

19 June 2023

Ms Clare Savage
Chair
Australian Energy Regulator
7/2 Lonsdale St
Melbourne VIC 3000

Electronic Submission - AERpolicy@aer.gov.au

AER Consultation Paper – Review of the cost benefit analysis guidelines and RIT application guidelines

Dear Ms Savage,

Energy Networks Australia (ENA) welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) Consultation Paper on its review of the Cost Benefit Analysis (CBA) Guidelines and Regulatory Investment Test (RIT) for Transmission (RIT-T) and Distribution (RIT-D) Application Guidelines.

ENA is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide over 16 million electricity and gas connections to almost every home and business across Australia.

The AER's review of the guidelines follows the Material Change in Circumstances (MCC) Rule change. The transitional Rules require the AER to review the three guidelines, both to provide guidance on specific aspects of the updated MCC arrangements and more generally in relation to cost estimation. The review of guidance on cost estimation reflects the recent focus by consumer groups on better understanding the basis for cost estimates used in the RITs, and how these estimates may change over the course of the investment planning and delivery process.

ENA supports increased transparency relating to the cost estimates presented as part of RITs. For major projects, consumers have indicated that they value this transparency and Network Service Providers (NSPs) have already increased the amount of information provided in the relevant RIT reports. Transparency around the basis for cost estimation also forms part of the NSPs' Business As Usual engagement with their stakeholders.

ENA therefore supports the AER's proposed focus on guidance that provides additional transparency to consumers in relation to how cost estimates have been derived, and the potential impact of changes in costs on RIT outcomes. ENA agrees that a focus on improved transparency is more appropriate than mandating particular approaches to cost estimation or requiring a particular degree of estimation accuracy.

In light of the wide range of investments subject to the RITs, including their value and the variations in specific circumstances, ENA cautions against being too prescriptive in the guidelines and including binding requirements on NSPs. Prescriptive, binding guidance would affect the processes NSPs need to adopt to prepare RIT reports. This can have material cost implications and also affect the timeliness of project planning. ENA considers that binding obligations would not be in the long-term interests of consumers.

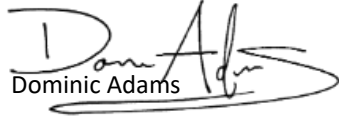
In this regard, ENA considers that:

- » The transparency around cost estimation approaches should be proportionate to the scale and nature of the investment involved.
- » Adoption of the AACE classification system could be made the presumptive approach for RIT-Ts for projects over \$100 million but should not be expected for all options in a given RIT-T, and should not be applied to RIT-Ds:
 - Where RIT-Ts include non-network options, it is unlikely to be feasible to require third-party proponents of those options to provide cost estimates in line with the AACE classification. Further, there may be network options included in a RIT-T which are unlikely to be top-ranked. Requiring an estimate in line with AACE classification in this case might impose additional estimation costs and extend timeframes, for limited benefit to stakeholders or consumers.
 - Cost estimates for distribution investments do not currently reference the AACE classification system, and imposing this requirement would require a material change to internal cost estimation processes. Given the smaller scale of distribution investments, or the driver of the MCC rule change, this does not appear warranted.
- » The provision of detailed guidance on a particular aspect of cost estimation (ie, contingency allowances) appears disproportionate, and does not reflect the reality of cost estimation at the RIT stage. Further, it is not clear that it would provide useful transparency for consumers:
 - ENA suggests this guidance not apply to RITs for projects below \$100 million.
 - Further, ENA expects that any guidance provided for projects above \$100 million would need to be substantively different from that currently provided for Integrated System Plan (ISP) projects, as that guidance is focused on the Contingent Project Application (CPA) process following completion of the RIT, when material additional information is available.
- » ENA supports sensitivity testing and boundary testing being conducted as part of RITs, where relevant, to provide transparency on the robustness of the preferred option. Sensitivity analysis is standard practice across RIT-T and RIT-D reports. However, ENA cautions against mandating sensitivity testing of particular variables (eg, costs), which will not always be material to the RIT outcome. It appears preferable to instead align the RIT guidelines with the CBA guidelines, where the latter requires 'RIT-T proponents *must consider* performing sensitivity testing by varying one or multiple inputs/assumptions'.
- » In relation to re-opening triggers, ENA agrees that the guidance provided should be non-prescriptive and include worked examples.
 - ENA encourages the AER to also include worked examples in relation to actions that may be taken by an NSP in response to a RIT re-opening trigger, and to set out the types of supporting information the AER expects it may require in evaluating an NSP's proposed course of action.
- » Finally, whilst welcoming guidance on the activities that may form part of 'early works' for ISP projects, ENA cautions against this guidance being prescriptive, and preventing either AEMO or an NSP identifying additional activities for a particular ISP project, as part of an early works CPA.

