

## AER REVIEW OF COST BENEFIT ANALYSIS AND RIT APPLICATION GUIDELINES

5 JUNE 2024

### INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

Thank you for the opportunity to make a submission under AER's Review of Cost Benefit Analysis (CBA) and RIT Application Guidelines.

In summary, the key issues we raise in this submission are:

#### **Including an emissions reduction benefit in the ISP and RIT.**

When accounting for emissions reductions, it is important to be very clear about where the emissions reductions are actually accounted for (i.e. at what point in the energy value chain do you account for emissions reductions).

AER's proposed approach of calculating the emissions reduction from the change in generation enabled by the transmission or distribution project is likely to over-represent the total emissions reduction created by the changing electricity system and create an outcome that the total emissions reduction from VRE and network projects will be approximately double that of the emissions reduction budget specified in the ISP.

#### **Social License**

Our main recommendation is that the varied quality transmission businesses' social licence engagement supports a minimum or specific requirement rather than a principles-based approach. Two key parts are for the AER to:

- specify the engagement requirements at the PADR and PACR, when there is generally no agreed route, and in early/preparatory works leading up to the contingent project application
- provide greater clarity on costs and benefits to be included in the RIT process to ensure a distinction between what costs can go into the RAB (consistent with the rules and the NEO) and what are appropriately paid for by Governments

## Sharing concessional finance

We assume that all projects that are part of the ISP or undergoing a RIT already meet the criteria that the need has been identified, that net benefits are likely to occur and that the project is financially viable. Therefore, concessional finance should be focussed on lowering the cost of the transition for consumers.

## Improving workability of the feedback loop

There are a number of shortcomings that we see with the feedback loop in its current form that are not addressed by improving the workability of it. While we appreciate time pressures on the process, improving workability looks a little like further diminishing the cost benefit analysis of projects. While some good work has been done on the capital cost data base, much of the base data used by AEMO and TNSP's appears to come from the same or similar sources. Therefore, the feedback loop in its current form tends to look like the industry/AEMO are correcting their own homework.

## Early works CPA

We will respond to this component of this submission via our submission to the AEMC on *Bringing early works forward to improve transmission planning* which is due on 4 July 2024

## VALUE OF EMISSIONS REDUCTION (VER)

The EUAA recognises that the ISP is (currently) a transmission transition plan to enable the replacement of coal fired power generation with Variable Renewable Energy (VRE). It is therefore appropriate that the ISP calculates the emissions reduction potential for both the proposed transmission network and the generators that will connect to it in the CBA. We assume that the intent of this is to ensure that projects that deliver the best combination of price, quality, safety, reliability and emissions reductions get built. Achieving the optimal combination of these objectives would be consistent with the National Electricity Objective (NEO).

It is important to highlight that “valuing” emissions reductions as part of the RIT or ISP should be pursued for the sole purpose of assessing the most credible option only that is consistent with the NEO. Apart from the recovery of project costs (cap ex, op-ex etc) no emissions reduction value or benefit should be available to the network operator.

With this in mind we are concerned with AER's proposed approach in the Draft Guidelines to calculating VER for RITs (which is the same as that for the ISP):

*“That is, the emissions reduction benefit in year t would be given by,*

*Emissions benefit<sub>t</sub> = VER<sub>t</sub> × (Base case emissions<sub>t</sub> – Investment case emissions<sub>t</sub>).*

*In which, for each year t:*

- total emissions in a state of the world is the sum of emissions produced by all generators in that state of the world; and*
- the emissions of each individual generator within a state of the world can be calculated as the product of the generator's total generation multiplied by its emissions intensity factor”*

When accounting for emissions reductions, it is important to be very clear about where the emissions reductions are actually accounted for (i.e. at what point in the energy value chain do you account for emissions reductions).

