Directions Paper

Social licence for electricity transmission projects

October 2023

AUSTRALIAN ENERGY REGULATOR

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Executive summary

This paper sets out the Australian Energy Regulator's (AER's) current approach to social licence issues in our regulatory remit for transmission businesses. We are publishing this now to gain stakeholder feedback to help refine our approach and to update our guidelines and instruments.

Development of Australia's electricity transmission network is vital to a successful transition to a low emission grid. However, new transmission lines will impact the lands and communities in which they are built. Transmission companies will therefore need to build and maintain a social licence to operate for their projects to succeed.

Effective engagement is fundamental to gaining the social licence needed to expand the transmission grid. Transmission businesses can build social licence by collaborating and resolving issues with impacted communities. Through effective engagement transmission businesses can identify ways to increase the benefits and minimise the negative impacts of new transmission lines on affected communities.

Effective engagement is also necessary to pass the regulatory planning and investment tests required under the National Electricity Rules. It allows transmission businesses to:

- Identify which options they should consider to address the electricity system's needs
- Understand the impact and feasibility of those options
- Better forecast the costs of options to identify which has the maximum net benefit.

Proposed expenditure related to social licence-building activities will need to be clearly related to stakeholder feedback on each transmission project. Without this, projects may not be able to progress in a timely manner and transmission businesses. Good engagement is also an important foundation for establishing the case for expenditure. However, we will still test the prudency and efficiency of all proposed cost recovery to ensure energy consumers are paying no more than necessary.

This paper sets out how we consider social licence issues can best be addressed within our regulatory remit, including:

- our expectations of transmission businesses in undertaking community engagement
- the outcomes we want to see from engagement
- when and how social licence issues can be factored into regulatory tests for the approval of and recovery of cost for new transmission development
- the evidence that we want to see to justify transmission network expansion and associated expenditure.

We ask for your feedback on this paper by 1 December.

We will use your feedback in refining our approach and in developing more detailed guidance for industry during 2024.

1 Introduction

The AER exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, affordable energy future for Australia as it transitions to net zero emissions.

The National Electricity Market is undergoing a period of substantial change as large amounts of dispersed renewable capacity is added to the market, and as ageing fossil fuel generators prepare to exit. The Australian Energy Market Operator (AEMO) has highlighted the significant amount of new energy infrastructure that needs to be built in the next decade to connect and deliver new renewable capacity – nearly 5,000 kilometres of electricity transmission lines[1] and over 20 GW of generation and storage developments.[2] To successfully make this transition the energy sector needs to build and maintain social licence to develop this infrastructure. The focus of this paper is on electricity transmission developments given the AER's regulatory role in transmission in the long-term interests of consumers.

Social licence or 'social licence to operate', is a broad concept covering factors related to the level of community acceptance of, or opposition to, potential change or an organisation's operations. New transmission lines will impact the lands and communities in which it is proposed, potentially in positive and negative ways. Therefore, successful investment in this infrastructure requires a serious effort from the sector, particularly transmission businesses, to closely engage with, and respond to, the needs of communities, First Nations and landholders.[3]

Social licence refers to level of acceptance of an organisation and its activities by a community.

This will rely on:

- Trust: which takes time and effort to establish
- Credibility: providing true and clear information and fulfilling commitments
- Legitimacy: clearly following all rules and obligations to meet community expectations.

Without social licence and careful consideration of impacted communities, projects may be delayed along with their associated consumer benefits. The benefits that could be foregone if this occurs may include reducing future costs of wholesale energy by incorporating new generation, maintaining the security and reliability of the energy system, and supporting the transition to net zero. Building social licence is therefore an important part of doing business in the energy sector. The prudency and efficiency of costs to achieve social licence should be considered along with other elements of transmission development and operation.

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1 Australian Energy Market Operator (2022), *Integrated System Plan, p. 63.*

2 Australian Energy Market Operator (2023), *Electricity Statement of Opportunities, p. 7.*

3 The term First Nations in this context includes Indigenous and Aboriginal people to acknowledge the diversity of Australia's First Peoples.

1.1 Objectives of this paper

This paper sets out how we think social licence issues can best be addressed.

We want feedback to refine and improve our approach.

We want to clarify how we consider social licence issues can best be addressed under the current regulatory framework governing transmission investments. In setting this out we seek to assist landholders, communities, and other interested stakeholders in engaging with the regulatory framework.

To better address social licence issues, this paper provides direction for transmission businesses and expectations of how they should undertake engagement with people impacted for their projects. Ultimately, we are focused on supporting how social licence is improved and how the requirements of the regulatory framework are satisfied. The paper is structured as follows:

- In Chapter 2, we outline our roles in regulating transmission developments in the National Electricity Market that relate to addressing social licence issues.
- In Chapter 3, we consider engagement and outline how it relates to our functions in the following chapters.
- In Chapter 4, we consider the transmission planning framework in more detail and outline the actions that we propose to take to address social licence issues in this context.
- In Chapter 5, we explain how we intend to assess and approve the recovery of social licence costs.
- In Chapter 6, we outline when and how we will undertake our work on social licence and how this will fit in with our broader work program.

