Guidelines to make the Integrated System Plan actionable

Response to AER Draft CBA Guidelines and proposed revisions to the RIT-T Application Guidelines

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Energy Networks Australia

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Key messages

- Energy Networks Australia generally supports the guidance in the AER's Draft Cost Benefit Analysis (CBA) Guidelines, although recommends some refinements that would further the overall objective of streamlining the investment assessment process and provide greater clarity.
- Energy Networks Australia considers the ISP framework changes to be in the interests of consumers:
  - they provide a robust end-to-end process under which investments are tested to ensure they provide benefits to consumers, whilst avoiding duplication in processes (reducing costs);
  - they reflect clear and transparent consultation around input assumptions, to provide consumers with confidence that the assumptions adopted are realistic.
- Energy Networks Australia supports the AER's proposed flexibility in the CBA Guidelines for AEMO in conducting its Integrated System Plan (ISP) analysis, coupled with increased transparency to ensure outcomes reflect consumer interests.
  - This balance is consistent with the discretion provided to AEMO in the new Actionable ISP Rules, whilst facilitating effective stakeholder engagement on how that discretion is exercised.
  - Consultation and transparency around the inputs, assumptions and scenarios adopted in the ISP is particularly important given these will now form the basis of more streamlined RIT-T assessments for actionable ISP projects, as well as for non-ISP RIT-Ts. Energy Networks Australia therefore supports the proposed AER transparency reviews.
- Energy Networks Australia supports the AER's proposed approach to achieving alignment between the ISP and RIT-T, and the resulting streamlined RIT-T process. Consistent with achieving this streamlining in practice, Energy Networks Australia recommends that:
  - Where the AER has made a contingent project application decision on an ISP project this should be treated as committed for the purposes of the ISP.
  - The guidance should be amended to require AEMO to adopt TNSPs' capital cost forecasts, to avoid RIT-T projects failing the AEMO feedback loop, triggering frequent ISP updates.
  - The AER's guidance on RIT-T sensitivities should make clear these should be focused on variables being considered at the RIT-T stage, rather than broader matters relating to NEM development that are more appropriately explored via the ISP scenarios (and ISP sensitivities).
- Greater clarity is required on the assessment of staged ISP projects and staged RIT-T projects, and the interaction with AEMO's feedback loop for automatic contingent project applications:

- It would be helpful for the final CBA Guidelines to provide some worked examples on this point, and Energy Networks Australia has provided some suggested examples.

» Energy Networks Australia supports the confirmation that AEMO's generation modelling can be adopted for RIT-Ts relating to Renewable Energy Zone (REZ) developments.

» Energy Networks Australia recommends the AER's guidance for non-ISP RIT-Ts be revised to only require ISP scenarios to be used where wholesale market outcomes are material to the outcome of the RIT-T, and where undertaking market modelling is not disproportionate.

- For many repex and reliability corrective action RIT-Ts the ISP scenarios will not have relevance.

1 Introduction

Energy Networks Australia is pleased to provide this submission to the Australian Energy Regulator (AER), in response the AER's package of draft guidelines issued in connection with the new actionable Integrated System Plan (ISP) framework.

Energy Networks Australia 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.

This submission focuses on the AER's draft Cost Benefit Analysis (CBA) Guidelines, which cover both AEMO's CBA assessment in developing the ISP and the subsequent RIT-T CBA analysis undertaken by the transmission network businesses (TNSPs) or AEMO (in Victoria), for actionable ISP projects.

Energy Networks Australia generally supports the guidance in the AER's Draft CBA Guidelines, although recommends some refinements in this submission. Energy Networks Australia has confidence that the changes are in the interests of consumers as they provide:

» a robust end-to-end process under which investments are tested to ensure they provide benefits to consumers, whilst avoiding duplication in assessment processes which can lead to higher costs and investment delays;

» clear and transparent consultation around input assumptions. Energy Networks Australia recommends changes to ensure due weight is given to transmission businesses' estimates of cost assumptions, to provide consumers with confidence that they are realistic.

Energy Networks Australia recognises that the new actionable ISP framework is intended to enable the investment planning process to operate more efficiently end-to-end, so that investments vital to providing benefits to customers in the transition of the National Electricity Market (NEM) can proceed in a timely manner. The recommendations provided in this submission are consistent with furthering this objective and ensuring that the actionable ISP framework operates effectively in practice, and that there is clarity around the AER's expectations for both the ISP and RIT-T assessments.