Each of the above points is expanded on in the attachment, in responding to the specific questions posed by the AER.

ENA looks forward to engaging with the AER on the further development of its updated guidelines. Should you have any queries on this response please feel free to contact Verity Watson, vwatson@energynetworks.com.au.

Yours sincerely,



Dominic Adams

General Manager - Networks

Attachment

RIT re-opening triggers

- » Do stakeholders agree with our proposed non-prescriptive approach to guidance on re-opening triggers (including worked examples, where required)?
- » Are there any other factors/principles other than those identified that RIT proponents should consider in setting out reopening triggers?

A material change in circumstances (MCC) might be caused by a range of factors, including:

- » increased labour and materials costs (which may not affect all credible options in the same way)
- » changes to government policy
- » external commercial decisions (such as the electrification of large loads) that alter the identified need or expected benefits of an investment, and
- » the ability of a non-network solution to proceed or meet the relevant timeframe.

Under the new Rules, re-opening triggers will apply to projects where the estimated cost of the preferred option exceeds \$100 million.¹ The inclusion of re-opening triggers in the RIT reports will provide increased transparency for consumers by identifying the factors that may lead to a re-evaluation of whether an investment option remains appropriate following the completion of the RIT.

ENA supports the AER's proposed non-prescriptive approach to providing guidance on the identification and development of re-opening triggers by the NSP. Such an approach:

- » is consistent with intent of the AEMC that guidance for re-opening triggers is not extensive or prescriptive, to enable proponents to develop reopening triggers that are appropriate to each project.²
- » recognises that the form and number of triggers is likely to reflect the complexity of the project, the specific circumstances of each RIT, and the dynamic nature of the energy market.
- » maintains the principle that the level of analysis in the RIT is proportionate to the scale and likely impact of changes in key variables.

ENA notes that NSPs will be required to consult on the proposed re-opening triggers at the PADR/DPAR stage of the RIT, which will provide an opportunity for stakeholders to provide input into the development of appropriate re-opening triggers. NSPs will also be required to set out how feedback from interested parties on proposed re-opening triggers has been addressed in the final RIT report.

¹ The AER's consultation paper (p. 14) refers to re-opening triggers applying to 'credible options above \$100 million'. However under the Rules, re-opening triggers will only apply to RITs where the estimated capital cost of the *preferred option* is above \$100 million.

² AEMC, *Material change in network infrastructure project costs*, Rule Determination, 27 October 2022, p 11.

Additional principles for the development of re-opening triggers could include that:

- » the triggers are sufficiently clear to allow consumers to understand the events, factors or circumstances that might lead to an MCC for a project:
 - Re-opening triggers that conflate the impact of a large number of variables are unlikely to be transparent. It may be appropriate to instead consider variations in related key variables as part of the sensitivity analysis presented in the RIT.
- » the triggers should reflect sensitivity testing or boundary testing presented in the RIT report, where appropriate.
- » where triggers reflect the impact of multiple variables, they should be internally consistent.

The MCC rule will require RIT proponents to notify the AER of an MCC and any actions they propose to take, and the timeframes in which any actions are proposed to be completed. The transitional rules³ require the AER to modify its CBA, RIT-T and RIT-D guidelines to cover examples of actions that may be taken by NSPs in response to an MCC occurring (which includes, but is not limited to, a RIT reopening trigger being triggered).

