex post review of capex on an ISP project. This section sets out the key draft changes that would enable the AER to undertake a targeted ex post review of ISP project capex and describes how an ex post review of ISP project capex would be undertaken.

### 3.1.1 An ex post review on ISP project capex would be triggered when there is a capex overspend on the project

Our draft rule introduces the term “ISP overspending requirement”.<sup>33</sup> An ex post review would be triggered if the ISP overspending requirement is satisfied.<sup>34</sup> The draft rule provides that an ISP overspending requirement is satisfied if all capex related to an ISP project exceeds a TNSP’s total capex allowance for that project, including any adjustments from approved pass through amounts.<sup>35</sup>

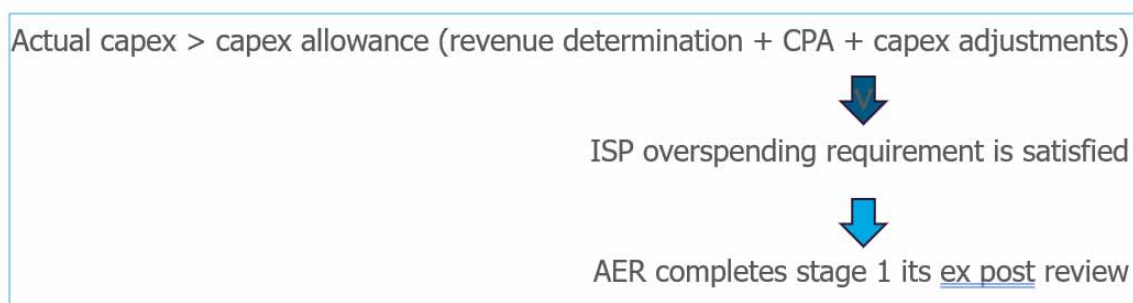
A TNSP’s capex allowance for an ISP project is included in its most recent revenue determination plus any subsequent AER determinations on the TNSP’s contingent project applications (CPA) related to the project.

Appendix C.1 describes the AER’s two staged approach to undertake an ex post review as part of a TNSP’s revenue reset process under the draft rule. If the AER maintains its two staged approach then, as part of stage one, the AER would initially test whether a TNSP’s actual capex on an ISP project exceeds its capex allowance for that project as specified in its revenue determination, plus any subsequent CPA determinations. As shown in Figure 3.1, if the actual capex is greater, an ex post review on that capex is triggered and the AER would:

- complete stage one, and
- consider whether to proceed to stage two or end the ex post review.

This is a change from the existing trigger for an ex post review. Currently, the AER would initially test whether there has been an overspend on a TNSP’s entire capex allowance. An ex post review would be triggered if a TNSP’s total capex exceeds a TNSP’s total capex allowance.<sup>36</sup>

**Figure 3.1: Trigger for ex post review**



Note: Capex refers to expenditure specifically for an ISP project

#### The ex post review would continue to occur as part of the revenue reset process

The draft rule would not require the AER to review ISP capex as soon as an ISP project is completed. Rather, an ex post review for an ISP project would be undertaken during the revenue reset period immediately following its completion, consistent with current arrangements.

Our draft rule would not change the timing of when an ex post review would be undertaken. Neither the current NER, or the changes made by the draft rule, place a requirement on the AER to make a determination on a capex overspend within any particular timeframe of the relevant

33 See definition of ISP overspending requirement in NER chapter 10 and clause S6A.2.2A(c1) of the draft rule.

34 Clause S6A.2.2A(f) of the draft rule.

35 Clause S6A.2.2A(c1) of the draft rule.

36 Clause S6A.2.2A(c) of the NER.

overspend requirement being satisfied.<sup>37</sup> Under the draft rule, the AER would continue to test whether there has been a capex overspend (i.e. whether the ‘overspending requirement’ or ‘ISP overspending requirement’ has been satisfied) and, if so, conduct an ex post review at the time it prepares a draft decision on a TNSP’s revenue proposal for the next regulatory control period.

For example, as shown in Figure 3.2, even though ISP project B is completed in 2028-2029, an ex post review could only be triggered in 2032-2033 during the revenue reset period.

The Commission recognises that delays between when an ISP project is completed and the AER’s initial test of ISP capex overspend may create some uncertainty for TNSPs, particularly where there has been an overspend of ISP capex relative to the allowance. However, on balance, the Commission considers it important that the AER is able to assess ISP project capex when it assesses non-ISP capex, to determine whether an overspend has occurred. This would ensure that, if both reviews are triggered, the AER would undertake ex post reviews for ISP capex and non-ISP capex in parallel. This would:

- avoid unnecessary costs associated with the AER potentially having to conduct multiple ex post reviews at different times during a regulatory control period.
- support the AER in assessing relevant data to identify any trends where there has been an overspend of both ISP and non-ISP capex.
- provide clarity and transparency to the relevant TNSP around the AER’s approach to capex more broadly – that is, to both past and future capex.

### 3.1.2 The AER would review all ISP project specific capex only once the project is completed

Our draft rule introduces the term “ISP project review period”. This would be the period over which a TNSP has incurred all capex on an ISP project. This could be over multiple regulatory control periods.<sup>38</sup>

Under our draft rule, the AER would review all capex that a TNSP incurs for a ISP project over the ISP project review period.<sup>39</sup> This effectively means that the AER is not limited to reviewing only capex incurred over the previous five years as it would be under current arrangements described in Box 2.<sup>40</sup> Under the draft rule, the AER can review all capex on an ISP project over the entire period in which TNSPs incurred capex .