Energy Networks Australia supports the balance the AER has reflected in its draft CBA Guidelines between prescription and flexibility for both AEMO and the TNSPs, and the guidance proposed to ensure that the ISP and RIT-T assessments are aligned and result in an overall streamlining of the assessment process. Energy Networks Australia also supports the various transparency measures proposed in the guidelines (including the proposed AER transparency reviews) and considers that this is a necessary companion to the discretion provided to both AEMO and the TNSPs.

Energy Networks Australia supports the AER's confirmation that AEMO's generation modelling can be adopted in RIT-Ts for REZ developments, as this addresses one of the barriers to the application of the RIT-T to proposed REZs, arising from future generation uncertainty.

Energy Networks Australia has recommended:

- Amending the guidance to require AEMO to adopt TNSPs' capital cost forecasts, in order to avoid RIT-T projects failing the AEMO feedback loop, triggering frequent ISP updates;
- Clarifying that the sensitivity analysis required at the RIT-T stage should be focused on factors relevant to the RIT-T analysis, rather than substituting for additional scenario analysis of sensitivity testing at the ISP stage;
- Specifying that Actionable ISP projects where the AER has made a Contingent Project Application (CPA) decision should be treated as committed in the ISP and RIT-T assessments;
- Providing further clarification and worked examples in the CBA Guidelines on the interaction between staged ISP projects, staged RIT-Ts and the AEMO feedback loop for automatic CPAs; and
- Amendment of the AER's guidance on the treatment of external funds in the ISP and RIT-T assessments, so that all external funds can be subtracted from capital costs as part of the assessment, to ensure the guidance is robust to technology developments and consistent with the REZ models being developed by the Energy Security Board.

Energy Networks Australia recommends that the proposed use of the ISP scenarios for non-ISP projects be revised, so that TNSPs have the flexibility to adopt scenarios that reflect those variables that are most relevant for a particular RIT-T. The ISP scenarios are focused on wholesale market developments which are much less relevant for many non-ISP RIT-Ts (particularly those relating to reliability corrective action and repex). This requires a corresponding change to the updated RIT-T instrument.

Energy Networks Australia supports the draft Forecasting Best Practice guidelines and does not comment on these further in this submission.

2 CBA Guidelines – ISP component

2.1 Transparency is key to balancing flexibility for AEMO

Energy Networks Australia supports the balance the AER has achieved in the Draft CBA Guidelines between the flexibility accorded to AEMO in undertaking its ISP assessment and the prescription on consultation and transparency in relation to that assessment. This balance is consistent with the discretion provided to AEMO in the new Actionable ISP Rules, whilst facilitating effective stakeholder engagement on how that discretion is exercised.

Consultation and transparency around the inputs, assumptions and scenarios adopted in the ISP is particularly important given these will now form the basis of more streamlined RIT-T assessments for actionable ISP projects, as well as being adopted as the default for RIT-Ts for non-ISP projects.

Energy Networks Australia notes that there will be costs associated with the increased transparency and encourages AEMO to accommodate this through being mindful of its overall costs in preparing the ISP.

Energy Networks Australia is concerned that the new framework could become unworkable if AEMO's assumptions around the costs of ISP projects do not reflect TNSPs' expectations in relation to outturn costs, based on their experience with project implementation. Material differences in cost assumptions could cause projects to fail the AEMO feedback loop, leading to frequent ISP updates.

Energy Networks Australia supports the AER's proposed guidance that AEMO be required to check its cost estimates against recent contingent project outcomes.[1] However, it notes there is no CPA process for transmission investments in Victoria. Energy Networks Australia recommends the guidance in the CBA Guidelines should be broadened to incorporate AEMO also having regard to recent tender outcomes for Victoria, and final project outcomes (including variations).

Further, although Energy Networks Australia recognises the AER's inclusion of discretionary guidance that AEMO works with TNSPs and/or non-network proponents to identify and value costs as accurately as possible,[2] it considers this guidance should be made mandatory.

2.2 Actionable ISP projects that have an approved Contingent Project Application should be considered committed

Energy Networks Australia considers that there should be clearer guidance around when an actionable ISP project is considered committed.

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[1] Draft CBA Guidelines, p. 17.

[2] Draft CBA Guidelines, p. 18.

Currently the draft CBA Guidelines[3] point to the criteria for committed projects set out in the definition in the RIT-T instrument. These criteria are currently applied to determine when generation projects are considered committed, and many of them relate to completed planning and procurement actions (e.g. contracts for supply and execution of major components have been finalised and executed).