The AER has not yet discussed the guidance it expects to provide in this regard. ENA suggests that:

- » a similar non-prescriptive approach (with worked examples) would be appropriate. For example, a potential course of action could be that the RIT proponent publishes updated NPV analysis to demonstrate the impact of the MCC.
- » the AER also includes guidance on what ‘supporting information’ it expects to require from an NSP in assessing any proposed course of action. Providing this guidance should reduce the likelihood that the AER will need to ‘stop the clock’ on the 40 day period it has to make its determination, in order to request further information, and would therefore minimise any delays.

Cost estimation: use of cost standard estimation classification system

- » Do stakeholders agree that it is desirable to adopt a consistent cost estimate classification system in the RIT-T and RIT-D application guidelines?
- » Do stakeholders have views on whether the application of an acceptable cost estimate classification should be a binding obligation on RIT proponents in applying the RIT?

ENA is generally supportive of the adoption of a consistent cost estimate classification system for RIT-T applications, for major transmission projects above \$100 million, if this provides greater transparency to consumers as to the nature of the cost estimates.

However, ENA does not support mandating the adoption of a particular cost estimate classification system, nor expecting that it be applied across all options in a given RIT-T assessment, or to smaller RIT-T

³ NER, 11.154.3 (a). For example, the requirement to provide guidance and worked examples on actions that may be taken in response to a RIT reopening trigger being triggered are set out for the RIT-T Application Guidelines in NER 5.16.2 (c)(10)(ii).

projects or to RIT-D applications, as this would impose additional costs without any material benefits for consumers.

Application to RIT-Ts

In relation to major transmission projects, ENA supports adoption of the AACE classification system as a general presumption for projects with a cost estimate of more than \$100 million. ENA does not consider that there would be any advantage in adopting an alternative accepted cost estimate classification system, particularly considering that AEMO adopts the AACE system for the ISP. A consistent classification approach across both ISP and RIT-Ts for major transmission projects would provide a useful and consistent approach to informing stakeholders of the expected accuracy of cost estimates. ENA does not consider that the same benefit would result in also requiring a consistent classification system to be adopted for smaller transmission projects (below \$100 million).

Further, ENA does not support the guidelines mandating the use of the AACE classification system for all options in a given RIT-T (for projects above \$100 million), as this will not always be practical:

- » Whilst it may be appropriate to estimate the likely top-ranked option (or options) in accordance with the AACE classification, it may not be material to the RIT-T outcome to adopt this estimation approach for all options included in the RIT-T assessment (and doing so would impose additional costs and increase timeframes).
- » Further, for non-network options (NNOs), the project cost estimates are typically sourced from the proponents, and it is not clear that a requirement to provide estimates to an AACE classification standard could be imposed on these third parties, nor how those cost estimates could be assured to be prepared on a like basis to the cost estimates of options prepared by the TNSP.

ENA therefore suggests that a proportionate approach be permitted to estimating costs for options that are either unlikely to be top-ranked or where the estimates are provided by NNO proponents, where that is still expected to provide a reasonable basis to compare the net benefit of different options, with the materiality of that approach being tested through sensitivity analysis (as relevant).

ENA strongly supports the AER's intent not to mandate the required level of accuracy to adopt within a standard classification system, as the level of accuracy achievable will depend on the nature of the specific project. For example, it may be necessary to procure quotes from suppliers to support more accurate cost estimates, which may not be feasible at the RIT-T stage. There is also a difference between the level of accuracy that can be achieved for greenfields and brownfields investments, as the AER recognises in its Consultation Paper.

It may be helpful for the AER guidelines to also set out the interaction between cost estimates in RIT-Ts and AEMO's Transmission Cost Database, so that stakeholders understand why divergences could arise. In particular:

- » AEMO's database is useful for providing generic estimates of NNO or modelled transmission projects, before they have undergone the RIT-T process.
- » TNSP estimates at the RIT-T stage reflect more detailed, bespoke estimates of specific transmission projects.