1.2 Stakeholder feedback

To inform how we plan and progress our future work, we are seeking feedback from individuals, communities, and the energy sector.

We are seeking feedback on this paper until **1 December 2023**.

We acknowledge that stakeholders are already contributing to many related processes and providing submissions to other projects. To minimise duplication of effort we are happy to accept feedback in a variety of forms and encourage stakeholders to approach us to discuss options that meet their needs.

Feedback we receive on this directions paper will guide our approach to further work on these issues in 2024.

We prefer to publish all submissions to facilitate an informed and transparent consultative process. We will treat submissions as public documents unless otherwise requested. All non-confidential submissions will be placed on the AER's website. For further information regarding the AER's use and disclosure of information provided to it, see the ACCC/AER Information Policy.

We request parties wishing to submit confidential information:

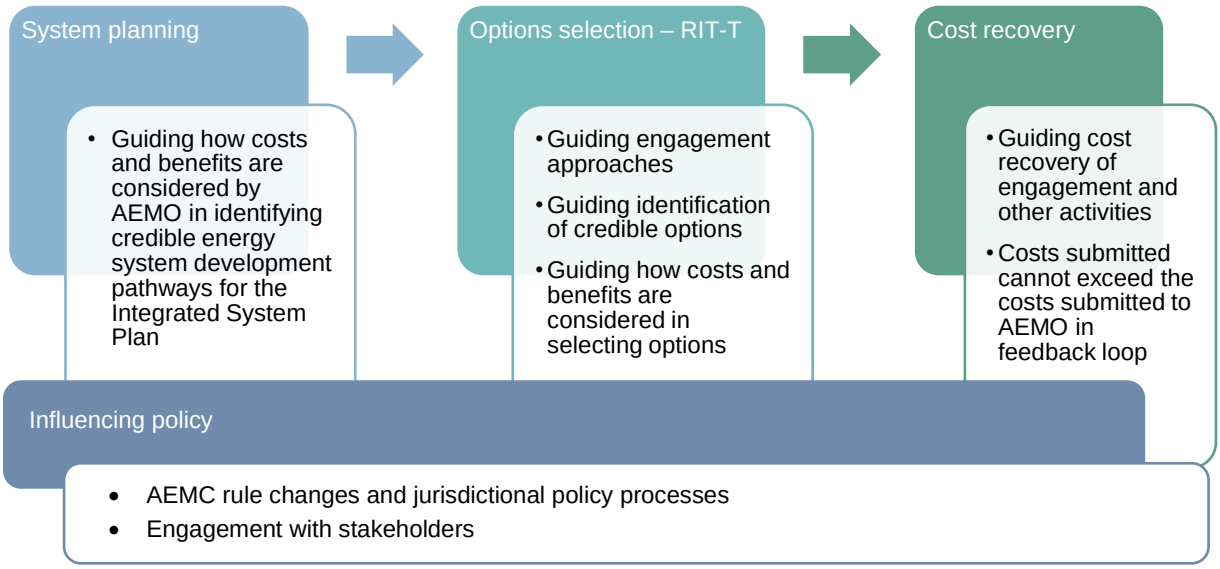
- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

2 Social licence and the AER's roles

Our regulatory roles in relation to transmission infrastructure are the starting point for our thinking about social licence in our functions. Figure 1 provides a summary of the broad phases where our roles interact with social licence issues, which are discussed further throughout this paper.

Social licence is relevant to our national transmission planning functions and our expenditure reviews for new transmission lines.