Energy Networks Australia notes that there is a practical issue in being able to effectively engage bidders for procurement contracts for large-scale ISP investments where there is continuing uncertainty as to whether the project is considered committed.

Energy Networks Australia proposes that an approved CPA determination by the AER should be sufficient to signal commitment. This appears consistent with the implied guidance in the draft CBA Guidelines that actionable ISP projects need not be re-tested by AEMO as part of the ISP once there is an approved CPA.[4]

Relatedly, Energy Networks Australia supports the discretion given to AEMO on whether to re-test whether an actionable ISP project that does not yet have an approved CPA remains consistent with the optimal development path.[5] There may be circumstances where a CPA is not yet approved, but where AEMO has a reasonable expectation that the project will proceed, with costs that are consistent with an earlier ISP assessment. In this case, there may be more relevant priorities for AEMO to focus on in the ISP assessment.

2.3 Treatment of funding by external parties

The draft CBA Guidelines draw a distinction between:

- funding from parties external to the NEM (e.g., governments) which should be subtracted from the investment cost for the ISP and RIT-T assessment; and
- funding from other NEM participants (wealth transfer) which should not be subtracted from the investment costs.

The Draft CBA Guidelines state that funding from external sources can only be deducted where it is considered 'committed.' Energy Networks Australia recommends that the AER provide further guidance on what it would consider to be sufficient evidence of commitment (e.g. whether a government announcement is sufficient or whether there needs to be committed funds).

The AER's proposed guidance is consistent with the existing RIT-T Application Guidelines. Energy Networks Australia continues to have concerns in relation to this guidance. As previously highlighted,[6] external funding (whether it is from a

[3] Draft CBA Guidelines, p. 14.

[4] Draft CBA Guidelines, p. 16.

[5] Draft CBA Guidelines, p. 16.

[6] Energy Networks Australia, *Draft Application Guidelines for the RITs – submission to the AER*, 7 September 2018, p. 19.

government, generator or any other party) will reduce the amount that customers have to pay for the investment through regulated charges. Drawing a distinction based on which party is providing the funding means some investments where the benefits customers receive outweigh the costs will not proceed. Energy Networks Australia therefore considers that funding provided by both parties external to the NEM and market participants should be subtracted from the investment costs used in the RIT-T.

This issue will become more prevalent as technology further develops, with some investments (such as storage devices) able to provide both network support and non-regulated services. The AER's approach will tilt the playing field towards non-network provision of these services (where only the contract costs will be included in the ISP and RIT-T CBA) and away from network provision (where the AER's guidance means that the whole cost must be included). This may result in higher costs to customers overall and appears inconsistent with the AER's objective of competitive neutrality.

Energy Networks Australia is also concerned that the AER's approach may end up being inconsistent with the REZ framework being developed by the Energy Security Board (ESB), in relation to the treatment of any generator contributions used to fund a portion of the transmission capacity for a REZ.

Energy Networks Australia encourages the AER to amend its guidance on the treatment of external funding so that funding from both external parties and market participants is subtracted from the RIT-T investment cost, to ensure that it remains robust to future technology and policy developments.

2.4 Other observations

Energy Networks Australia has the following comments in relation to other specific points in the draft CBA Guidelines:

- Energy Networks Australia supports the proposal for AEMO to present the results of a risk neutral decision-making approach, even where it decides to depart from this approach in identifying the optimal development path, as this provides a helpful point of reference:
  - Energy Networks Australia supports the requirement for AEMO to identify the additional costs associated with adopting a risk averse development path and justifying how this reflects customers' risk priorities (rather than AEMO's risk priorities), and the requirement for AEMO to identify distributional impacts.
  - Energy Networks Australia notes that whilst identification of distributional impacts on consumers is appropriate and relevant for the strategic NEM-wide focus of the ISP, it would not be appropriate to also require this analysis for each subsequent RIT-T assessment.
- Energy Networks Australia supports the discretion provided in the guidelines for AEMO to determine the appropriate approach to quantifying benefits (e.g. for High Impact Low Probability (HILP) events), and the requirement for AEMO to present the breakdown of each class of market benefits in the ISP;