As shown by the red triangles in Figure 3.2, under the current arrangements, the AER would review the capex incurred delivering ISP projects A and B in two parts. This is because capex on these projects was incurred over two review periods. Under our draft rule, the AER would instead only undertake a single review of all capex for each ISP project. For example, for ISP project A, the ISP project review period would be seven years (2024-2031), which would enable the AER to review the capex incurred over the seven years at once in the 2032-2033 period

#### **An ISP review period that is not limited by five years better enables the AER to assess capex**

In bi-lateral discussions with the AER during TPIR, the AER considered that currently, it is difficult to assess the materiality and efficiency of capex overspends if a TNSP incurs capex on an ISP project across multiple review periods.

37 See clause S6A.2.2A(f) of the draft rule (and current NER).

38 See the definition in clause S6A.2.2A(a1) of the draft rule.

39 Schedule 6A.2.2A(c1) of the draft rule.

40 See the current definition of ‘review period’ in clause S6A.2.2A(a1) of the NER.

The current review period limits the AER's review to five years as described in Box 2 and illustrated in Figure 3.2. If an ISP project is not completed within these five years, or if TNSPs incur capex on the project beyond five years, then the AER would not be able to review all capex relating to the specific ISP project. If the AER is unable to review ISP capex holistically, it would be difficult to determine the efficiency of the capex.

Introducing the term "ISP project review period" therefore enables the AER to access complete information on matters such as project specific capex drivers and project specific management practices and processes. These are important factors in understanding whether capex is prudent and efficient over the full life of the project.

### **Box 2: The five year review period under existing arrangements**

The current review period is defined from the perspective of the period for which the AER is making a revenue determination.

The review period spans five years which includes:

- the first three years of previous regulatory control period,
- and the last two years of the immediately previous regulatory control period.

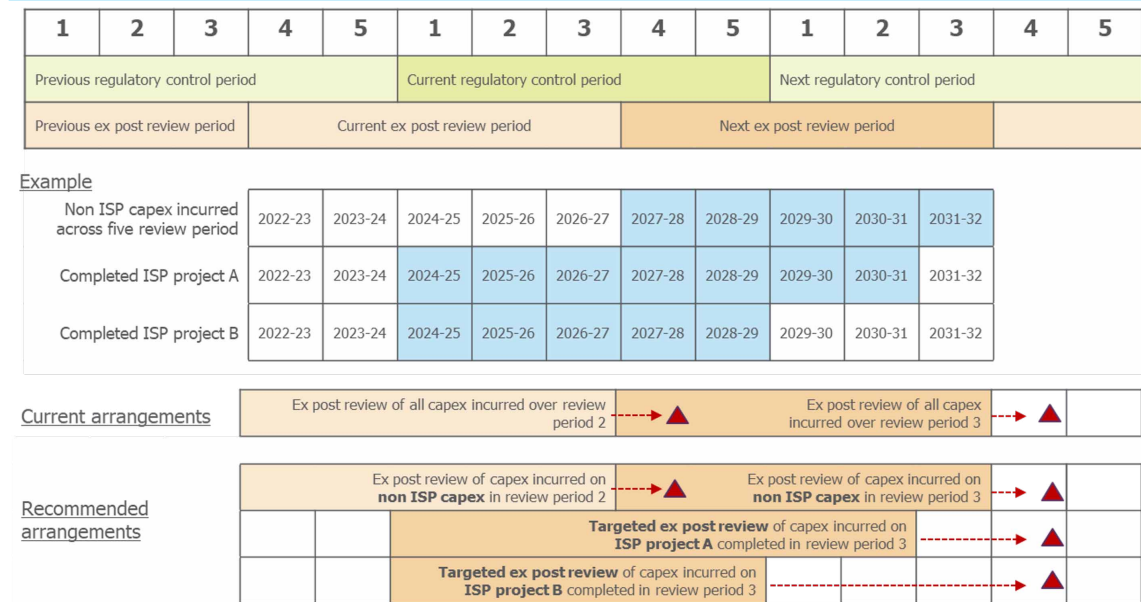
For example, with reference to Figure 3.2, in 2027-2028, the AER undertakes an ex post review as part of the revenue reset process for a TNSP's revenue determination for the 2029-2034 period.

- the previous regulatory control period would be the 2024-2029 period
- the immediately previous regulatory control period would be the 2019-2024 period.

This would mean that under current arrangements, if the AER would undertake an ex post review in 2026-2027, the AER would review the TNSP's capex incurred between July 2022 - June 2027 (five years).

Source: Clause S6A.2.2A(a1) of the NER.

**Figure 3.2: Ex post review timeline under our draft rule**



▲ Point of ex post review (the ex-post review is assessed in year 4 of the RCP and is published in year 5)

Note: The figure represents three consecutive regulatory control periods. Highlighted in blue is when a TNSP incurs capex. For project A, a TNSP will incur capex in all five years of the current regulatory control period and for two years in the next regulatory control period. The ex-post review is usually conducted in year 4 of the current regulatory control period as shown by the red triangle. Currently, for project A, the AER would review capex incurred in the first three years of the current period in year 4 of the current period. The AER would then review the remaining four years of capex in year 4 of the next regulatory control period. Under our draft rule, the AER would review all seven years of capex in year 4 of the next control period.

### 3.1.3 The AER would review capex for completed actionable ISP projects

Our draft rule introduces a definition of “reviewable ISP project”. This would clarify what ISP projects are subject to the AER’s targeted ex post review.

