

5 February 2021

Mr Jim Cox  
Deputy Chair  
Australian Energy Regulator  
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## **AER Draft guidance note – regulation of actionable ISP projects**

Dear Mr Cox

Energy Networks Australia (ENA) welcomes the opportunity to provide a response to the Australian Energy Regulator (AER) Draft guidance note – regulation of actionable Integrated System Plan (ISP) projects.

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

ENA supports the improved clarity, transparency and predictability this additional guidance provides for the regulatory processes supporting the delivery of large actionable ISP projects.

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### **In summary:**

- » It is important that the guidance note is fit for purpose, proportionate and can be scaled to appropriately manage both \$3 billion interconnector investments and minor upgrades;
  - » Transmission Network Service Providers (TNSPs) support stakeholders being well informed and having an opportunity to ask questions to enable networks to promote consumer confidence in projects. The management of interactions with landowners and community clearly sit with the relevant TNSP;
  - » There is no one size fits all procurement approach. ENA support early engagement with the AER on the procurement approach to be adopted for an ISP project;
  - » The guidance note should provide flexibility for the market to evolve and a risk approach that best suits characteristics of the individual project and market circumstances at the time of development and delivery;
  - » ENA support the additional guidance for staged Contingent Project Applications (CPAs), noting this may be useful to reduce uncertainty associated with ISP project forecasts for certain costs;
  - » Where an actionable ISP project has any material changes in the cost forecast or project expectations, ENA support notifying stakeholders and helping them to explore and understand the reasons for any changes. In the event of an ex-post review the process should (almost) solely focus on the actionable ISP project.
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### *Supportive of a fit for purpose, scalable approach*

ENA supports the improved clarity, transparency and predictability that this additional guidance provides for the regulatory processes supporting the delivery of large actionable ISP projects. ENA recognises that the guidance note is not binding on TNSPs nor the AER. It is important that the guidance note is fit for purpose, proportionate and can be scaled to accommodate a range of project sizes. Processes need to be proportionate and scalable to cater for \$3 billion interconnector investments or minor upgrades.

Minor upgrades on existing interconnectors, or provision of a battery, or a synchronous condenser to meet an urgent need can also be actionable ISP projects and may not warrant the full extent of the proposed approach. The purpose of the guidance is directed towards large greenfield transmission projects. ENA recommend that the guidance be limited to large greenfield ISP projects or alternatively, TNSPs engage with the AER upfront on a more proportionate response for specific projects. An example of this may be a more proportionate pre-engagement or procurement approach for a small brown field interconnector upgrade where it may be suitable to use the existing TNSPs procurement approach and contractor panel.

It should be noted that this guidance doesn't apply in Victoria due to the contestable framework for transmission augmentations and may not apply to states where governments have opted out of certain aspects of the rules and AER oversight. It is important that the regulated approach which provides robustness and transparency is not bypassed because of the regulatory burden that may be caused.

### **Contingent Project Application guidance**

AER have proposed further guidance in the following areas:

- » Pre-lodgement stakeholder consultation;
- » Early information sharing with the AER;
- » Effective and transparent project management and governance;
- » Detailed procurement preparation and planning, execution and contracting arrangements; and
- » An approach to risk assessment and management.

### **Pre- CPA lodgement stakeholder engagement**

ENA supports improving stakeholder engagement and community understanding of ISP projects costs, benefits and risks. This provides greater opportunity for the project to be designed with local community input in mind. Interactions with landholders and the community are the responsibility of the relevant TNSP to manage.

As noted above, the level of additional engagement at this stage in ISP projects should be proportionate; greenfield infrastructure development of this scale needs more engagement than small projects on existing infrastructure, which don't directly impact individual properties and communities.

The AER suggests that for large greenfield projects, engaging with impacted communities can help the TNSP identify community risks associated with the project that can impact the proposed route and potentially have a material impact on the costs.