- The draft CBA Guidelines[7] set out requirements on AEMO in responding to non-network options (NNO) which do not meet the identified need. Where AEMO's reasoning is related to risk or uncertainty, this includes providing an assessment of the risk, including the cause, the likelihood of the risk eventuating, the nature and magnitude of the impact, and a comparison of the non-network option cost with the ISP candidate option cost:
  - Whilst recognising the AER's desire to increase transparency in relation to the consideration of NNOs, Energy Networks Australia considers that the proposed requirement would impose material costs.
  - Energy Networks Australia recommends that this guidance is either removed in the final guidelines, or made discretionary rather than being a requirement.
- The draft CBA Guidelines require VCRs to be taken from the AER's most recent VCRs for unplanned electricity outages in the NEM.[8]
  - Energy Networks Australia recommends that this guidance be expanded to also explicitly refer to the Wide Area Long Duration Outage (WALDO) VCR estimates and methodology being developed by the AER, as a subset of the AER's VCR estimates.

[7] Draft CBA Guidelines, p. 43.

[8] Draft CBA Guidelines, p. 10.

3 CBA Guidelines (RIT-T component)

3.1 Interaction between the ISP and RIT-T assessments

The draft CBA Guidelines aim to reduce the need for extensive analysis at the RIT-T stage. [9] The AER is concerned with both regulatory process costs and delays in progressing investments.

Energy Networks Australia recognises that the new actionable ISP framework is intended to enable the investment planning process to operate more efficiently end-to-end, so that investments can proceed in a timely manner.

The AER's draft CBA Guidelines further streamline the RIT-T assessment, tying it more closely to the ISP assumptions and scenarios, in a way that is likely to reduce the extent of the analysis required at the RIT-T stage for many investments.

Energy Networks Australia supports the approach in the draft CBA Guidelines, although notes that there may be some RIT-Ts (for example, where new non-network options are evaluated and/or additional project staging identified) where the RIT-T assessment may continue to be substantive, in order to ensure the identification of the preferred option is robust, and which will therefore impact the timeframe required and increase process costs.

Similarly, the discretion for the TNSP to adopt alternative assumptions where there has been a material change in circumstance remains important in ensuring the robustness of the outcome.

Energy Networks Australia supports the AER's proposed approach to achieve alignment between the ISP and RIT-T assessments, through allowing AEMO to reflect its approach in selecting the optimal development path by specifying the identified need and scenarios to be adopted in the RIT-T. Energy Networks Australia considers this is likely to be effective in achieving alignment.

Energy Networks Australia urges AEMO to reflect this approach in its final 2020 ISP as far as possible for actionable ISP projects to which the new CBA Guidelines will apply. Without this, there remains a risk of non-alignment for any actionable ISP projects identified in the final 2020 ISP where the RIT-T has not already commenced (and a Project Assessment Draft Report published), which may delay investment and increase regulatory process costs.[10]

Energy Networks Australia supports the inclusion of all other ISP projects in the optimal development path in the base case for the RIT-T assessment, apart from the project being assessed (i.e., the 'take one out at a time' approach).[11] It would be helpful for the CBA Guidelines to provide an example of how this would be applied where the actionable ISP project is the first stage of a staged project (see section 3.3 below).

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[9] AER, *Fact Sheet – Providing Guidance about Integrated System Plan Processes*, 15 May 2020, p.2.

[10] Energy Networks Australia understands from the AER's comments at its webinar that where the 2020 ISP does not specify the scenarios to be adopted for an actionable ISP project to which the new CBA Guidelines apply that the TNSP will continue to determine the appropriate scenarios as currently.

[11] Draft CBA Guidelines, p. 61.

Consistent with the aim of streamlining the RIT-T assessment, the CBA Guidelines should not lead to an expectation that the RIT-T will explore sensitivities that are more appropriately reflected in the ISP (e.g. early asset retirements, HILP events[12]). An expectation of widely cast sensitivity analysis could re-introduce the need for material market-modelling analysis as part of the RIT-T, counter to the aim of restricting the scenarios considered at the RIT-T stage. The focus should instead be on sensitivities which more closely relate to the analysis being undertaken at the RIT-T stage, e.g. capital costs and discount rates.

The requirement for sensitivity analysis needs to be proportionate and to build on the ISP assessment (and modelling that can be accessed from AEMO). Energy Networks Australia recommends that the final CBA Guidelines reflect this principle.

In addition, the draft Guidelines require the TNSPs to have regard to any relevant risks identified in stakeholder submissions in conducting sensitivity analysis. Although Energy Networks Australia recognises the importance of being responsive to stakeholder submissions, where risks have been considered (or raised as part of stakeholder consultation) as part of the ISP, it considers it would be duplicative to consider them further as part of a RIT-T sensitivity.