**A reviewable ISP project would be:**<sup>41</sup>

- **an actionable ISP project that has been commissioned and energised within the AER’s review period, or**<sup>42</sup>
  - “commissioned” and “energised” means a “completed” project where electricity can flow. After commissioning, TNSPs can submit to the AER, the actual capex that it has incurred for the entire completed project. These terms should be included because the review of ISP capex should be for capex incurred for the entire project, and not just capex incurred over a defined five year period.
  - reviewable ISP projects includes projects listed in a current ISP as both committed and anticipated ISP projects. These are projects that were specified as actionable ISP projects in a previous ISP but are no longer specified in a current ISP as actionable (because, for example, the project is being progressed by the relevant TNSP and has advanced to a committed stage). For example, Project EnergyConnect (PEC) is listed in the 2024 draft ISP under committed and anticipated ISP projects, however, it was an actionable ISP project in the 2020 ISP and so PEC is still considered an actionable ISP project under the

41 Clause S6A.2.2A(a1) of the draft rule.

42 AEMO’s ISP classifies certain projects as ‘actionable ISP projects’. Under chapter 10 of the NER, an actionable project is a project that relates to a transmission asset or non network option which addresses an identified need specified in an ISP and forms part of an optimal development path.

NER. PEC would therefore be a reviewable ISP project in respect of an ex post review for the purposes of the draft rule once it has been commissioned and energised.

- **a stage of an actionable ISP project which has been commissioned and energised within a review period.**

The second limb of the definition acknowledges that some actionable ISP projects may be broken up into stages with expected delivery dates that are far apart. AEMO may specify whether an actionable ISP project is a staged project.<sup>43</sup> A project may be staged for various reasons including to manage uncertainty around the optimal timing or optimal capacity of a project.<sup>44</sup> TNSPs may also choose to stage their projects where it is efficient to do so (and even where the ISP has not).

The Commission considers that the AER should be able to review capex incurred for a project stage once it is completed and energised. This would prevent a significant lag period between when infrastructure is completed and delivering benefits to consumers, and when the AER would undertake an ex post review on the infrastructure capex. This would improve cost recovery certainty for TNSPs.

For example, if the ISP or a TNSP separates an actionable ISP project into two stages:

- stage one - building a transmission line
- stage two - increasing the capacity of the line

The AER would review the capex incurred to deliver each stage separately after each stage has been commissioned and energised.

Stages that do not deliver infrastructure that can be energised would not be separate reviewable ISP projects. We consider that the AER would not be able to undertake a holistic assessment of capex for a stage that cannot be energised. For example, the AER would not review an early works project stage separately. This is because it would be difficult to assess the efficiency of early works without a completed piece of energised infrastructure the AER could attribute capex on early works to. The Commission considers it would be beneficial for the AER to provide further guidance on when stages of an actionable ISP project may be treated as separate reviewable ISP projects.<sup>45</sup>

### **Our draft rule represents a minor change to the definition of reviewable ISP project to improve clarity**

The proposed rule defined a reviewable ISP project as an actionable ISP project, or a stage of an actionable ISP project that has been staged by the ISP.<sup>46</sup>

Our draft rule:

- removes the condition for the ISP to stage a project because it may be efficient for TNSPs to stage projects, even where the ISP has not.
- provides clarity on what project stages the AER can review separately by specifying that the project stage must be commissioned and energised. The Commission considers the AER should not review all project stages as separate projects. Only project stages that deliver infrastructure through which electricity flows and delivers benefits to consumers may be treated as a separate reviewable ISP project.

<sup>43</sup> Clause 5.22.6(a)(6)(vi) of the NER.

<sup>44</sup> The ISP may use staging to describe how a project is planned to be delivered despite the project not being a staged ISP project. For example the 2024 ISP describes two stages of PEC although PEC is not a staged project.

<sup>45</sup> The draft rule would require the AER to update its Guideline as discussed in section 3.3 but does not specify what the AER must include in the updated Guideline.

<sup>46</sup> DCCEEW, *Managing Integrated System Plan project uncertainty through targeted ex post reviews - rule change request*, December 2003, p. 8.

### Box 3: Projects delivered by two or more TNSPs

Actionable ISP projects that are interconnectors spanning multiple regions would be delivered by multiple TNSPs. A reviewable ISP project refers to a single TNSP's capex allowance, not the total capex allowance for the entire interconnector. A reviewable ISP project, in the case of an interconnector, would be the part of the actionable ISP project for which a TNSP has been provided a capex allowance. This is because the rules around ex post reviews apply to ISP projects in respect of a particular TNSP and the assessment of that TNSP's capex.

For example, in the case of PEC, the AER would review ElectraNet's capex incurred for the delivery of the South Australian portion of PEC separately from Transgrid's capex incurred in the delivery of the NSW portion. Once the South Australian portion is commissioned, or energised, the AER would review the project capex in ElectraNet's next revenue reset period. The AER would not be required to wait for the NSW portion of PEC to be completed.

### Question 1: Can stakeholders clearly identify reviewable ISP projects?

We welcome stakeholder views on whether the definition of reviewable ISP project(s) in the draft rule enables stakeholders to clearly identify:

- for which projects the AER would undertake an ex post review on project capex?
  - a project may be staged in multiple ways. Does the rule provide sufficient clarity on when a relevant project stage would be reviewed as a separate project?
- how these projects would trigger an ex post review?
- when the AER would undertake an ex post review?

### 3.1.4 The AER would be able to exclude ISP capex from a TNSPs RAB that the AER considers is inefficient

Our draft determination is to enable the AER to exclude capex from a TNSP's RAB up to value of the capex overspend for a specific ISP project.<sup>47</sup> For example, if a TNSP spends \$20 million more than its capex allowance for an ISP project, the AER may only exclude up to \$20 million from the TNSP's RAB.

The AER may only exclude capex from a TNSP's RAB that the AER considers is imprudent and inefficient – that is, capex that the AER determines does not reasonably reflect the capital expenditure criteria.<sup>48</sup> Appendix C.2.2 explains how the AER would assess a TNSP's capex and how the AER would adjust a TNSP's RAB.