- » Consistent with this, AEMO intends to use the TNSP's RIT cost estimates where available (noting that AEMO may cross check with the Transmission Cost Database and add offsets to prices advised by TNSPs to ensure uncertainty and risks are applied consistently across investment options).⁴

Application to RIT-Ds

ENA does not support the introduction of a requirement on DNSPs to adopt a standard cost classification system for cost estimates used in RIT-D applications:

- » DNSP RIT projects are typically of a smaller scale than transmission projects.
 - If this requirement were to be imposed for RIT-Ds, ENA suggests it should be subject to a materiality threshold (ie, only to projects above \$100 million).
- » DNSPs do not currently adopt a standard cost estimate classification approach, and so imposing a requirement to do so would necessitate changes to DNSPs' current estimation processes, with associated cost implications.
- » Further, due to the nature of distribution investments, currently in many cases the cost estimate for the investment that forms the preferred option is subject to a greater degree of refinement. Applying the same classification to all options in a RIT-D would require additional project development activities, adding to overall costs and timeframes.
- » The adoption of a cost estimation approach aligned with the AACE classification system is likely to increase the lead time for projects.
- » The inclusion in the RIT-D assessment of sensitivity analysis around cost estimates already demonstrates the extent to which the accuracy of the cost estimate is or is not material to the RIT-D outcome.

Sensitivity analysis

- » Should a binding obligation be imposed on RIT-T (non-actionable ISP projects) and RIT-D proponents to conduct sensitivity analysis on the estimated costs of credible options in the RIT application guidelines?

ENA supports robust sensitivity testing of credible options to understand the impact of uncertain input assumptions (including cost assumptions) on the RIT outcome. RIT reports routinely include sensitivity analysis and boundary tests on the key input assumptions for that RIT, typically including project capital costs.

ENA cautions against introducing a binding obligation in the guidelines to conduct sensitivity analysis on a specific variable (ie, costs), as the relevance and nature of particular sensitivity tests will depend on the specific circumstances of each RIT. Specifically:

⁴ AEMO, *Draft 2023 Transmission Expansion Options Report*, p. 15

- » Sensitivity testing should reflect a consistent underlying driver. That is, if an increase in the capex cost of an option is expected as a result of factors (eg, a change in steel prices) that would also affect other options, the sensitivity testing should vary capex costs consistently across all of these options (as well as also considering any potential impact on the base case).
- » For some RITs variations in opex may have the potential to affect RIT outcomes, but for others the level of opex will not be material to the outcome.
- » Where a RIT is the result of an externally imposed obligation with only one credible option, mandatory sensitivity tests do not provide a meaningful contribution to the RIT assessment.

Further, it does not appear warranted to introduce a binding obligation on sensitivity testing of one input assumption, given that other variables may have more of an impact on the RIT outcome in some cases.

The AER notes in its Consultation Paper that the CBA Guideline states RIT-T proponents *must consider* performing sensitivity testing, and seeks input on whether binding obligations in the RIT-T and RIT-D Application Guidelines would deliver a more consistent approach between the three guidelines. In response, ENA notes:

- » the Rules already require the RIT-T for non-actionable ISP projects and the RIT-D to specify that a sensitivity analysis is required of any modelling relating to the cost-benefit analysis,⁵ and
- » the existing RIT-T and RIT-D Application Guidelines *recommend* RIT proponents use sensitivity analysis to assist in determining reasonable scenarios. This is essentially the same as the obligation on RIT-T proponents for actionable ISP projects to consider performing sensitivity testing under the CBA Guideline.⁶

Rather than introducing a binding requirement to conduct sensitivity testing on costs, ENA suggests that alignment between the guidelines might be better achieved through updating the RIT Application Guidelines to include the same provision as the CBA Guidelines, ie:

*‘RIT -T proponents **must consider** performing sensitivity testing by varying one or multiple inputs/assumptions’*

Improved cost estimation transparency

- » Do stakeholders agree with our proposed approach to guidance to increase the transparency of the cost estimates of credible options? For example, by requiring RIT proponents to set out their cost estimation methodology, including key inputs and assumptions that are material in the cost estimation of credible options.