Figure 1 – AER functions and social licence

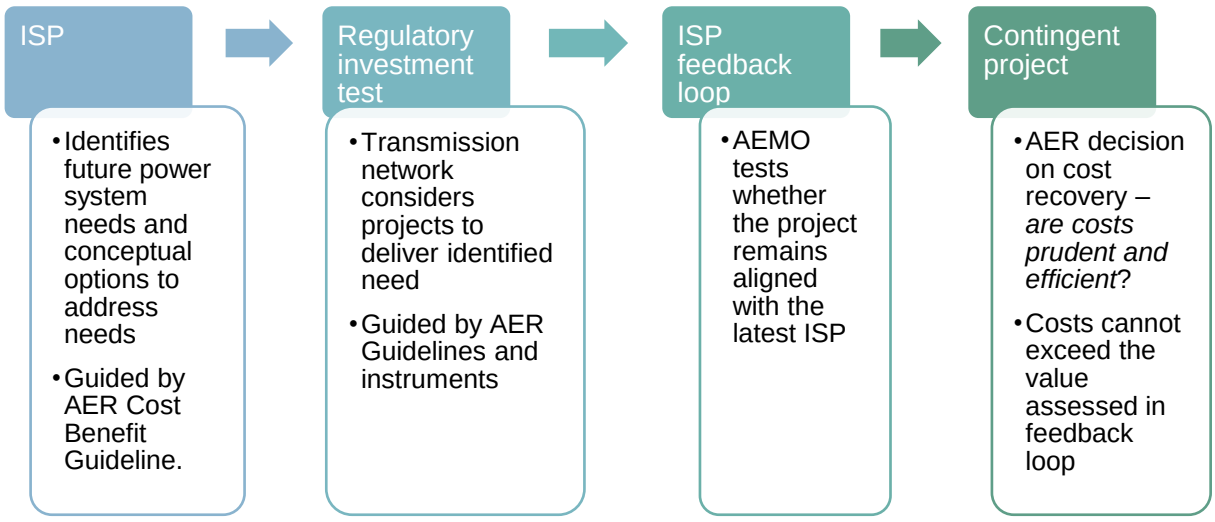


2.1 Regulation of the Integrated System Plan and Regulatory Investment Test for Transmission

The electricity transmission planning framework is intended to ensure that the long-term interests of consumers are provided for through planning to meet future power system needs. Two key elements of this planning framework are:

- Integrated System Plan (ISP) – This is a whole of system plan that provides a roadmap for the development of the energy system while maintaining energy reliability and security at lowest cost through the transition to net zero.
- Regulatory Investment Test for Transmission (RIT-T) – This is the process through which transmission proponents must assess credible options to address an identified electricity system need and identify a preferred option. The preferred option must maximise the net economic benefit to all those who produce, consume and transport electricity in the national energy market (NEM).[4]

Figure 2 – stages of the transmission planning and economic assessment process[5]



Source: AEMO, *2022 Integrated System Plan*, June 2022, p. 22.

The rules provide the AER with a role in:

- Determining the details of the RIT-T including the threshold for the scale of projects to which it should apply.
- Providing guidance on how the cost benefit analysis process for the ISP should be undertaken.

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4 Unless the project is required for reliability purposes.

5 The discussion in this paper is focused on the process for projects that are actionable under the ISP, given their scale and impact on communities and significance for the energy transition. The framework for other transmission projects is largely aligned and the differences are unlikely to result in a material difference in social licence consideration.

- Providing guidance on how the RIT-T should be applied including acceptable methodologies for valuing the costs of a credible option and guidance on engagement with consumers and other stakeholders.
- Overseeing compliance with the rules and guidelines for system planning.

2.2 Network determinations and cost recovery

We regulate electricity transmission businesses by setting the maximum amount of revenue they can earn, and the price they can charge, for regulated services. The rules provide for a propose-respond model: network businesses submit revenue proposals upon which we make determinations. Our decisions are made after considering factors including:

- quality of engagement with customers
- projected demand for electricity
- age of infrastructure
- operating and financial costs
- network reliability and safety standards[6]

We also assess contingent project applications, which allow a transmission business to amend their revenue determination for projects reasonably required to be undertaken, but were previously excluded because of uncertainty about its requirement, timing or costs. Many large transmission projects fall into this category. Our decisions for contingent projects will likely consider many costs that directly relate to social licence related engagement and activities.

2.2.1 Renewable Energy Zones

New South Wales, Victoria and Queensland all have clear policy positions which depart from the regulatory framework set out in the National Electricity Rules (NER) for some specific aspects of transmission planning and development.

- NSW implemented its Electricity Infrastructure Investment (EII) Act in 2020.[7]
- Queensland released draft legislation in 2023.[8]
- Victoria has released its framework and plans to introduce legislation in 2024.[9]

Common features in the state frameworks include:

6 In future we will also consider an emissions reduction objective and a value of emissions reductions.

7 https://www.energy.nsw.gov.au/nsw-plans-and-progress/major-state-projects/electricity-infrastructure-roadmap

8 https://yoursayhpw.engagementhq.com/energy-bill-consultation

9 https://engage.vic.gov.au/victorian-transmission-investment-framework

- Each state undertakes, or proposes to undertake, state-wide strategic electricity system planning, based on the development of an optimal pathway for the transition.[10]
- New functions have been created for state-based bodies[11] to undertake infrastructure planning and carry out initial community engagement, recognising the importance of social licence for transmission infrastructure projects.
- Each jurisdiction has prioritised projects to create renewable energy zones (REZs) for efficient location of renewable generation and to improve their connection to load centres.
- Through the establishment of access schemes and community benefit sharing schemes, generators will make a financial contribution to the REZ network connections, system security and social licence.
- The broader implications for communities are considered in the design, with examples of requirements including locally sourced and created jobs, training and housing.

2.3 Policy development

The AER draws on its expertise in energy markets and its analysis to inform and influence debate about energy policy. We contribute to policy processes and reviews that support the energy transition where these impact on competition, consumers, and the role of the AER, including AEMC rule changes and reviews.

We are currently contributing to several processes in relation to social licence including:

- The Australian Energy Infrastructure Commissioner's Community Engagement review.
- The Energy and Climate Change Ministerial Council's review of the Integrated System Plan – which will include consideration of social licence considerations in relation to the barriers to the planning and construction of ISP projects.
- AEMC rule change processes on:
  - Enhancing community engagement in transmission building
  - Improving the workability of the feedback loop.
- Engagement with individual state governments on the development of REZ policy and legislation**.**

[10] For example, the NSW framework requires the production of an Infrastructure Investment Opportunities report and the corresponding Network Investment Strategy, and in the Queensland framework the SuperGrid Infrastructure Blueprint and Renewable Energy Zone Roadmap set out the optimal infrastructure pathway.