Enabling the AER to exclude inefficient capex from a TNSP's RAB would prevent consumers from paying for inefficient capex and encourage the TNSP to incur capex efficiently.

#### The AER would adjust the CESS penalty where it excludes capex from the RAB

The Commission considers that our draft rule would not change how the capital expenditure sharing scheme (CESS) would work.

We consider that the AER has the flexibility under the existing NER to ensure that the ex post review and the CESS can continue to work together.

<sup>47</sup> Clauses S6A.2.2A(f) & S6A.2.2A(g)(1a) of the draft rule.

<sup>48</sup> Clause S6A.2.2A(f) of the NER.

As set out in the AER's Guideline, if the AER makes a determination to exclude capex from a TNSP's RAB, after undertaking an ex post review, the AER would need to adjust the CESS payments. This ensures that the TNSP is not penalised twice for the same inefficient capex, namely, under both the CESS and the ex post review mechanism.<sup>49</sup>

Currently, the AER would only adjust the RAB and CESS payments in respect of the previous five years of any capex overspend as this is the current review period under the NER. However, as explained in section 3.1.2, our draft rule would introduce an ISP project review period which may go beyond five years and may include multiple regulatory control periods. The Commission considers that it would be beneficial for the AER to include in its updated Guideline, discussed in section 3.3, how the AER would adjust the RAB and CESS payments for ISP projects which include capex over multiple regulatory control periods.

#### Box 4: Overview of the CESS

The CESS provides TNSPs with an incentive to undertake efficient capex during a regulatory control period. It achieves this by rewarding TNSPs that spend less than their capex allowance and penalising TNSPs that spend more than their capex allowance. Under the CESS, the TNSPs would:

- retain 20% of any underspend, where the underspend is greater than 10% of the capex allowance, or
- incur 30% of the cost of any overspend.

Source: See AER, *Capital expenditure incentive guideline*, April 2023, pp. 1-8.

## 3.2 The AER must review non-ISP project capex if a TNSP exceeds its capex allowance for non-ISP projects

#### Box 5: Draft determination - Targeted ex post review for non-ISP project capex

Our draft determination is to apply the existing ex post review arrangements to the sum of all capex that is not attributed to an ISP project (non-ISP capex).

Under our draft rule, the existing ex post review arrangements that applied to total capex, would be applied instead to the sum of non-ISP capex incurred during the review period.<sup>50</sup> This would mean that:

- an ex post review for non-ISP projects would be triggered when the sum of the TNSP's actual capex on all other projects, that are not ISP projects, exceeds its non-ISP capex allowance (i.e. whether the 'overspending requirement' is satisfied). Under this process the AER would continue to test if there was an overspend at the time of the revenue reset.<sup>51</sup>
- the capex subject to review would be non-ISP capex incurred in the five years prior to the revenue reset process, as explained in Box 2.<sup>52</sup>

49 For more detail on how the CESS would be adjusted see: AER, *Capital expenditure incentive guideline*, April 2023, pp. 8-9.

50 The draft rule amends the NER definition of 'review period' to clarify the terminology, but does not change the effect of which years it covers.

51 Clause S6A.2.2A(c) of the draft rule.

52 See definition of 'review period' in clause S6A.2.2A(a1) of the draft rule.

- the AER would only be able to exclude capex up to the amount that was overspent on non-ISP projects that the AER considers is inefficient.<sup>53</sup>
- if the AER does exclude capex from a TNSP's RAB, the AER would adjust the application of the CESS.

### 3.3 The AER must update its Guideline by 1 August 2025

#### Box 6: Draft determination - Implementation of the draft rule

Our draft determination is to require the AER to update its *Capital expenditure incentive guideline* within twelve months of a final rule being made to include how the AER would undertake separate, targeted ex post reviews for ISP project capex and non-ISP capex.

Our draft determination is to require the AER to set out how it conducts ex-post reviews for ISP projects and non-ISP projects in its Guideline.<sup>54</sup>

The AER would be required update its Guideline within twelve months from when any final rule is made. For example, if a final rule is made on 1 August 2024, then the AER would be required to update its Guideline by no later than 1 August 2025.<sup>55</sup> Any consultation undertaken before the final rule is made may be taken to satisfy the rules consultation procedures.<sup>56</sup>

Any final rule, if made, would commence once the Guideline has been published, which is expected to be no later than 1 August 2025.

Updating the Guideline would ensure:

- the AER consults on how it will undertake ISP project specific ex post reviews and that its methodology is accessible in a guideline recognised in the Rules.
- the AER's assessment of ISP and non-ISP capex in an ex post review is transparent, further increasing certainty for TNSPs.

As explained in appendix C, the current Guideline sets out the AER's approach to ex post reviews as required by the NER.<sup>57</sup> This includes how the AER would exclude certain types of capex from being included in the roll forward of the RAB, and how any CESS penalties are adjusted following a decision to exclude capex from the RAB.

The draft rule requires the Guideline to set out the manner in which the AER proposes to make determinations under clause S6A.2.2A(a) of the NER if the overspending requirement or ISP overspending requirement is satisfied. The Guideline does not currently include discussion on the ISP overspending requirement since it is proposed to be introduced by this draft rule. Therefore, the AER would be in breach of the NER if the AER did not update the Guideline to reflect separate targeted ex post reviews after any final rule is made.