ENA supports increased transparency relating to the cost estimates presented as part of RITs. For major projects, consumers have indicated that they value this transparency and NSPs have already increased

⁵ NER Clauses 5.15A.2(b)(11) and 5.17(c)(9)(iv)

⁶ See page 41 of the *RIT-T Application Guidelines* and page 43 of the *RIT-D Application Guidelines*.

the amount of information provided in the relevant RIT reports. Further, transparency around the basis for cost estimation forms part of NSPs' BAU engagement with their stakeholders

As a consequence, ENA is generally supportive of additional guidance relating to transparency around cost estimation. Consistent with our view on other aspects of the CBA and RIT guidelines, any additional guidance should be non-prescriptive, and the expected degree of transparency should be proportionate to the scale of the proposed investment. This will ensure that the information provided can be tailored to the particular investment and circumstances, so that consumers are provided with meaningful information without being swamped with unnecessary detail.

ENA also notes that there may be commercial sensitivities around some of the assumptions underlying cost estimates, particularly where it is based on information provided by third party suppliers. It is therefore important that any guidance allows for flexibility around information disclosure.

Contingency allowances

- » Is there a need for transparency in the RIT regarding the relationship between contingencies to account for cost uncertainty and the level of cost accuracy of credible options?

ENA considers that transparency around how cost estimates have been developed (as discussed above) will help stakeholder understanding, without the need to emphasise one particular element of the cost estimates (eg, contingency allowances). ENA therefore questions whether the provision of further information on contingency allowances would in practice provide a benefit to consumers at the RIT stage.

For smaller projects and BAU investments, cost estimates at the RIT stage do not generally include contingencies for specific risks.

ENA therefore suggests that any guidance on increasing the transparency around the treatment of contingencies in cost estimates be limited to major projects (above \$100 million). The treatment of contingencies becomes more important as project size grows, due to the greater number of stages and components where uncertainty may need to be incorporated into cost estimates.

ENA also notes that the existing AER guidance note for actionable ISP projects is focused on cost estimation in the context of a Contingent Project Application (CPA), which will be based on more detailed analysis and the availability of more information (eg, from procurement processes) than is available for cost estimates at the RIT stage. ENA considers that this guidance would therefore need to be substantially amended to be applicable to cost estimates at the RIT stage.

Early works (actionable ISP projects)

- » Do stakeholders agree with our proposed approach to guidance that balances prescription of the activities included in the scope of early works with the flexibility for RIT-T proponents to include activities consistent with the AEMC's definition of early works?
- » Are there activities that should be included in the scope of the early works that are consistent with the AEMC's definition of early works?

ENA welcomes additional guidance on the activities that may form part of ‘early works’, where it provides greater certainty (for both NSPs and consumers) on the types of activities that may be accepted by the AER as part of an early works CPA.

However, ENA cautions against this guidance being prescriptive or being presented as an exhaustive list of early works activities. In its Transmission Planning and Investment Review Stage 3 report, the AEMC recommended further clarifying in the Rules that AEMO is able to identify early works activities as part of an ISP, but also made clear that any list of early works identified by AEMO in the ISP would be non-exhaustive and non-prescriptive.⁷

Ultimately, the early works activities that are appropriate for a specific project will depend on the nature of that project, and may in some cases even be unique to that project. ENA’s view is that TNSPs are best placed to identify the early works activities that have the potential to improve the accuracy of cost estimates and/or to ensure that a project can be delivered within the required timeframes, as part of the detailed planning process. Ultimately, the AER is able review and determine whether to allow these activities to be funded as part of a CPA. It would not therefore be desirable for the CBA Guidelines to limit the activities that may be later identified as early works (either by AEMO in the ISP or by the TNSP as part of an early works CPA application).

ENA therefore suggests that any guidance for early works should be non-prescriptive and non-exhaustive.

Examples of specific activities that could be involved in early works include:

- » Stakeholder engagement and social licence acceptance.
- » Detailed design works and equipment specifications.
- » Site surveys and geotechnical studies.
- » Early phase procurement, including the development of tender documentation and contractor engagement.
- » Procurement of long lead time equipment.
- » Land valuation and securing land purchase options.
- » Commencement of the project development and approval process.
- » Identification and early construction of access tracks

⁷ AEMC, *Transmission Planning and Investment Report, Stage 3 Final Report*, May 2023, p. 20.