[11] NSW Energy Corporation in NSW, VicGrid in Victoria, and Powerlink in Queensland.

3 Engagement to support social licence

This chapter establishes principles of engagement that we believe are relevant to the regulatory processes that we oversee. They build upon, and are consistent with, our Better Resets Handbook, work done by energy industry group the Energy Charter, and guidance from the Clean Energy Council and individual state governments.[12]

Chapters 4 and 5 provide more specific guidance on how this engagement can inform regulatory proposals from transmission businesses.

3.1 Why is effective engagement important to support our regulatory decisions?

Effective engagement is necessary to build the social licence for a transmission project to proceed.

It promotes collaboration and provides evidence to support regulatory proposals.

When we refer to effective engagement, we mean engagement that facilitates collaboration and a dialogue between landholders, communities, the broader consumer base, and transmission businesses.

Effective engagement provides evidence to support the content of project proposals to the AER.

For example, effective engagement can:

- Highlight what may or may not be a credible option for a transmission project.

12 Queensland Government, Regional Energy Transformation Partnerships Framework Draft for Consultation, October 2022.

New South Wales Government Office of Energy and Climate Change, *First Nations Guideline – Increasing income and employment opportunities from electricity infrastructure projects*, August, 2022.

Frangos. M, Bassani. T, Hollingsworth. J, Briggs. C, (2021), *First Nations Guidelines: Case Studies on First Nations community engagement for renewable energy projects*. Sydney: NSW Department of Planning, Industry and Environment.

Office of Energy and Climate Change, *Central-West Orana REZ Working with the community and First Nations guidelines*, August 2022.

Victorian Government Department of Environment, Land, Water and Planning, *Community Engagement and Benefit Sharing in Renewable Energy Development*, July 2021.

Victorian Government Department of Environment and Climate Action, *Victorian Transmission Investment Framework Final Design Paper*, July 2023.

Tasmania Department of State Growth, *Renewable Energy Development in Tasmania – A Guideline for Community Engagement, Benefit Sharing and Local Procurement*, 2022.

- Help understand what factors a community may be willing to accept and their most substantial concerns – including what actions by the transmission business are most likely to build social licence for the project.
- Allow for the identification of cost-efficient solutions to resolve concerns which could otherwise prevent the timely development of infrastructure necessary to meet future energy needs.

3.2 AER's expectations for engagement

Our expectations include that transmission businesses will:

- meet, and explain how they have met, the Rule requirements and relevant jurisdictional policies and guidelines.
- undertake best practice engagement, in accordance with broadly accepted guidance in the sector.

In setting expectations for engagement to provide direction on how transmission businesses can better engage with stakeholders, we considered the range of guidance that is available (and planned in future) and advice we have received. To avoid duplication with other guidance, and potential confusion amongst stakeholders, we do not propose to create additional guidance specifically for community engagement for new transmission developments.

We are instead basing our expectations on the fact that transmission businesses are already required or have publicly committed to meeting certain best practice engagement principles and outcomes. Many of these guides have been developed through extensive stakeholder consultation and are already accepted by many groups.

Therefore, our expectations are that transmission businesses:

- will meet, and explain how they have met, the Rule requirements and relevant jurisdictional policies and guidelines.[13]
- will undertake best practice engagement, in accordance with broadly accepted guidance in the sector. We note that there are various guides available, but current examples include:
    - recommendations made by the Australian Energy Infrastructure Commissioner in his annual reports and forthcoming community engagement review
    - The First Nations Clean Energy Network's Best Practice Guides

[13] The AEMC's impending rule change to improve community engagement in the electricity planning process is relevant. We expect this rule to commence on 5 December 2023. We will look to update our guidelines accordingly.

- the Energy Charter's[14] guidelines, including:
  - The Social Licence Best Practice Guideline
  - Landowner & Community Better Practice Engagement Guide
  - Energy Charter's First Nations Better Practice Community Engagement Toolkit.

As detailed further in Chapter 5, the AER has also received advice from Deloitte on the approach to reviewing cost recovery for social licence engagement and activities.[15] This advice contains principles for social licence engagement, as well as some principles for First Nations engagement. We have also published this to support our Directions Paper and provide further context to stakeholders, but do not propose to introduce these principles as an additional layer of requirement on transmission businesses. We have taken this position given the focus of this advice to inform cost recovery process and as the principles largely overlap with other publicly available guides that have been broadly tested.

Our Better Resets Handbook also provides guidance on consumer engagement[16], with some principles broadly applicable to community engagement for social licence.

Chapters 4 and 5 provide further discussion on the process and evidence that we would expect to demonstrate how businesses have met these principles and commitments.