The AER currently includes further guidance on ex post reviews for actionable ISP projects in its Regulation of actionable ISP projects guidance note (guidance note).<sup>58</sup>

53 Clause S6A.2.2A(f) of the draft rule.

54 Rule 6A.5A(b) of the draft rule.

55 Clause 11.[xxx].2(a) of the draft rule.

56 Clause 11.[xxx].2(b) of the draft rule.

57 Rule 6A.5A(b) of the NER.

58 See AER, *Regulation of actionable ISP projects - guidance note*, March 2021, pp. 32-37.

The Commission considers that all guidance on how the AER would undertake ex post reviews for both ISP and non-ISP projects should sit within the Guideline. This would improve clarity and make it easier for stakeholders to access information on ex post reviews.

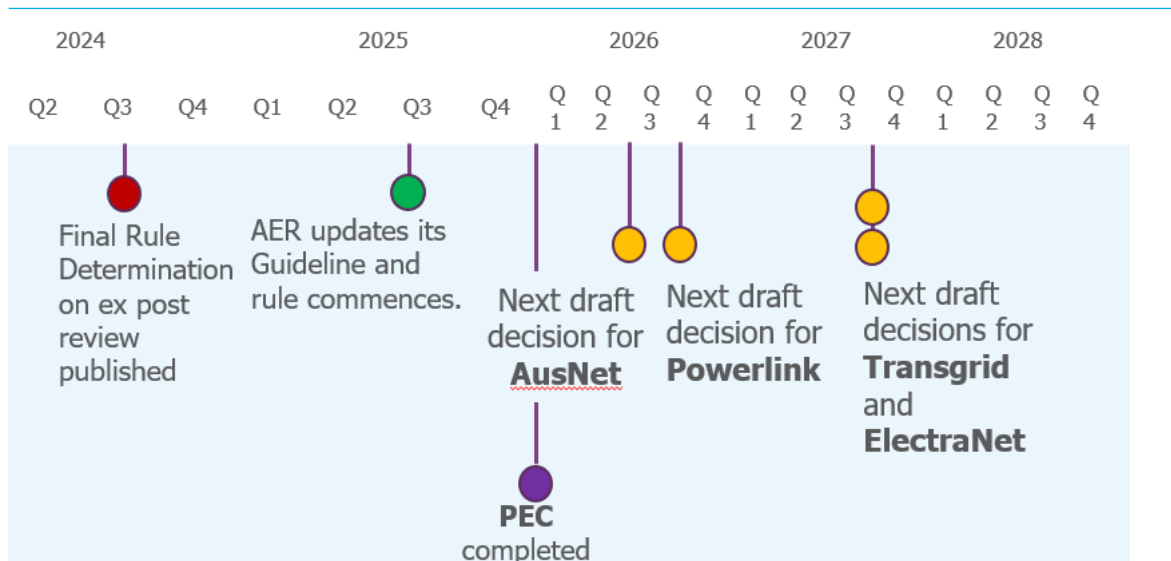
### 3.3.1 The draft rule would apply to all current actionable ISP projects progressed under the NER

The final rule, if made, would commence in August 2025. This would mean that the AER would undertake targeted ex post reviews in respect of TNSP’s revenue reset periods from August 2025. Given this timeframe, all the current actionable ISP projects would be subject to the arrangements under our draft rule.

The earliest completed project that was an actionable ISP project would be PEC, noting parts of PEC would be completed from 2024. As shown in Figure 3.3, the AER’s draft determinations on Transgrid and ElectraNet’s revenue proposals for the 2028-2032 period are expected to be published in 2026-2027. During this revenue reset period, the AER would review total actual capex for PEC, assuming PEC is completed in accordance with current timeframes.<sup>59</sup>

If a TNSP completes two ISP projects before its revenue reset period, the AER would review capex on each project separately.

**Figure 3.3: Revenue reset timeline**



Note: Dates represented are indicative

<sup>59</sup> The AER would review whether ElectraNet overspent its capex allowance for the South Australian portion of PEC and review whether Transgrid overspent its capex allowance for the portion of PEC in NSW.

## A Rule making process

A fast track rule change request includes the following stages:

- a proponent submits a rule change request
- the Commission initiates the rule change process by publishing a notice which communicates the Commission’s decision to fast track the rule change
- the Commission publishes a draft determination and, if relevant, a draft rule
  - stakeholders lodge submissions on the draft determination and engage through other channels to make their views known to the AEMC project team
- the Commission publishes a final determination and, if relevant, a final rule.

You can find more information on the rule change process in *The Rule change process – a guide for stakeholders*.<sup>60</sup>

### A.1 The Minister for Climate Change and Energy proposed a rule to improve the existing ex post review mechanism

The rule change proposed a rule change consistent with the TPIR stage 3 recommendations to:<sup>61</sup>

- separate the ex post review of ISP project capex from non-ISP project capex, and
- extend the review period for ISP projects beyond five years to include all capex that was incurred for an ISP project up to completion.

### A.2 The proposal addressed additional risk around ISP projects

The rule change request notes that as the size and complexity of transmission projects – specifically those identified in the ISP – grows, there is increased risk and uncertainty regarding costs.<sup>62</sup>

The rule change request considers it is important that the AER can review capex effectively to ensure consumers are adequately prevented from costs risks.<sup>63</sup>

However, the rule change request notes that there is ambiguity around whether the AER can undertake a review of project specific capex. This, the rule change request suggests, creates uncertainty for TNSPs in determining whether non-ISP capex could be subject to exclusion from their RAB if overspend has only occurred on an ISP project.

The rule change request also notes that existing guidance makes it challenging for stakeholders trying to understand how the AER would consider ISP projects as part of an ex post review.<sup>64</sup>

### A.3 It proposed to do so by separating the ex post review mechanism into targeted reviews

The rule change request considered that a targeted ex post review for ISP projects would.<sup>65</sup>

60 AEMC, *The rule change process: a guide for stakeholders*, June 2017, available [here](#).

61 DCCEE, *Managing Integrated System Plan project uncertainty through targeted ex post reviews - rule change request*, December 2003, p. 3.