In addition, where TNSPs are exempt from drafting a Project Assessment Draft Report for an ISP identified need which addresses reliability corrective action,[13] Energy Networks Australia suggests that a TNSP be released from its obligation to engage with consumers and other stakeholders and address any relevant concerns in the Project Assessment Conclusions Report.[14] Release from this obligation seems appropriate given this engagement has already occurred as part of the Draft ISP consultation process and there is not an opportunity to engage or to receive submissions once the Project Assessment Conclusions Report has been published under the RIT-T process.

3.2 Application of the RIT-T to Renewable Energy Zones

Energy Networks Australia strongly supports the AER's confirmation in its draft CBA Guidelines that a TNSP can adopt the ISP's generation modelling outcomes for the RIT-T assessment of actionable ISP projects relating to REZ developments. Energy Networks Australia would also support confirmation in the RIT-T Application Guidelines that TNSPs can adopt the ISP's generation modelling outcomes for non - ISP RIT-T assessments.

This approach addresses one of the barriers to application of the RIT-T to proposed REZs, as it provides a clear approach to how the inevitable uncertainty in relation to the extent of future generation development is to be addressed.

Energy Networks Australia notes that there remain other barriers to the development of REZs, which are being considered as part of the current ESB consultation process on REZ development models.

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[12] See draft CBA Guidelines p. 64.

[13] NER 5.16A.4(n) and Draft CBA Guidelines, p. 68. Note that the reference in the draft CBA Guidelines to NER 5.16A.4(m) appears incorrect.

[14] Draft CBA Guidelines, p. 66.

3.3 Greater clarity required on staged ISP and staged RIT-T projects and the interaction with contingent project applications

Energy Networks Australia supports the AER's intent to allow consideration of project staging as part of the RIT-T assessment, even where the ISP has identified a single stage candidate actionable ISP option.

Energy Networks Australia encourages the AER to provide greater clarity in the CBA Guidelines and worked examples in relation to how staged ISP projects and staged RIT-T projects are envisaged to work, and the interaction with AEMO's feedback loop for CPAs. This is a new area of the actionable ISP framework that was not subject to material consultation as part of the ESB's development of the actionable ISP Rules.

The CBA Guidelines could add material value through illustrating the AER's expectations around how this new aspect of the planning framework will operate, which will help inform stakeholder's understanding of the AER's intended compliance approach around these new provisions.

Energy Networks Australia has provided two worked examples for the AER's consideration, relating to:

- a single actionable ISP project (with no staging) leading to a single RIT-T that identifies a preferred project with two stages; and
- a staged ISP project with the TNSP required to apply the RIT-T to the first stage only.

Energy Networks Australia considers that each of these cases would benefit from greater clarity in the final CBA Guidelines.

Single actionable ISP project, staged RIT-T project

In relation to a single actionable ISP project (with no staging) leading to a single RIT-T that identifies a preferred project with two stages, Energy Networks Australia has set out below its understanding of how the CBA assessment would be applied.

It would be helpful if the AER confirmed whether this understanding is correct (preferably through inclusion of a worked example) and also provided illustrative circumstances of when the RIT-T would not need to be re-applied for a subsequent project stage.

Example 1: A single actionable ISP project (with no staging) leading to a single RIT-T that identifies a preferred project with two stages

- Suppose AEMO identifies an actionable ISP project without any staging but directs the TNSP to apply a RIT-T that considers potential project staging.
- The identified need expressed by AEMO is that the project must:

  meet future demand in the region in a high demand growth scenario (reflecting future spot loads), taking into account the uncertainty that such high demand will eventuate.