TNSPs support stakeholders being well informed and having an opportunity to ask questions to enable networks to promote consumer confidence in the project. A change of route can have the

potential to increase or decrease overall costs ultimately borne by all electricity consumers. Ultimately local advocacy groups' positions may not align with the ISP and regulatory cost/benefit processes. TNSPs can seek to proactively identify and manage risk in this area, however, support from state and local government for generation and transmission projects will be crucial in garnering wider project support.

Unless there is a material change in circumstance, engagement by the TNSP in the pre-lodgment CPA phase should be contained to issues that arise post the completion of the Regulatory Investment Test – Transmission (RIT-T).

#### **Early engagement with the AER**

ENA note that the new actionable ISP rule framework does not require TNSP Board approval as a trigger to lodge a CPA.

AER expect TNSPs to share early information on the CPA planning and preparation including whether the TNSPs Board have committed to proceeding with the project (subject to the CPA outcome) and whether financing for the project has been obtained. Prior to the CPA being submitted to the AER or during the AER assessment of the application, businesses will be continuing to support the ISP project through the regulatory processes. Energy Security Board and Council of Australian Governments supported this model and its implementation in 2020. If the AER pursues this requirement then the AER may need to consider staging its decision process also.

#### **Effective procurement approach**

AER has provided comprehensive views on the procurement approach. As noted above for an ISP project that is a small value or brownfields, it may be more efficient to use internal business procurement approaches: existing contracting tender panels and contracting approaches. Procurement approaches can also be influenced by resource availability, location of the investment, size of the investment and past contractor performance etc.

Different procurement approaches should be able to be adopted for different types of projects. There is no one size fits all procurement approach. ENA support early engagement with the AER on the procurement approach to be adopted for an ISP project.

#### **Evaluation of reasonable price for overall delivery**

The AER states that it wants to see how the efficiencies in the design of the solution have been sought. Any functional specification issued to the market needs to consider whole of life costs, meet TNSPs obligations under state and national frameworks, including reliability, system security, resilience etc. rather than just a focus on upfront costs. Robust procurement and evaluation criteria will assess a range of factors in considering responses to the functional specification and the more detailed offers. Evaluation of offers will need to weigh up a broad range of issues regarding project delivery and ongoing asset management to ensure a reasonable price for the overall delivery.

#### **Risk management approach**

ENA accepts that large actionable ISP should include an appropriate risk management framework. As the AER notes, risks can be avoided, mitigated, transferred or accepted. Different contracting approaches may allocate risks between the TNSP and the contractor differently. TNSP's internal project governance will evaluate projects offers against a broad range of criteria and will make a reasonable decision on risk management, having weighed up a range of factors impacting project delivery. As the Australian Energy Market Operator (AEMO)/GHD work notes, the risks are expected

to be shifted to contractors as estimates advance. It is highly unlikely that individual risks will be quantified and made visible in tenders.

A common and consistent approach between the AER guidance note and AEMO initiative will considerably add value to both objectives. ENA note in the recent Inputs, Assumptions and Scenarios Report that AEMO will be consulting on the transmission database in May 2021. There is benefit if the AER and AEMO processes are complementary.

An important principle is that risks are allocated to those who are best placed to manage them.

Transmission project risks vary between projects and the characteristics of each project, there is no one size fits all risk allocation matrix, and hence accuracy of the risk quantification.

The guidance note should provide flexibility for the market to evolve and a risk approach that best suits characteristics of the individual project and market circumstances at the time of development and implementation.

TNSPs may have different risk appetites and a more flexible risk framework would be able to consider various risks and fair outcomes for relevant consumers and TNSPs. Some costs, which are outside of the TNSPs control, may be better managed by isolating these costs and enabling the actual costs to be passed through, as this is likely to provide a fairer outcome for customers.

#### ***Efficient staging of Contingent Project Applications***

ENA support the additional guidance for staged CPAs, noting this may be useful to reduce uncertainty associated with ISP project forecasts for certain costs. ENA appreciates the level of detail in this process that has been developed between the AER and TransGrid on the application of an early works CPA followed by the infrastructure delivery CPA.