3.3 Future updates and workstreams

Following its Transmission Planning and Investment Review and a rule change request, the Australian Energy Market Commission (AEMC) is progressing a rule change to improve community engagement in the electricity planning process. This is due to be completed by the end of 2023. The draft AEMC determination on this rule change is proposing to:

- Clarify that transmission businesses are required, as part of preparatory activities, to engage with stakeholders who are reasonably expected to be affected by the development of the actionable ISP project, future ISP project, or project within a REZ stage. This includes local landowners, local council, local community members and traditional owners.
- Expand the definition of an interested party in the NER to include local councils and community groups.
- Introduce community engagement expectations for transmission businesses when engaging with these stakeholders.

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14 We note that AusNet Services, Powerlink, TasNetworks, and TransGrid are signatories to the Energy Charter and have thus have committed to the five Principles of the Energy Charter to guide customer-centric culture change.

15 Deloitte, *Assessment of Social License Costs for the Australian Energy Regulator*, 2023.

16 Please see section 3.1.1 of the *Better Resets Handbook*. The recommendations for customer engagement with respect to the nature of engagement, the breadth and depth of engagement and the evidence collected are relevant to engagement with landholders and communities impacted by proposed transmission lines.

The Australian Energy Infrastructure Commissioner is due to deliver his findings and recommendations to the Commonwealth Energy Minister by the end of 2023. A government response is expected in early 2024.

We will provide further guidance in relation to the AEMC rule change and any relevant recommendations from the Australian Energy Infrastructure Commissioner in our review of the transmission planning guidelines and in our assessment of contingent project applications. These future workstreams are summarised in Chapter 6.

3.4 Questions for stakeholders

- **Are the expectations in this chapter an appropriate approach for the AER to take?**
- **What additional guidance on engagement may be needed?**
- **What other publicly available guidance should transmission businesses consider?**
- **Should any elements be removed from our expectations?**
- **Are there any barriers to transmission businesses meeting these expectations?**

4 Electricity transmission planning and economic assessment framework (ISP and RIT-T)

There are three main areas social licence issues can be considered under the transmission planning rules:

1. Engagement to develop the ISP/RIT-T
2. Identifying credible options
3. Assessing costs and benefits

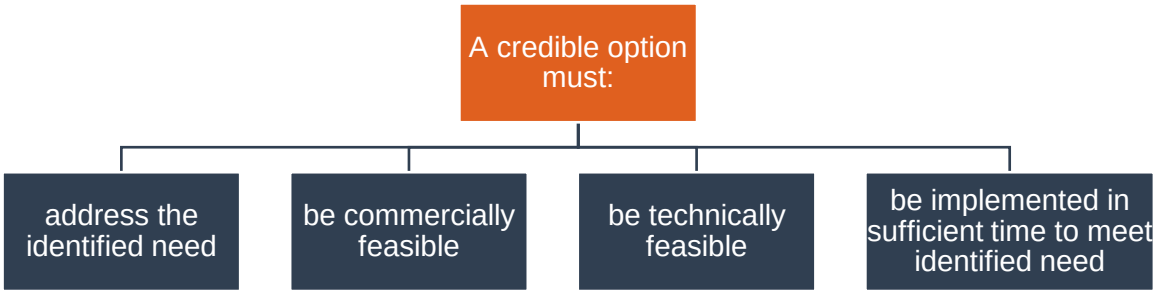
Transmission businesses must apply the RIT-T to any projects where the estimated capital expenditure is over $7 million. The rules require that, in doing this, transmission businesses must identify the credible option for a project that maximises the present value of net economic benefit to all those who produce, consume and transport electricity in the market (the preferred option).

Equivalent requirements apply to AEMO in preparing the ISP. The ISP establishes a whole of system plan for the NEM, including actionable ISP projects for which transmission businesses are then required to conduct RIT-Ts. The RIT-T assessment process explores different options for meeting the need identified in the ISP, to ensure a thorough cost benefit analysis, and then selects a preferred option to take forward.

The following sections outline how social licence can be considered as part of this process.

4.1 Identification of credible options in a RIT-T assessment

In completing a RIT-T, a transmission business must consider all credible options.



We would expect that in its consideration of credible options a transmission business will establish how social licence issues related to the option have been considered to meet each of these criteria.

4.2 Economic assessment – costs and market benefits in ISP and RIT-T assessments

To be able to be included in an ISP or RIT-T assessment, the benefits of a project must be "market benefits". The total market benefits of a particular option are best understood as being the benefits of the option to all those who produce, distribute and consume electricity in the NEM. Conversely, costs that can be counted are those that are either negative market benefits, or that are internalised via expenditure by the transmission proponent (i.e., expenditure on engagement activities to build and maintain social licence).

For social licence costs to be included in an economic assessment it will generally be incurred by the transmission business and must be quantifiable. There are many costs that clearly will be included in the assessment, many of which relate to obligations a transmission business must meet under relevant legislation, regulations or other requirements. Some examples include:

- Landholder compensation
- Other landholder payments (e.g., arrangements in place in Victoria, NSW and Queensland)
- Implementing First Nations and community engagement guidelines
- Legal costs associated with navigating judicial processes (e.g., following appeals or disputes raised by landholders and communities).

