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AER's Capital Expenditure Incentive Guideline Review — Consultation Paper — 21 February 2025

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 5,000MW of generation capacity.

We appreciate the opportunity to comment on the AER's guideline review. We supported Minister Bowen's rule change proposal[1] regarding targeted ex post reviews of large, 'Actionable' transmission projects.

Transgrid recently announced that the NSW portion of Project EnergyConnect will (so far) cost $3.6 billion[2], double the amount approved by the AER.[3] The timing of this advice to industry, only 20 months prior to scheduled completion, is of deep and fundamental concern to EnergyAustralia, especially given the drivers attributed to the cost blowout. Extrapolation of the AER's calculations suggests that a doubling of project cost would equate to a $44 total bill impact for NSW households, per year over the 2023-2028 regulatory control period. As we raised during the AEMC's recent transmission framework review[4], there is a gap in the rules regarding delivery of the modelled customer benefits of these projects. This allows proponents to suggest (but not be held accountable for) bill savings, in this case at least $100 per year.[5] A cost increase of $1.8 billion would mean this project no long delivers net benefits to customers, which were estimated at only $201 million in its final (updated) Regulatory Investment Test (RIT-T). This casts a shadow over other similar transmission projects which were also approved in spite of having relatively small cost-benefit ratios. These projects are already highly disputed by a range of stakeholders, and ongoing community opposition is a key challenge in delivering an orderly transition. The AER's approach to reviewing all Actionable projects must accord to the high standards expected by consumers paying for them through application of a RIT-T economic assessment. The AER's ex post review of EnergyConnect will be a critical test case.

[1] Managing ISP project uncertainty through targeted ex post reviews | AEMC

[2] EnergyConnect update | Transgrid

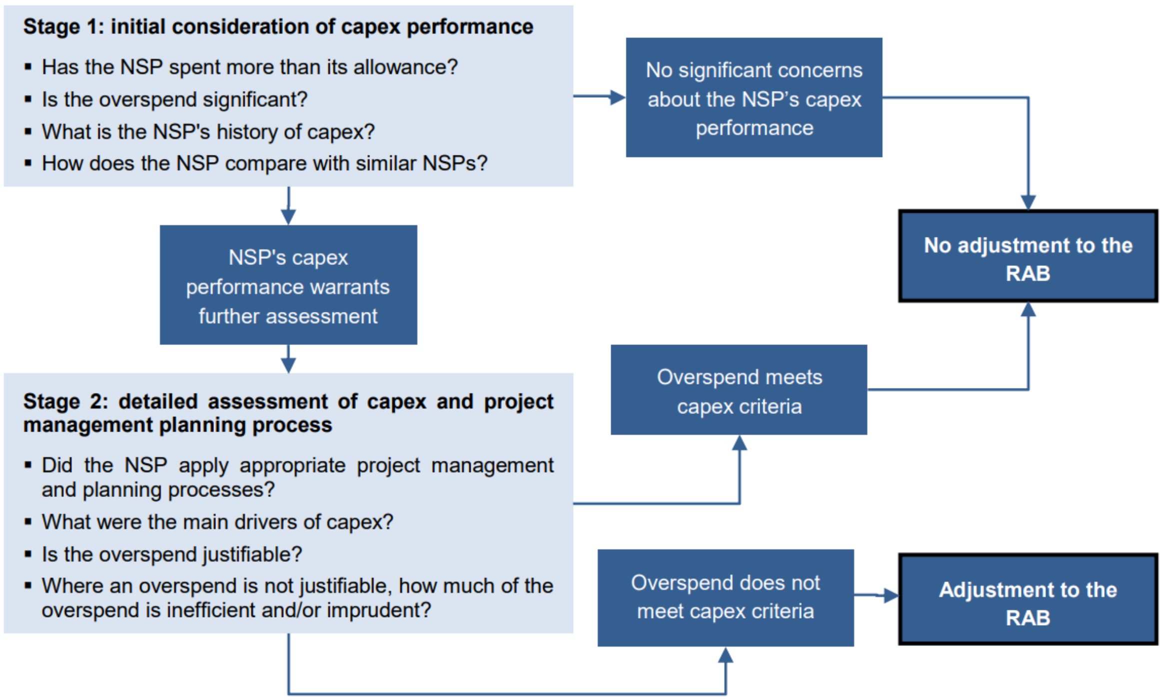
[3] AER approves costs for Project EnergyConnect | Australian Energy Regulator (AER)

[4] https://www.energyaustralia.com.au/sites/default/files/2023-04/EnergyAustralia_AEMC%20Transmission%20review%20-%20stage%20three%20paper_3%20Nov%202022.pdf

[5] Electricity interconnector on track to deliver savings

The Minister's rule change and the AER's consultation paper deal with the ability to separately review Actionable projects, including those spanning multiple regulatory control periods, and incentive framework interactions. We consider, however, the core of the AER's existing guideline regarding ex post reviews requires improvement and this needs to be the primary focus of its current consultation. That is, the AER should review its guidance on how it determines prudence and efficiency as a reasonable reflection of the capex criteria under "stage two" of its review process (see illustration below). The related elements of the AER's 'guidance note' on the regulation of Actionable projects[6], published in 2021, should also be examined and revised where appropriate.