- The TNSP considers staging in the RIT-T and identifies the preferred option to be:
  - a 132 kV double circuit transmission line; with
  - one line connected in stage 1; and
  - the second line connected in stage 2 following confirmation of additional spot load of 200 MW (i.e., the decision rule for stage 2).
- The TNSP seeks confirmation via the AEMO feedback loop that this staged option (including the decision rule) is consistent with the optimal development path. AEMO provides this confirmation.
- The TNSP submits a Contingent Project Application to the AER for stage 1 of the project, which is approved. The TNSP proceeds to invest in stage 1.
- AEMO's subsequent ISP includes stage 2 of the project in the optimal development path, as the decision rule is expected to be met in the following 2 years:
  - Stage 2 is not reflected in the ISP counterfactual development path as there is no approved contingent project application for this second stage and it is not a committed project;
  - Stage 2 is not identified as an actionable ISP project in this subsequent ISP (as it was already identified as part of an actionable ISP project in a previous ISP);
  - the ISP does include the identified need for stage 2 of the project;[15]
  - the timing of the project reflects the decision rule in the earlier RIT-T; and
  - the costs of the project are updated to reflect AEMO's latest cost estimates.
- The TNSP does not have to re-apply the RIT-T for this actionable ISP project, given the earlier RIT-T.[16]
- The following year the decision rule for stage 2 is reached. However, the TNSP's estimated costs of stage 2 have increased since the original RIT-T.
- The TNSP initiates the AEMO feedback loop for stage 2 of the project to confirm that:
  - the proposed stage 2 option is the same option that is reflected in the latest ISP;

[15] NER 5.16A.5(b)(1) requires that as part of the actionable ISP project trigger, AEMO must confirm that the preferred option addresses the relevant identified need in the most recent ISP.

[16] The initial RIT-T covering both stages of the project is sufficient to satisfy 5.16A.5 for an automatic contingent project application for the second stage.

- the increase in costs for stage 2 is consistent with AEMO's assessment of stage 2 costs in the latest ISP or, if it is higher, that does not change the status of the option as part of the latest ISP optimal development path. The feedback loop in effect confirms that there has been no 'material change in circumstance' that requires the RIT-T to be re-applied.

- The TNSP submits a second contingent project application to the AER covering stage 2 of the project.

Staged ISP project with only the first stage identified as an actionable ISP project

The identification of a staged ISP project and the application of the RIT-T to a single stage of the project only, raises some more complex issues which would benefit from clarification.

Energy Networks Australia understands from the draft CBA Guidelines that the options considered in the RIT-T in this circumstance would only relate to the specific stage of the ISP option (where that has been defined as an actionable ISP project), and would not include consideration of future stages of that ISP project. The challenge then becomes framing the RIT-T assessment in a way that enables that first stage to be shown to provide a positive net market benefit (consistent with AEMO's assessment in the ISP).

One issue for clarification is whether subsequent stages of the ISP project should be treated in the base case for the RIT-T, where their scope or timing is affected by the first stage.

Energy Networks Australia recommends that the RIT-T base case should include the expected timing and nature of subsequent project stages (which are 'modelled projects') on the assumption that the first project stage is not undertaken. For example, in the case of a staged ISP project in which the first stage reflects early works that would enable the remainder of the project to be completed more quickly, the assumption made in the base case could be that in the absence of the early works stage the entire ISP project would be completed two years later. As far as possible, TNSPs would draw on the ISP assessment to identify the appropriate assumptions to adopt in the base case.

In directing the TNSP to conduct a RIT-T on a single stage of an ISP project, it will also be important for AEMO to consider which scenarios are relevant for the RIT-T. Where an ISP project is staged in order to provide future flexibility where circumstances develop such that the project becomes required, and to avoid incurring further costs in other circumstances, then AEMO's ISP assessment will already have taken into account option value. In order to avoid duplication of this assessment, it may be appropriate for AEMO to direct the TNSP to only consider the ISP scenario in which the full ISP project is eventually required, so that the benefits of being able to bring forward the project through undertaking the stage 1 early works are captured in the RIT-T assessment (with the project stage having a positive net market benefit).

Example 2 below is provided for the AER's consideration.

Example 2: A staged ISP project with the TNSP required to apply the RIT-T to the first stage only (early works)