Impacts of a transmission project on local amenity, aesthetics or other human and environmental factors do not fit directly into this cost-benefit framework under the Rules. However, we consider they can have a bearing on ISP and RIT-T projects in three ways:

- Opposition to the project on these grounds may lead to the project being prevented (e.g., due to land access issues and/or legal challenges on planning grounds). In this case, given the likelihood of cancellation, an argument could be made that the project delivery option impacted by these issues is neither commercially nor technically feasible, and is therefore not a credible option for the purposes of the ISP and the RIT-T.
- Opposition may lead to the project being delayed. This may mean that the market benefits will be realised later and might therefore be lower than they would otherwise be if the project had been able to proceed more quickly.
- The transmission proponent may need to incur material expenditure to address concerns and proceed with a development (e.g., such as by building the line along a longer route or making other significant changes).

Materiality in ISP and RIT-T assessments

When considering which costs and market benefits (including negative benefits) related to social licence should be included in an ISP or RIT-T assessment, the rules contemplate that a transmission business will consider materiality. For the ISP, a cost is material if it could lead to the identification of a different development path (and therefore a different set of projects) as being the optimal development path by AEMO. In the case of the RIT-T, a cost is

material if it could lead to the identification of a different option as being the preferred option (and therefore the option that should proceed).

While some costs may be immaterial for the purposes of the ISP or RIT-T assessment (which is focused on selecting the projects and options, if any, that should proceed), it is important to note this does not prevent a transmission business from proposing to recover such costs if they are necessary to deliver the selected option.

Additional classes of benefits and costs in ISP and RIT-T assessments

The Rules preclude the consideration of externalities, immaterial and unquantifiable factors in an ISP and RIT-T cost benefit analysis. This means most direct impacts of transmission lines on landholders and communities (like a reduction in visual amenity) are excluded (although the overall impact of concerns about a project may be considered as describe above).

However, for both the ISP and for RIT-Ts, the AER can specify additional classes of market benefit or costs. Our ability to do this is constrained by the rules. In considering any proposals in this regard that are permitted under the rules, we would also consider:

- Whether the additional class would make it difficult for AEMO, in respect of the ISP, and transmission proponents, to comply with their obligations under the rules (e.g., if we were asked to include a class of cost which can't be quantified).
- Whether the impact of the additional class would be immaterial to the outcome in comparing options.

4.3 Engagement

Transmission investment proponents are required to undertake specific consultation and engagement as part of the RIT-T process.

This consultation process provides a particular opportunity for a transmission business to demonstrate and test how its engagement has contributed to the project proposal. It also allows for the transmission business to convey how engagement has:

- **Informed option identification** - Comprehensive early engagement with communities and landholders is likely to be needed to uncover issues that may cause the project to be delayed and not meet the identified need. Similarly, engagement is also likely to be needed to help uncover whether there are any items that may impact technical feasibility, particularly where local landholders or First Nations people have a closer connection to the land, its characteristics and cultural significance.
- **Identify additional costs or market benefit impacts** - Early engagement with local First Nations people, communities and landholders may also be critical in supporting which, if any, additional classes may be material to the assessment.

The Rules also require that the RIT-T proponent seek submissions from Registered Participants, AEMO and interested parties on the proposed preferred option presented, and the issues addressed, in their project assessment draft report. The project assessment

conclusions report must set out a summary of, and the response to, submissions received from interested parties.[17]

4.4 Future work and questions for stakeholders

This paper sets out the direction for how we believe social licence issues should be considered under the transmission planning rules. We will develop further guidance on its application throughout 2024.

While we consider the current framework allows for social licence issues to be considered through these elements of the framework, our guidelines could give more detail on this. We plan to address this when we update our guidelines in 2024.

This timing has been chosen because it will allow us to run one guideline review process to incorporate social licence elements alongside changes needed in response to AEMC rule changes and the inclusion of emissions reduction in the National Electricity Objectives. This will reduce the burden placed on stakeholders to contribute on two issues in one process.

4.5 Questions for stakeholders

- **Are there other ways in which social licence issues can be considered as part of the ISP and RIT-T process under the current rules?**
- **Are there any changes we should make to the approach in this chapter?**
- **Where should we focus on in providing further guidance to the sector when updating our guidelines?**

[17] NER 5.16A.4(f)(j) for actionable ISP projects

5 Cost recovery

We acknowledge transmission businesses will incur costs to build and maintain social licence during the construction and maintenance of new transmission lines. These businesses should receive adequate funding if they can appropriately identify how the social licence costs they will incur contribute to the delivery of prescribed transmission services. The onus is on the transmission businesses to establish how each element of its social licence costs contributed to the delivery of the overall project in a prudent and efficient manner. The AER will consider this on a project-by-project basis in determining a revenue allowance for the transmission business.

Chapter 3 highlights that as a key element to support the energy transition we want to see genuine and respectful engagement with First Nations people, landholders and communities. A flow-on implication of this is that we are in principle open to considering the expenditure required for transmission businesses to respond to the needs identified through engagement by groups impacted by transmission infrastructure. As with any expenditure proposal, this will need to meet requirements of the rules – in broad terms, to be prudent and efficient.