Where costs arise during infrastructure delivery and are unable to be quoted/contracted, are outside of the TNSP's control, this approach will not be able to improve the estimate or reduce this risk of a poor estimate which could impact consumers or the TNSP. This is discussed further in the ex-post review section below.

ENA concur with the AER that breaking the regulatory process up into too many stages may not be efficient and could result in a large regulatory burden for all stakeholders. ENA note that if an ISP project could be subject to multiple CPAs, that the TNSP would need to engage with the AER and AEMO to discuss the approach. Each CPA is subject to the trigger event criteria which includes AEMO's written confirmation through the feedback loop to ensure:

- » the preferred option addresses the relevant identified need in the most recent ISP and aligns with the most recent optimal development path; and
- » the cost of the preferred option does not change the status of the actionable ISP project as part of the optimal development path.

This ensures that the ISP projects are still in the long-term interests of consumers and are not delivered at any cost. The AER note that projects may not proceed further where there has been a material change in circumstances that make the project economically unviable, or the project may no longer pass the feedback loop. ENA support the AER guidance that where a subsequent stage does not proceed that costs of the first stage will be treated in line with the TNSPs approved capitalisation and cost allocation policies.

### ***Ex-post review processes***

ENA note the two stage ex-post review and that the process applies to the TNSP's total capital expenditure in the regulatory period. As the AER notes, they have flexibility to focus on individual ISP projects within the overall allowance. The AER must take into account information and analysis that the TNSP could reasonably be expected to have considered or undertaken at the time that it undertook the relevant capital expenditure. ENA recommend that the ex-post review process focus (almost) solely on the actionable ISP project rather than the total capital expenditure in the relevant period.

Where an actionable ISP project has any material changes in the cost forecast or project expectations, ENA support notifying stakeholders and helping them understand the reasons for any changes.

As noted in the CPA staging section, staged CPA's can improve the cost forecasts for some but not all costs. There are certain types of costs, for example government environmental offset costs which are not able to be accurately forecast. The magnitude of these costs only becomes clear well into the project delivery phase. Trying to estimate unknown costs outside of the TNSPs control accurately may result in a poor outcome either for consumers or for the TNSPs. These types of costs are better suited to an adjustment of the total project cost/revenue, once the cost is known by the TNSP. AER approval of the adjustment costs should then be able to be included in the total project cost recovery. The categories where this might apply would need to be narrowly defined and agreed with the AER in the CPA process and could include such items as biodiversity costs invoiced by government once the project has commenced and land acquisition and land payments have been made. ENA welcome further discussion with the AER on this approach.

### **Ex-post statement on efficiency and prudence**

The AER's proposed approach intends to report key information about ISP projects, including the progression of cost estimates from the ISP, RIT-T, CPA and actual project costs. To understand how a project's cost changes, the total project costs and allocation across states needs to be considered as the portion of costs in one state vs another could change as could the overall benefit case. Change of scope can be a large driver of cost movements from project concept to execution, this makes any "apples vs apples" benchmarking problematic. Aspects of the project can also legitimately change from the draft/final ISP, RIT-T to CPA as the underlying details become better specified. Changes in costs and project progress can occur when addressing cultural issues, soil testing, improved footing design, additional complexity with locational factors such as terrain, and traversing national parks, for example.

Costs will evolve from initial estimation as a possible project in the ISP to a better specified project, supported by a tender process and negotiated final offers. It would be expected that the final costs in the AEMO feedback loop and the lodged CPA will vary from the early cost estimates as more definitive detail on costs is acquired throughout the project process.

This key information should be reported for all actionable ISP projects, including those subject to state based regulatory processes, to the extent its contestable arrangements allow. ENA is pleased that in a recent public webinar AEMO advised that they plan to treat projects in different regions consistently, ENA trusts this includes transparency of initial cost estimates through to actual costs for all ISP projects and all states to inform cost development for future ISP projects.

Should you have any queries on this response please feel free to contact Verity Watson,  
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Yours sincerely,



Andrew Dillon  
**Chief Executive Officer**