62 Ibid, p. 1.

63 Ibid, p. 2.

64 Ibid.

65 Ibid, p. 6.

- clarify the ex post review arrangements for both non-ISP and ISP project capex and the time periods over which they occur,
- promote efficient delivery of major transmission projects while ensuring the regulatory framework is fit for purpose, and
- safeguard consumers by making sure they only pay the efficient costs for major transmission investment.

The rule change request also notes that providing clarity and certainty in the regulatory framework for the AER and TNSPs will:<sup>66</sup>

- enable the AER to rigorously assess and consider the overall efficiency of capex incurred on specific ISP projects where there has been an overspend, and
- decrease administrative burden for the AER and TNSPs by reducing the effort and time required to gather and assess information and evidence to determine the materiality or efficiency of potential overspend on ISP projects spanning multiple review periods.

## A.4 The process to date

On 18 April 2024, the Commission published a notice advising of its intention to initiate the rule making process in respect of the rule change request.<sup>67</sup> The Commission decided to fast-track this rule change request. This is because it concluded that the rule change request is consistent with the relevant recommendation of TPIR and adequate consultation with the public was undertaken during that review on the relevant recommendation.<sup>68</sup>

Accordingly, the Commission did not publish a consultation paper upon initiation of the rule change process and there has been no formal consultation carried out in this rule change process to date.

<sup>66</sup> Ibid.

<sup>67</sup> This notice was published under section 95 of the NEL.

<sup>68</sup> The decision to fast-track the rule change request was made under section 96A(1)(a)/96A(1)(b) of the NEL.

## B Regulatory impact analysis

The Commission has undertaken regulatory impact analysis to make its draft determination.

### B.1 Our regulatory impact analysis methodology

#### **We considered a range of policy options**

The Commission compared a range of viable policy options that are within our statutory powers. The Commission analysed these options: the rule proposed in the rule change request and a business-as-usual scenario where we do not make a rule.

#### **We identified who would be affected and assessed the benefits and costs of each policy option**

The Commission's regulatory impact analysis for this rule change used qualitative methodologies. It involved identifying the stakeholders impacted and assessing the benefits and costs of policy options. The depth of analysis was commensurate with the potential impacts. Where commensurate and feasible, the Commission has quantified the impacts. The Commission focused on the types of impacts within the scope of the NEO.

Table B.1 summarises the regulatory impact analysis the Commission undertook for this rule change. Based on this regulatory impact analysis, the Commission evaluated the primary potential costs and benefits of policy options against the assessment criteria. The Commission's determination considered the benefits of the options minus the costs.

**Table B.1: Regulatory impact analysis methodology**

Assessment criteria	Primary costs	Primary benefits	Stakeholders affected	Methodology QT = quantitative, QL = qualitative
Outcomes for consumers	nil	Consumers benefit from only paying for the efficient costs of ISP projects.	<ul style="list-style-type: none"> <li>• TNSPs</li> <li>• Consumers</li> <li>• AER</li> </ul>	<ul style="list-style-type: none"> <li>• QL: policy analysis and stakeholder feedback to assess all benefits and costs to consumers.</li> </ul>
Implementation considerations	The AER to incur some costs when undertaking an update to its Guidelines.	nil	<ul style="list-style-type: none"> <li>• AER</li> </ul>	<ul style="list-style-type: none"> <li>• QL: stakeholder feedback to assess costs to AER and impact on capital expenditure sharing scheme plus cost allocation processes.</li> </ul>
Principles of good regulatory practice	nil	The TNSPs and AER benefit from certainty of how capex overspends are to be assessed and recovered from consumers.	<ul style="list-style-type: none"> <li>• AER</li> <li>• TNSPs</li> </ul>	<ul style="list-style-type: none"> <li>• QL: stakeholder feedback to assess benefits of certainty.</li> </ul>

## C The existing ex post review mechanism

Clause 6A.14.2(b) and S6A.2.2A of the NER enables the AER to undertake an ex post review of TNSP capex overspends. The AER Guideline and guidance note provide greater detail on how an ex post review is undertaken.

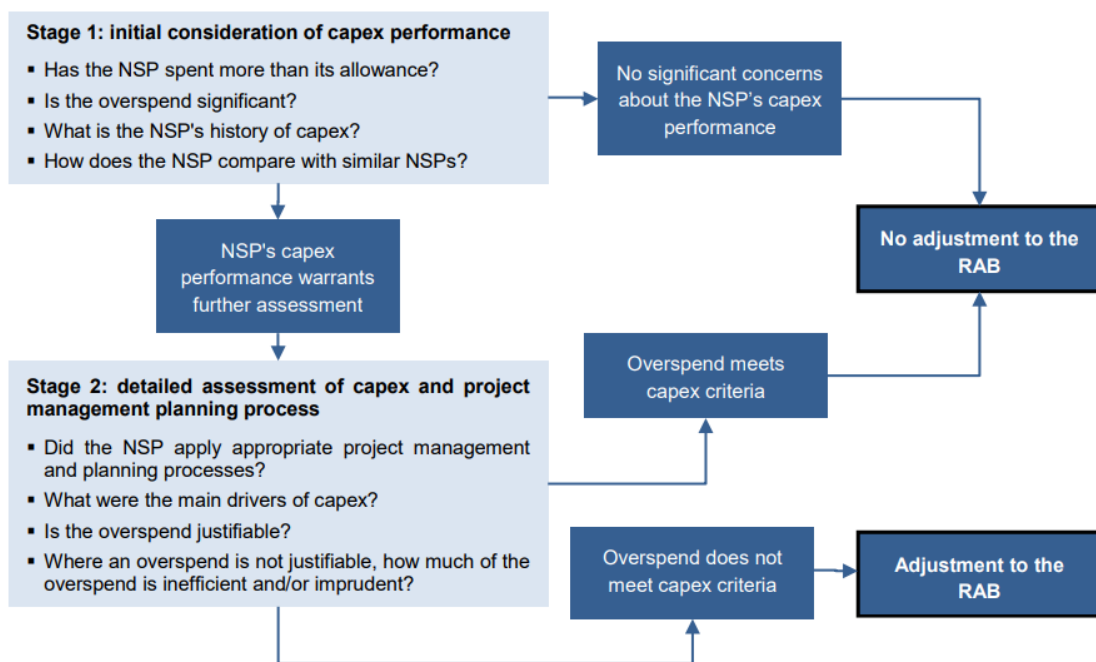
The purpose of an ex post review is to ensure that, where a TNSP materially overspends its capex allowance, only capex overspend that the AER considers is efficient (satisfies the capex criteria) is rolled into a TNSP's RAB and can be recovered from consumers. The ex post review thus prevents consumers from paying for capex overspends that are inefficient. The ex post review is a mechanism of last resort which the AER would only use to address material capex overspends. This is because the economic regulatory framework primarily relies upon ex ante incentives, such as the CESS, to promote efficient project delivery and capex.