We are providing direction on the process and criteria we believe should apply to the assessment of expenditure related to engagement and other activities required to build and maintain social licence.

We engaged Deloitte to provide advice on a framework to assess social licence costs.[18] This report has informed our Directions Paper and is published as a complement to our Directions Paper to provide additional context to stakeholders.

The following sections set out the process we expect businesses to follow, along with some early thinking on how expenditure could be considered. It should be taken as a preliminary guide. Any specific expenditure allowances would be considered as part of each particular proposal, in its own context and obligations.

There are two parts to our proposed assessment approach. These are an assessment of a transmission business':

- engagement approach to build and maintain social licence
- activities in response to engagement feedback to build and maintain social licence.

Social licence costs can potentially be classified as either capital expenditure or operating expenditure. Due to the bespoke nature of social licence costs and its effect over the life of a large transmission project, we consider social licence costs should normally be included as capital expenditure as part of a transmission network's regulatory proposal. This ensures that the costs are directly attributed to the project. However, a transmission may still propose social licence costs as operating expenditure which tends to be for recurrent costs.

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18 Deloitte, *Assessment of Social License Costs for the Australian Energy Regulator*, 2023.

The Rules allow transmission businesses to recover costs for early works phases of ISP projects. We envisage that at the Stage 1 early works phase, costs related to social licence would primarily relate to engagement expenditure, as there would be little information on which to base an assessment of activity expenditure. However, at later stages it may include both engagement and activity expenditure.[19]

The AER approves expenditure allowances for regulated businesses to meet the following objectives under the NER:

- to meet or manage expected demand
- to comply with regulatory obligations or requirements
- maintain the safety, quality, reliability, and security of supply of the network.

At this time, our direction is that this guidance will provide certainty to transmission businesses on the framework in which we consider social licence costs, when weighed against other factors, to be prudent and efficient. We do not intend to be prescriptive on types of costs that could be related to social licence. We recognise that this area is still developing and there may be future changes in how social licence is obtained by transmission businesses. It will also be specific to, and should be shaped by, the needs of affected communities.

The development and evolution in approach is also being driven by governments and other stakeholders including the Australian Energy Infrastructure Commissioner, the AEMC and the Energy Charter. We encourage transmission businesses to draw on new insights and recommendations. The existing regulatory framework for considering prudent and efficient expenditure is flexible to be able to accommodate changes, where justified.

5.1 Assessment of social licence engagement

For the purposes of assessing social licence engagement expenditure, we consider that this would broadly include engagement with members of the community that are affected by the transmission project. We note that the AEMC's draft determination for enhancing community engagement sets a minimum obligation on transmission businesses, but this does not prevent the inclusion of stakeholders beyond those categories.

Our expectations for community engagement highlight that we place importance on it to better understand and respond to the community, and wherever possible resolve community concerns that may otherwise delay or prevent the project. Efficiency and prudency assessments will, however, remain as a core element of expenditure proposals – including for engagement. Efficiency should

We expect that expenditure proposed for social licence engagement will be supported by an engagement plan, which identifies the process a transmission business will follow and the outcomes to be achieved.

[19] We acknowledge that businesses may also be conducting community engagement as part of their business-as-usual activities that would inform social licence activities expenditure. This may result in a determination that recovers actual expenditure or seeks both engagement and activity expenditure at the first stage.

not be interpreted as minimising engagement costs, but should instead clearly set out what outcomes the expenditure proposed is designed to achieve and how those benefits compare to the costs.

5.1.1 Process for engagement in the expenditure proposal

Wherever a transmission business seeks to recover expenditure associated with social licence engagement they must submit an engagement plan. This plan should cover the specific, additional engagement proposed. The engagement plan must set out:

- why the engagement activities are efficient
- the costs and activities included in the plan that are shared with other services and engagements
- why the engagement will be effective and satisfy any relevant guidelines or legislation
- how a transmission business will identify efficient social licence activities using the engagement.

Transmission businesses may engage with us prior to submitting their engagement plan and subsequently developing a proposal to recover social licence engagement costs.

The engagement plan will assist us in assessing how a transmission business will conduct its engagement. Development of an engagement plan should occur prior to undertaking engagement and be updated throughout the engagement process if required. The engagement plan submitted as part of any cost recovery process should reflect the most up to date process and framework that the transmission business will undertake. Transmission businesses remain accountable for specific engagement actions and outcomes achieved. When we review an engagement plan, we will not provide approval of the specific approaches and activities proposed by transmission businesses. We will instead consider whether the engagement will efficiently identify social licence activities. Factors we will consider are:

- whether the engagement is appropriately justified
- how costs are forecast, and
- how the outcomes of the engagement will used to identify social licence activities.

5.1.2 Criteria for considering expenditure

The AER does not propose to assess and provide approval for each specific engagement cost category. In relation to prudency, transmission businesses should ensure their proposal addresses the following questions:

- Are the social licence engagement actions attributable and proportionate to the provision of a particular electricity transmission infrastructure project?
- Are the social licence engagement actions needed and appropriate to achieve the project outcome?
- Are these social licence engagement actions over and above existing engagement?

