FACT SHEET – May 2020

Draft guidelines for a best practice Integrated System Plan

The AER is seeking views on its draft guidelines that will shape how the Integrated System Plan (ISP) identifies projects in the long-term interest of consumers.

What are our draft guidelines?

We have made draft cost benefit analysis guidelines, which set out the cost benefit analysis for the Australian Energy Market Operator (AEMO) to apply when developing the ISP. The guidelines also set out how the regulatory investment test (RIT–T) will apply to projects identified in the ISP.

In addition, our draft forecasting best practice guidelines set out the consultation and forecasting processes for AEMO to follow when developing the ISP.

Finally, we have also updated the existing RIT–T instrument and guidelines to recognise the role of the actionable ISP.

An 'actionable' ISP

The Energy Security Board has included the ISP in the National Electricity Rules.

As part of making the ISP 'actionable', we are developing guidelines to govern the analysis and consultation that underpins the ISP and related regulatory investment tests.

Actionable ISP Rules

What are the objectives of our draft guidelines?

Our draft guidelines clarify how AEMO will develop the ISP and how transmission businesses will apply the RIT–T when there is an actionable ISP. In both cases, this will entail applying a rigorous cost benefit analysis. While AEMO has flexibility around how it identifies optimal investments, its decisions must be fully transparent.

The draft guidelines minimise duplication between the ISP and RIT–T by requiring RIT–T applications to use ISP inputs, assumptions and analysis as much as possible. In addition, by encouraging AEMO to explore a broad range of projects (including non-network projects) at the ISP stage, the draft guidelines aim to reduce the need for extensive analysis at the RIT–T stage.

What cost benefit analysis are we proposing for the ISP?

The draft guidelines require AEMO to perform a cost benefit analysis when identifying the optimal group of projects to occur in the National Electricity Market (or "optimal development plan"). Identifying the optimal development plan entails:

- Identifying different "development plans" for transmission investments and modelled generation build in the National Electricity Market. Each development plan must be able to meet forecast power system needs, including relevant policy requirements.
- Transparently ranking development plans by their estimated benefits and costs under scenarios of the future, weighted by the likelihood of scenarios occurring (the "risk neutral" approach). The draft cost benefit analysis guidelines describe how AEMO should estimate these benefits and costs.
- Considering how different development plans mitigate key risks that AEMO identifies. AEMO may depart from the "risk neutral" approach when selecting the optimal development plan. For example, it may use a "risk averse" approach that weights scenarios where particular risks eventuate by more than the scenario's likelihood of occurring.

When choosing which development plan is optimal, AEMO will use its judgement to draw on the outcomes of the risk neutral approach, a risk averse approach, or some combination of them. However, the optimal plan must have greater benefits than costs in the most likely scenario of the future. AEMO must also be transparent about

its choice. This includes explaining why the difference in cost to consumers of taking a risk averse approach may be justified.

How will the ISP and RIT–T work together?

For key transmission projects that form part of the optimal development plan, the ISP will identify the need for undertaking that investment, and a candidate project to meet each need. The ISP will trigger transmission businesses to undertake a RIT–T on needs associated with their network to explore different options for meeting those needs.

The RIT–T will continue to be a cost benefit analysis that draws on many aspects of our existing RIT–T application guidelines. Transmission businesses will compare the costs and benefits of the ISP candidate option alongside the costs and benefits of other options for meeting the need for the investment. This cost benefit analysis will draw on the analysis undertaken in the ISP, including by using the same modelling inputs. This will minimise any duplication between the ISP and RIT–T.

To align the approach to risk in the RIT–T with that in the ISP, where the ISP has recommended a transmission project because it addresses specific risks, AEMO may build these risks into the identified need. This directs the transmission business to focus only on options that address the risk.

The draft guidelines also allow AEMO to choose which scenarios of the future are relevant to consider in the RIT–T application (which may only be one scenario). Reducing the number of scenarios streamlines the RIT–T. Allowing AEMO to choose which scenarios are relevant for specific projects helps align the ISP and RIT–T. The scenarios that AEMO chooses must come from the set of ISP scenarios, which AEMO will have consulted on in the ISP process. Where AEMO chooses multiple relevant scenarios, it will direct the transmission business on how to weight the scenarios. These weightings must be proportional to the likelihood-based weightings in the ISP.

Other key parts of the draft cost benefit analysis guidelines

The draft cost benefit analysis guidelines also provide key details around how AEMO will:

- Incorporate option value when choosing the optimal development path. Option value includes retaining flexibility where certain actions are irreversible or accelerating projects to create option value at a development path level. AEMO should consider staging projects to retain flexibility. The draft CBA guidelines refer to staging mechanisms (multiple RIT-Ts, or one RIT-T but multiple contingent project applications).
- Consider non-network options, which are projects that use a non-network means to address a need on the network (e.g. using demand management to provide network support). While RIT–T applications can also explore non-network options, the draft guidelines encourage AEMO to consider non-network options early in the ISP process by engaging with non-network option proponents. This may allow AEMO to include non-network options in development plan options.
- Perform ‘feedback loops’ and ISP updates. The feedback loop is where AEMO assesses whether a project selected in a RIT–T aligns with the ISP. AEMO will determine what analysis and modelling is required in a feedback loop and must explain its decisions.

Key dates

- We will hold a webinar on the draft guidelines on **4 June 2020**. Register your interest at ISPGuidelines@aer.gov.au
- Submissions on the draft guidelines close **26 June 2020.**
- We will publish the final guidelines on **21 August 2020.**
- The new guidelines will apply to the 2022 ISP and to some current and all future RIT–T applications.