The NER does not prescribe the process for which the AER may undertake an ex post review. The AER has the flexibility under the NER to decide how an ex post review may be undertaken. Currently, as described in the Guideline, the AER would undertake a two stage ex post review process.<sup>69</sup> The two staged process includes:

- Stage one: Initial consideration of capex performance
- Stage two: detailed assessment of capex and project management planning process

As part of the AER's revenue determination on a TNSP's revenue proposal, the AER must include an ex post statement of efficiency which provides information about the prudence and efficiency of capex that the AER will include as part of a TNSP's opening RAB balance for the period. The ex post statement of efficiency would reflect an ex post review the AER undertakes.

**Figure C.1: Staged process for ex post review under existing arrangements**



Source: AER, *Capital expenditure incentive guideline*, April 2023, p. 13.

69 AER, *Capital expenditure incentive guideline*, April 2023, pp. 12-19.

## C.1 Stage one: Initial consideration of capex performance

During a TNSPs revenue reset period, the AER must test the prudence and efficiency of TNSP capex before rolling any capex into a TNSP's RAB for the following regulatory control period.

The AER will only review capex incurred in the past five years within a TNSP's review period.<sup>70</sup> An ex post review is triggered when a TNSP's actual capex for this period exceeds its capex allowance for the period.<sup>71</sup> As part of Stage one, the AER would test whether the overspend was material and whether it warrants further assessment.

If the AER considers that a TNSP has materially overspent its capex allowance and a detailed further assessment of the capex overspend is needed then the AER would proceed to stage two of its ex post review, if not, the ex post review would end and stage one.

## C.2 Stage two: detailed assessment of capex and project management planning process

Stage two will involve a detailed assessment of the drivers of the TNSP's capex and the TNSP's management and planning tools and practices.

### C.2.1 The AER must assess the prudence and efficiency of capex

In deciding whether capex is prudent and efficient, the AER must consider whether TNSP capex reasonable reflects the capital expenditure criteria outlined in Box 7.<sup>72</sup>

As part of the AER assessment, the AER would consider whether the TNSP has applied:<sup>73</sup>

- appropriate project management plans and processes including asset management, project delivery controls, procurement strategies, asset life cycle management, resourcing strategies, program management and risk management, and
- appropriate project governance and capital governance.

The AER would also consider any independent audits undertaken as part of a TNSP's asset management and planning processes.<sup>74</sup>

For ISP projects specifically the AER would consider whether TNSPs have:<sup>75</sup>

- actively monitored the actionable ISP project and notified stakeholders and AEMO of any material cost overruns, and any other material changes in their cost forecasts or expectations for the project,
- delivered the actionable ISP project in accordance with project governance structures, and project and risk management plans/processes demonstrated in its CPA, and
- controlled and minimised any cost overruns through project controls and other processes demonstrated in its CPA.

70 Clause S6A.2.2A(a1) of the NER.

71 Clause S6A.2.2A(c1) of the NER.

72 Clause S6A.2.2A(f) of the NER.

73 AER, *Capital expenditure incentive guideline*, April 2023, p 14.

74 Ibid.

75 AER, *Regulation of actionable ISP projects - guidance note*, March 2021, pp. 34-35.

### Box 7: Capital expenditure criteria

There are three capital expenditure criteria:

1. the efficient costs of achieving the capital expenditure objectives<sup>1</sup>,
2. the costs that a prudent operator would require to achieve the capital expenditure objectives, and
3. a realistic expectation of the demand forecast and cost inputs required to achieve the capital expenditure objectives.

Source: Clause 6A.6.7(c) of the NER.

Note: <sup>1</sup>the capital expenditure objectives are set out in clause 6A.6.7(a) of the NER.

## C.2.2 The AER may exclude any prudent and inefficient overspend from the RAB

If the AER considers that all or part of a TNSP's capex overspend does not reasonably reflect the capital expenditure criteria, that is capex is inefficient or imprudent, the AER would adjust the amount of capex that can be included in the RAB and recovered from consumers in the next regulatory control period as outlined in Box 8.