- A proposed interconnector has been identified as a staged ISP project in the latest ISP:
  - The first stage covers early works: this is identified as an actionable ISP project for which the TNSP must complete a PADR in the next two years. AEMO directs the TNSP to conduct this RIT-T under the ISP step-change scenario.
  - The second stage covers the full implementation of the project: this is identified as a future ISP project. The early works stage will reduce the build time for the overall project from a total of five years to a total of three years. The second stage is expected to form part of the optimal development path if NEM development reflects the ISP step-change scenario, but not under other ISP scenarios.
- The TNSP completes a RIT-T covering the stage 1 early works actionable ISP project only.
  - The RIT-T does not include stage 2 (full implementation) of the ISP project as part of any of the credible options assessed, as this is not yet identified as an actionable ISP project. The decision rule as to when to build the full project is complex and multi-variate and so AEMO has determined that it needs to be considered as part of a future ISP and identified as an actionable ISP project at this time.
- In the stage 1 early works RIT-T, the TNSP compares:
  - one credible option related to the detailed planning and procurement of major equipment (since there are no realistic project variants for these early works); against
  - the base case.
    - The base case includes all other actionable ISP projects and modelled future ISP projects (as relevant for the step-change scenario).
    - Given the linkage between the early works stage and full project implementation (a future ISP project), the timing of full project implementation assumed in the base case occurs two years later than the assumed date if the stage 1 early works are not undertaken, and the scope and cost reflect those of undertaking the project in a single stage only.
  - The RIT-T only considers a single scenario (the ISP step-change scenario):
    - Under this scenario, where the stage 1 project is undertaken, its impact on the 'state of the world' is to bring forward the timing of stage 2 (full implementation) by two years, with a consequent impact on NEM investment and dispatch outcomes.
- The RIT-T assessment demonstrates a positive net market benefit for undertaking stage 1:
  - The ISP assessment has already found that the full interconnector project has benefits under the ISP step-change scenario, and has also identified option value from undertaking the stage 1 early works to enable the full

interconnector to be completed more quickly where the step-change scenario eventuates;

  - The RIT-T assessment would assess the net market benefit of the early works stage (which would include the costs and benefits of bringing the full implementation project forward by two years) against the base case in which full implementation occurs two years later.

- Following the completion of the RIT-T the TNSP applies for contingent project approval for the early works project:
  - The TNSP requests confirmation from AEMO under the feedback loop that the preferred early works option (as identified in the RIT-T) is consistent with the optimal development path;
  - AEMO provides that confirmation.
  - The TNSP submits a contingent project application to the AER for the early works stage only. The AER approves the application and the TNSP then proceeds with the stage 1 early works.
- The TNSP is not able to proceed with the stage 2 full implementation of the ISP project (or to seek further contingent project funding) until AEMO identifies the full implementation of the project as an actionable ISP project in a subsequent ISP:
  - If and when this occurs the TNSP applies a new RIT-T to the full implementation of the project and seeks AEMO feedback loop confirmation regarding the preferred RIT-T option prior to lodging a new contingent project application with the AER.

3.4 AEMO feedback loop

The AER notes in its Explanatory Statement[17] that the guidance on the feedback loop applied by AEMO prior to a TNSP's CPA is intended to ensure:

- transparency, by AEMO publishing written confirmation to the RIT-T proponent;
- that the preferred option from the RIT-T is tested under the same decision-making approach as used in the most recent ISP; and
- a balanced trade-off between precision and materiality.

In performing the feedback loop, the draft CBA Guidelines require that AEMO consider:[18]

- replacing the ISP candidate option with the RIT-T preferred option;
- re-running the CBA model and scenario analysis, if practicable, to test whether the optimal development path remains positive in the most likely scenario and is

[17] AER Explanatory Statement, p. 41

[18] AER Draft CBA Guidelines, p. 46.

still optimal under the same decision-making approach (or that any difference is immaterial);

- conducting more intensive modelling and scenario analysis the greater the cost difference between the RIT-T option and ISP candidate option;
- the costs of changing the optimal development path to accommodate the preferred RIT-T option, where the difference between the preferred RIT-T option and the ISP candidate option is small.

Energy Networks Australia considers there would be value in refining the guidance provided to AEMO in relation to the feedback loop.

Energy Networks Australia does not support the need to conduct 'more intensive modelling and scenario analysis' the greater the cost difference between the RIT-T option and the ISP candidate option. The assumptions and scenarios considered in the ISP should be broad enough to reflect the reasonable range of differences in outcomes, and so should not need to be re-evaluated at the feedback loop stage. Further, AEMO's selection of the optimal development path may not draw on a wide range of scenarios and the feedback loop should not extend to become a re-evaluation of AEMO's ISP decision on the optimal development path but, as highlighted by the AER, should reflect a re-application of the same decision-making approach.

Energy Networks Australia recognises the AER's concerns around potential increases in costs at the CPA stage compared to the ISP. However this is more appropriately addressed by requiring AEMO to base the ISP cost estimates on information provided by the TNSPs, and then consideration by AEMO of whether any material change in costs reflects a material change in circumstances that requires an ISP update.