AER's proposed approach of calculating the emissions reduction from the change in generation enabled by the transmission or distribution project is likely to over-represent the total emissions reduction created by the changing electricity system and create an outcome that the total emissions reduction from VRE and network projects will be approximately double that of the emissions reduction budget specified in the ISP.

This double accounting arises from the AER proposing that the emissions reductions from generators is attributed 100% to the transmission or distribution project during the RIT when in fact the emissions reduction benefit will sit with the generators once the project is built. i.e. the total level of emissions reduction will be attributed to both the generators (i.e. via wholesale market transactions) and the network service provider (via RIT CBA justification). The proposed methodology is likely to double account the emissions reduction consumers will ultimately pay for the emissions reduction in both the network charges (due to increased network cap-ex) and the electricity purchase.

While we agree with the AER's *Guidance on Valuing Emissions Reduction* released earlier this year, we consider that in the current Draft Guidelines the AER needs to propose a methodology that proportions the emissions reduction from a VRE generation project across the generation and the network project that enabled that generation.

It should be noted at this point that in some situations, valuing emissions in a RIT will likely lead to increased consumer costs. For example, when a TNSP is assessing system strength options. In assessing non-network solutions as part of the assessment, using existing assets where cap-ex has been substantially written down is likely to lead to the lowest cost outcome for consumers. When emissions reductions are factored in these very low-cost non-network solutions will no longer be viable, leading to significant additional spending by the TNSP. The NEO is designed to balance a range of factors, including consumer costs, but in this example the scales seem to be tipped against the cheapest option.

## **SOCIAL LICENCE AS IT APPLIES TO ISP PROJECTS**

This section draws and builds on our earlier submission on the AER Directions Paper<sup>1</sup> where we welcomed the AER providing more explicit guidance for transmission businesses on how to incorporate social licence into their RIT-T planning. Our main proposition in that submission was that the revised Guidelines should be as explicit as possible around:

- what best practice social licence engagement should look like
- which is then used as a basis for assessing the prudence and efficiency of both proposed expenditure and any ex-post application for additional expenditure above the approved expenditure to be included on the RAB

We concluded that:

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<sup>1</sup> <https://www.aer.gov.au/documents/energy-users-association-australia-submission-aer-social-licence-electricity-transmission-projects-directions-paper-1-december-2023>

*“... a crucial aspect of consumers having some degree of confidence that the AER is indeed working to ensure consumers are better off now and, in the future, is that transmission businesses actually bear the costs of their poor social licence engagement.”*

This is why we prefer the approach of minimum or specific requirements rather than a principles-based approach. We have seen many examples in recent years of poor social licence engagement by transmission businesses which have sought to operate on a ‘self-developed’ principles basis. This has resulted in substantial delays as community opposition has led to routes being changed a number of times, completion timetable has been extended by years from the ISP optimal timing and capex costs have increased substantially. We believe that a principles-based approach risks a continuation of these adverse outcomes.

The AER should clearly describe:

- the expectations on social licence engagement for the PADR and PACR (when there is generally no preferred route) and then what should occur between the PACR and the contingent project application including as part of early/preparatory works
- What level of social licence cost accuracy should be achieved in the PACR
- What level of social licence cost accuracy should be achieved at the end of early/preparatory works as part of the final contingent project application recognising that even then the final route selection may not be completely agreed
- How this level of accuracy is then applied in an ex-post pass through application by the transmission business.

### **Identifying credible options in a RIT-T assessment**

We offer the following comments on the issues the Directions Paper identified as maybe affecting the identification of a credible option:

*Project not proceeding* – we consider the risk of an ISP project not proceeding in some form or other is almost zero. For example, while the Western Renewables Link has been delayed many years by social licence concerns, the Victorian Government has taken a range of steps to ensure that it is built. The response to extended community opposition is a combination of restrictions on the community’s ability to delay the project, increased compensation and compulsory acquisition.