### Box 8: CURRENT APPROACH TO RAB ADJUSTMENTS FOLLOWING AN EX POST REVIEW OF CAPEX OVERSPENDS

- The AER may decide that part or all of an overspend is inefficient or imprudent and should be excluded from the relevant TNSP's RAB following a targeted ex post review of capex.
- Inefficient or imprudent capex overspends incurred in years one, two and three of the regulatory control period would not be rolled into the RAB at the end of the period in practice, and consumers would not fund any of this capex.
- However, the AER would need to make a net present value (NPV) adjustment to the RAB where an inefficient or imprudent capex overspend has been incurred in a previous regulatory control period. This is because the overspend incurred in a previous regulatory control period would already have been rolled into the RAB at the end of that period. Consumers will already have funded at least part of this overspend through higher prices.
- The AER would make an NPV adjustment to ensure the TNSP does not retain any revenue through the RAB from capex that does not meet the capex criteria to ensure consumers are compensated for the delay in conducting the ex post review of overspends incurred in a previous regulatory control period.
- Where the AER excludes capex from the RAB after an ex post review, it may also need to make a corresponding adjustment to the capital expenditure sharing scheme (CESS) so that TNSPs do not incur a penalty of more than 100 per cent of an overspend.

Source: See AER, regulation of actionable ISP projects - guidance note, March 2021, p. 37.

## D Legal requirements to make a rule

This appendix sets out the relevant legal requirements under the NEL for the Commission to make a draft rule determination.

### D.1 Draft rule determination and draft rule

In accordance with section 99 of the NEL, the Commission has made this draft rule determination in relation to the rule proposed by the Honourable Chris Bowen, Minister for Climate Change and Energy.

The Commission's reasons for making this draft rule determination are set out in section 2.3.

A copy of the draft rule is attached to and published with this draft determination. Its key features are described in chapter 3.

### D.2 Power to make the rule

The Commission is satisfied that the draft rule falls within the subject matter about which the Commission may make rules.

The draft rule falls within section 34 of the NEL as it relates to regulating the activities of persons (including Registered participants) participating in the national electricity market.<sup>76</sup>

### D.3 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the draft rule
- the rule change request
- stakeholder input received as part of consultation undertaken by the TPIR
- the Commission's analysis as to the ways in which the draft rule will or is likely to contribute to the achievement of the NEO
- the revenue and pricing principles.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>77</sup>

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 functions.<sup>78</sup> The draft rule is compatible with AEMO's declared network functions because it does not affect those functions.

<sup>76</sup> Section 34(1)(a)(iii) of the NEL.

<sup>77</sup> Under s. 33 of the NEL and s. 73 of the NGL 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. In December 2013, it became known as the Council of Australian Government (COAG) Energy Council. In May 2020, the Energy National Cabinet Reform Committee and the Energy Ministers' Meeting were established to replace the former COAG Energy Council.

<sup>78</sup> Section 91(8) of the NEL2.

## D.4 Making electricity rules in the Northern Territory

The NER, as amended from time to time, apply in the Northern Territory, subject to modifications set out in regulations made under the Northern Territory legislation adopting the NEL.<sup>79</sup> Under those regulations, only certain parts of the NER have been adopted in the Northern Territory.

The draft rule does not relate to parts of the NER that apply in the Northern Territory. As such, the Commission has not considered Northern Territory application issues.

### Test for scope of “national electricity system” in the NEO

Under the NT Act, the Commission must regard the reference in the NEO 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:<sup>80</sup>

1. the national electricity system
2. one or more, or all, of the local electricity systems<sup>81</sup>
3. all of the electricity systems referred to above.

### Test for differential rule

Under the NT Act, the Commission may make a differential rule if it is satisfied that, having regard to any relevant MCE statement of policy principles, a differential rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule.<sup>82</sup> A differential rule is a rule that:

- varies in its term as between:
  - the national electricity systems, 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.

A uniform rule is a rule that does not vary in its terms between the national electricity system and one or more, or all, of the local electricity systems, and has effect with respect to all of those systems.<sup>83</sup>

The Commission’s draft determination in relation to the meaning of the “national electricity system” and whether to make a uniform or differential rule are set out in chapter 2.

## D.5 Civil penalty provisions and conduct provisions

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

The draft rule does not amend any clauses that are currently classified as civil penalty provisions or conduct provisions under the National Electricity (South Australia) Regulations.

<sup>79</sup> These regulations under the NT Act are the National Electricity (Northern Territory) (National Uniform Legislation) (Modifications) Regulations 2016

<sup>80</sup> Clause 14A of Schedule 1 to the NT Act, inserting section 88(2a) into the NEL as it applies in the Northern Territory.

<sup>81</sup> These are specified Northern Territory systems, listed in schedule 2 of the NT Act.

<sup>82</sup> Clause 14B of Schedule 1 to the NT Act, inserting section 88AA into the NEL as it applies in the Northern Territory.

<sup>83</sup> Clause 14 of Schedule 1 to the NT Act, inserting the definitions of “differential Rule” and “uniform Rule” into section 87 of the NEL as it applies in the Northern Territory.

The Commission does not propose to recommend to the Energy Ministers' Meeting that any of the proposed amendments made by the draft rule be classified as civil penalty provisions or conduct provisions

## D.6 Review of operation of the rule

The draft rule does not require the Commission to conduct a formal review of the operation of the rule. The Commission may however self-initiate a review of the operation of the rule at any time if it considers such a review would be appropriate, pursuant to section 45 of the NEL.

## Abbreviations and defined terms

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Capex	Capital expenditure
CESS	Capital expenditure sharing scheme
Commission	See AEMC
CPA	Contingent project application
ISP	Integrated system plan
NEL	National Electricity Law
NEO	National Electricity Objective
NER	National Electricity Rules
NT Act	<i>National Electricity (Northern Territory) (National Uniform Legislation) Act 2015</i>
Proponent	The individual / organisation who submitted the rule change request to the Commission
RAB	Regulatory asset base
TNSP	Transmission network service provider