Figure 1 Staged process for ex post review



Source: AER - Capital expenditure incentive guideline - July 2024.pdf

We appreciate the AER needs to exercise discretion and not issue overly prescriptive guidelines. However, the current guideline materials reflect what we consider to be a fairly low hurdle in terms of justifying cost increases ex post. We recommend the AER review its anticipated assessment approach and set clear expectations that it will pursue outcomes for customers and regulated entities that would be observed in a workably competitive market. Specifically, the AER should consider:

- the standard of project management, procurement, supply contracting and planning processes adopted. Any approved overspend should be conditional on absolute and independently validated best practice in these areas, not simply the observance of reasonable endeavours or 'appropriate' standards. The AER's existing guidance material variously refers to what is "reasonably expected" and

[6] https://www.aer.gov.au/industry/registers/resources/reviews/regulation-large-transmission-projects/final-decision

"foreseeable", and this should be read in the context of large, discrete projects with high costs and consequences for customers and the broader market.

- the extent to which projects had already been subjected to several upward revisions in costs during their RIT-T assessment and the contingent project application processes, thus informing the root causes and expectation of further cost increases.

- specifically how to treat instances of cost increases arising due to supply bottlenecks. This is likely to be a recurrent issue with large Actionable transmission projects being constructed concurrently. This is particularly relevant given Transgrid announced the results of its tender in October 2020[7], and its claims of significant benefit through bundling VNI West, HumeLink and EnergyConnect. Ex post reviews might also inform ex ante oversight of how project proponents structure contracts with delivery partners to deal with this issue.

- the extent of any scope creep and poor decision making or timing of decisions that has led to cost overruns, and extent to which the business has genuinely attempted to reduce scope to fit into approved/affordable budgets.

- benchmarking across network businesses in how these risks have been managed in their jurisdiction and in project execution. This includes how well they have managed their delivery and procurement risk profile, the balance of work outsourced or completed in-house, and how they have maintained or maximised competitive tensions. Again, in the context of EnergyConnect, the timing of the latest cost blowout notification and its size raises very significant concerns about contract controls. It also raises questions on how Transgrid has progressed and approved the project internally, recognising the regulatory risk it has created for itself and whether it has stopped to check value for money.

- broader questions of risk allocation and treatment of contingencies. Even where network businesses have robust risk management processes in place there is still a question whether customers should be forced to pay for the entirety of cost overruns. The AER applies sharing ratios in the context of expenditure incentives which in part reflect allocation of forecasting risk, and the same considerations should apply in the treatment of ex post expenditures.

- whether cost thresholds should apply that warrant different approaches by the AER in undertaking assessments, including intervention ahead of project completion. For example, should moderate (e.g. 10 to 20%) cost overruns be subject to any ex post review, and be subjected to ex ante incentives only? There will be a point at which cost increases demonstrate that a network business is not responding to ex ante incentives, and further thresholds again (e.g. above the value of project benefits or some other customer willingness to pay measure) where costs should not be recoverable under any circumstance.

- project abandonment. The AER's consultation paper raises questions about how the application of capital expenditure incentives provides a gaming opportunity in network businesses abandoning prudent projects. Our concern is the opposite. The designation of projects as "Actionable" should not mean they be executed at any cost and as fast as possible. Their designation in AEMO's optimal

[7] https://infrastructurepipeline.org/project/project-energyconnect

development pathway is on the basis of certain ex ante cost estimates that have low levels of accuracy. A loosely defined and 'last resort' approach to ex post reviews, combined with the inherent difficulties in assessing efficiency and prudence after the fact, result in very weak incentives to materially modify project scope or cease projects entirely when costs become excessive.

- transparency for stakeholders. Given the high level of interest in these projects, the AER's guidelines should bind network businesses in terms of processes and information disclosure such that stakeholders can see the full set of justifications for cost over-runs. In particular we would be interested in seeing how TNSPs regarded project net benefits where costs have escalated, and how they generally took action in the long term interest of consumers under changing circumstances.

If you would like to discuss this submission, please contact me on [redacted] or [redacted]

Regards

Lawrence Irlam
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