*Project delay* - we consider that the risk of project delay leading to a project not being implemented in sufficient time to meet the identified need as also almost zero. All ISP optimal development path projects from every ISP since the first in 2020 have been delayed beyond their optimal timing, but none have been abandoned.

*Cost and benefit estimation* – community opposition has led to increased costs in all ISP projects. Committed and anticipated projects are assumed to proceed irrespective of changes in costs and benefits and are included in the ISP counterfactual. Neither large increases in costs nor lengthy project delays have led to already actionable projects having negative net benefits.

In summary, we do not think there will ever be a situation where an ISP project is no longer technically feasible. Community engagement of ISP projects continues until there is an acceptable route that may or may not require

compulsory acquisition. This means the Guidelines should address how a transmission business should proceed to the point of final investment decision such that the expenditure on gaining the social licence is prudent and efficient.

### **Costs and market benefits in ISP and RIT-T assessments**

Social licence costs continue to expand from the initial compensation payments to landowners who host network infrastructure. Some jurisdictions are now paying compensation to landowners who are visually impacted by network infrastructure and wider community related benefits that are not directly related to the costs of building the infrastructure. We offer the following comments on the questions asked:

- we support the AER providing greater clarity on the cost and benefit categories that may be included to address social licence issues; worked examples would be very helpful
- we do not support an expansion in the categories of costs and benefits; the current rules are designed to ensure electricity consumers only pay for benefits they receive as electricity consumers; if there are wider community costs then they should be paid for by Governments, not electricity consumers
- measuring the impact of a delay is going to be difficult given the low level of accuracy in costs at the PACR stage which will probably assume timely implementation of the proposed social licence strategy; later capex estimates have greater accuracy but also include any impact of a social licence delay; that makes it difficult to separate out the cost of that delay given the different accuracy level of early works vs PACR capex estimates; we look forward to commenting on proposals to address this issue in other submissions

It is not just a matter of clearly defining what categories of costs and benefits should be included, the AER also needs to provide clear guidance on how it will assess the prudence and efficiency of the proposed expenditure. We discuss some of the issues here in our earlier submission. We think it important that transmission businesses take the risk of poor social licence engagement, which is seen not only in increase social licence related costs, but in potentially significant capex increases. Electricity consumers have no way of mitigating that risk and should not have to bear it through pass through increases in the RAB.

### **Community and stakeholder engagement**

We believe the proposed expectations on transmission businesses are reasonable as a minimum standard but they require explicit guidance rather than a principles based approach.

While we support a clear definition of stakeholders that are 'reasonably expected to be affected by the development' it should be clear that this does not mean the social licence costs associated with all these stakeholders should end up in the transmission business' RAB. There should be a clear separation between which community and stakeholder groups are consulted and the level of any social licence compensation on the one hand and the question of who pays on the other.

We would suggest that a review of the most recent best practice social licence guidelines e.g. by the Energy Charter and the recent Australian Energy Infrastructure Commissioners Community Engagement Review would provide good guidance on a 'reasonable endeavours' definition. Any definition cannot be static. As is the case with BAU network engagement, the best practice bar is continually raised and the quality of engagement improves.

The AER should provide guidance on what the regular opportunities for regular involvement that the RIT proponent should provide. That guidance should be part of requirements for a best practice engagement plan to meet its reasonable endeavours obligation.

It would be helpful for the AER to clearly set out what is expected in the PADR and PACR and what can be left to the early/preparatory works.

It is interesting to note that while the Consultation Paper talks about the AER's role in achieving the NEM objective (p.6) there is no mention in the social licence section of electricity consumers, who end up paying the social licence bills, as a stakeholder.

AEMO has taken initial steps to include the impact of social licence on capex and schedule in the 2024 ISP. There is much more work to be done in the 2026 ISP to examine these variables in more detail as well as implementing the recommendations from the ISP to improve accessibility of the ISP and incorporating community acceptance considerations into transmission expansion options. We are not sure of how AEMO is going to directly engage with communities to consider locations of possible future ODP projects and how this will inform the ISP given these projects do not have a route. Getting detailed evidence from transmission businesses implementing ISP projects is likely to provide the information required for actionable projects and then practical data to apply to future projects.