We also recognise that each transmission business will have varying baseline levels of social licence in their respective communities. As a result, the level of engagement required to build

social licence will differ between businesses. Despite this, we will assess how the expenditure proposed compares across businesses and to their other engagement activities. We do not propose to develop a benchmark at this time but are open to feedback as to whether this would be useful.

In relation to the efficiency test, transmission businesses should ensure their proposal describes how the proposed costs proposed are efficient (e.g., demonstrated by competitive procurement, benchmarking or another relevant process). Where a high level efficiency test is not available, transmission businesses may need to perform a more bottom-up assessment to show the costs are efficient.

As we enter a period of substantial transmission development, the needs and requirements of engagement will change over time. We expect to take a flexible approach that enables transmission businesses to adopt an approach that is tailored to the context of the community and project.

5.2 Assessment of social licence activities

We expect that expenditure proposed for social licence activities will be informed by the outcomes of engagement and clearly address community and landholder concerns that may prevent the project progressing. This expenditure should also be tested in consumer engagement.

This framework provides guidance on our expectations for transmission businesses to establish the prudency and efficiency of social licence activity costs beyond meeting its minimum regulatory obligations. For example, this could include an increase in amenity or a change in the planned route following engagement with an affected landholder.

The transmission business must, however, clearly establish that in the absence of incurring the proposed expenditure for each social licence activity, the ability of the network to proceed with the delivery of the transmission project would be significantly impacted. This is consistent with the NER which requires transmission expenditure to relate to the provision of prescribed transmission services.[20]

We do not propose to rule that certain activities should be explicitly allowed or excluded at this time. We intend to use a ‘but for’ test to review this method and subsequent activities. Under this test we will consider whether the project’s objectives cannot be efficiently and prudently met *but for* the method taken. We do not intend to assess each individual activity, but rather the overall method, package and costs proposed.

To justify its expenditure, we recommend a transmission business develops a social licence activity plan which should include the following details:

- the objectives of the social licence activities

[20] NER 6A.6.7 (a)

- how the specific activities were selected (i.e. from the result of early and extensive community engagement)
- how they link to the delivery of the particular transmission project
- detail of any alternative funding option used or to be pursued (e.g. government grants or concessional finance)
- detail of how the activities support or are consistent with the National Electricity Objective, and
- detail of how that network's consumers (as distinct from impacted landholders and communities) were engaged and have assessed the proposal – including their consideration of how options and trade-offs between objectives are balanced.

This detail will allow us to consider a broad range of potential social licence expenditures. We will consider the social licence activity plan as a package. We need to be satisfied that a transmission business has identified the prudent and efficient expenditure to gain social licence. In isolation, individual social licence activities may appear efficient. This does not guarantee the package will be efficient. For example, they may be duplicative or work at cross-purposes.

At any point in a transmission businesses' engagement process, it may develop a framework for social licence activities. Cost recovery for social licence activities should reflect the framework set out in the social licence activity plan and be clearly linked to the social licence engagement undertaken for the respective project.

5.3 Cost recovery decision points

We consider the primary cost recovery methods for social licence costs are through network determinations and contingent projects. These are ex-ante assessments and for this reason we have placed greater reliance on transmission businesses providing us with engagement and activity plans.

Cost pass throughs are only likely to be relevant where there has been a change in a regulatory obligation. We note that where a transmission business identifies a cost pass through event related to social licence, it must accurately identify the additional costs of such a change and take into account any prior regulatory processes which provide for social licence costs.

At this time, we do not believe it is reasonable for a transmission business to request a cost pass through when social licence outcomes are different to its forecast. This would be contrary to our ex-ante regulatory framework. For this reason, transmission businesses should undertake robust stakeholder engagement and to develop a clear social licence engagement plan to minimise this risk.

5.4 Future work and questions for stakeholders

As noted earlier, we will consider whether additional, more specific guidance for social licence engagement activities and cost recovery may be required. Our decision about this will be informed by the feedback received to this Directions Paper and any insights from contingent project assessments that may be submitted to the AER prior to that time.

Depending on progress by transmission businesses and other judicial processes this could include Humelink, VNI West, North-West Tasmania and Marinus Link.

- **Is there additional guidance required immediately to support cost recovery for social licence related expenditure?**
- **Does this process provide sufficient conditions to ensure that the costs recovered from consumers are prudent and efficient? How much input should transmission business consumer engagement have in relation to social licence expenditure?**
- **Does this guidance potentially restrict costs from being recovered that a transmission business would reasonably expect to incur to support building and maintaining social licence?**
- **What areas should we focus on in providing further guidance to the sector?**

6 AER forward work program

The AER will use feedback on this paper to guide our consideration of social licence issues going forward. Though we will conduct further consultation on those projects at that time, if you would like to be kept informed on the progress of these projects please let us know in your feedback or contact us directly.

Figure 3 AER forward work program related to social licence