## **IMPROVING WORKABILITY OF THE FEEDBACK LOOP**

There are a number of shortcomings that we see with the feedback loop in its current form that are not addressed by improving the workability of it. While we appreciate time pressures on the process, improving workability looks a little like further diminishing the cost benefit analysis of projects. While some good work has been done on the capital cost data base, much of the base data used by AEMO and TNSP's appears to come from the same or similar sources. Therefore, the feedback loop in its current form tends to look like the industry/AEMO are correcting their own homework.

Based on the consultation paper it is clear that the AER are proposing to incorporate the AEMC suggested changes to streamline and/or shorten the feedback loop process that involves a TNSP seeking confirmation from AEMO that:

- The preferred RIT-T option addresses the relevant need identified in the most recent ISP and aligns with the optimal development path (ODP) outlined in that ISP, and
- The costs of this option do not change the status of the actionable ISP project as part of the ODP.

We note that AEMO does not actually say the project still has net benefits nor has any additional independent, external assessment been conducted. All that AEMO is required to do is that it retains its actionable ISP status.

Ideally energy users would like to see AEMO reassess the net benefits of projects in the ISP and to have that subjected to further external assessment to provide consumers comfort that the least cost projects are being pursued.

If the feedback loop is designed to allow AEMO/TNSP to say they have protected customer interests then diminishing the process does not satisfy this assertion.

## SHARING CONCESSIONAL FINANCE BENEFITS WITH CONSUMERS

The lack of transparency surrounding the provision of concessional financing makes these questions difficult for consumers to answer. If a project proponent is pursuing a RIT or if a project is part of the ISP optimal development path we assume that:

- The need has been identified
- The net benefits have been quantified
- The project is financially viable for the proponent to pursue

We believe the RIT and ISP assessments should be conducted absent concessional finance. Projects are either viable or they are not. Concessional finance should be used to lower the cost of the transition for consumers. In all of these circumstances the entire benefit of concessional finance should be passed through to consumers. There are a number of ISP projects that have received concessional finance, but as consumers do not have access to the details of these arrangements it is impossible for us to provide a “worked example” as requested in the consultation paper. We encourage more transparency of these arrangements.

We note that while concessional finance helps deliver a lower cost of capital there are additional benefits that arise, most notably that the commonwealth is able to take on a level of risk that alternate financiers may not wish to take. Therefore, participation of the commonwealth combined with the provision of concessional rates lowers the overall risk profile of the project for all debt providers. Therefore, even when the benefits of concessional finance are passed through to consumers, these additional risk related benefits will still reside with the project proponent.

We do accept (to a degree) that changed financial circumstances (such as significant cost increases) can impact project viability post ISP and or RIT assessment and therefore there may be a need for concessional finance to “get it over the line”. We note that while this consultation paper is concerned with the regulatory treatment of concession finance, additional support is also being provided to project proponents by way of accelerated depreciation now being available (pending AER assessment and approval). Clearly in these circumstances the benefit of concessional finance must be passed through to consumers if for no other reason than to help offset the significant near-term cost impacts of accelerated depreciation.

## EARLY WORKS CONTINGENT PROJECT APPLICATION BEFORE COMPLETION OF A RIT-T

We will respond to this component of this submission via our submission to the AEMC on *Bringing early works forward to improve transmission planning* which is due on 4 July 2024. While we understand that the AER included this topic in the current consultation to ease consultation fatigue, we will not form a position on how we consider early works on contingent projects should be treated in the RIT-T prior to forming a position on the AEMC paper. AER should have delayed submission to the current Consultation Paper to align with that of AEMC if it wants “informed” responses.

Do not hesitate to be in contact should you have any questions.



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