Energy Networks Australia also questions the guidance on AEMO considering the costs of changing the optimal development path to accommodate the preferred RIT-T option. Energy Networks Australia understands that this is intended to capture the practicality of changing course on the optimal development path, where planning activities and investments are already well advanced. Energy Networks Australia considers it important that any assessment of the costs of changing the optimal development path focus on incremental forward-looking costs (since any costs already incurred are sunk). However, coupled with this Energy Networks Australia also re-emphasises its concern (raised during the consultation on the actionable ISP Rules) that there needs to be adequate cost recovery provisions for TNSPs who have undertaken planning processes as a consequence of the ISP and where there is a subsequent change in the optimal development path.

Finally, Energy Networks Australia considers that the CBA Guidelines could helpfully note that the AEMO feedback loop is not intended to assess the technical characteristics of the preferred option, which is considered by the TNSP as part of the RIT-T evaluation.

3.5 Other observations

In relation to other specific points in the draft CBA Guidelines:

- Energy Networks Australia seeks confirmation that the RIT-T compliance report can be issued as a table (and potentially included as an appendix to the Project Assessment Conclusions Report), and that there is no expectation that the compliance report will be formally approved by the AER prior to the TNSP starting the CPA process.
- The draft CBA Guidelines require TNSPs to adopt the same discount rate as used in the Inputs, Assumptions and Scenarios Report (IASR) or ISP update.[19] If there has been a more recent AER electricity transmission regulatory determination, Energy Networks Australia recommends that TNSPs should instead be required to adopt this value as the lower bound regulated discount rate, as reflecting the most up-to-date estimate.
- The draft CBA Guidelines suggest a change to the calculation of terminal value. Specifically, the draft Guidelines require O&M costs to be incorporated in the calculation of terminal value where the modelling period is shorter than the life of the credible option.[20]
  - This is a new requirement which is not discussed in the Explanatory Statement and has not also been proposed in the discussion of costs for the ISP assessment or the updated Application Guidelines for non-ISP RIT-Ts.
  - This proposal appears to reflect a misunderstanding of the role of terminal values, which is essentially a means of apportioning capital costs between the assessment period and the remaining period of the asset's life.
  - Energy Networks Australia strongly recommends this guidance is removed.
- Energy Networks Australia seeks confirmation that although the CBA Guidelines will not apply to current actionable ISP projects that have completed a PADR, the automatic feedback loop CPA provisions in the Rules can still be accessed by TNSPs for these projects (consistent with the transitional provisions in the ISP Rules).

[19] Draft CBA Guidelines, p. 56.

[20] Draft CBA Guidelines, p. 57.

4 RIT-T application guidelines (non-ISP projects)

The AER's proposed changes to the RIT-T guidelines for non-ISP projects increase the expectation that the RIT-T will generally adopt the ISP inputs and scenarios.[21]

The proposed changes to the RIT-T Instrument require the RIT–T proponent to adopt the ISP scenarios in the most recent input, assumptions and scenarios report unless it provides demonstrable reasons for why adding, omitting or varying these scenarios is necessary.[22]

Energy Networks Australia notes that for where market benefits are unlikely to impact the outcome of the RIT-T, the ISP scenarios will have little or no relevance. This is particularly the case where the options being considered will have no impact on the wholesale market, which is the case for many repex RIT-Ts (such as the replacement of substations or secondary systems) and may also be the case for reliability corrective action repex RIT-Ts.

Repex RIT-Ts generally adopt scenarios focused on those parameters that will materially affect the RIT-T outcome, such as assumed VCRs, capital costs and the discount rate.[23]

Energy Networks Australia notes that there will be some non-ISP RIT-Ts where there is a material impact on the wholesale market, which does have a material impact on the outcome of the RIT-T assessment (for example, the replacement of assets along a major transmission flow path). However, this will not be the case for all non-ISP RIT-Ts.

Energy Networks Australia recommends the AER's guidance be clarified to only require ISP scenarios to be used for non-ISP RIT-Ts where wholesale market outcomes are material to the outcome of the RIT-T, and where the market modelling is not disproportionate to the investment. This will also require a consequent change to the RIT-T instrument itself.

Similarly, the RIT-T Application guidelines for non-ISP projects should not require TNSPs to take into account factors such as electricity pricing reforms, and policies relating to features of the NEM, in cases where they have no relevance for the RIT-T outcome.

Energy Networks Australia also notes the reference to the continuing role for the AER is the assessment of non-ISP RIT-Ts as part of CPA triggers (despite the removal of the NER 5.16.6 provision).[24] This is at odds with Energy Networks Australia's understanding of the ESB's intent when it consulted on the removal of NER 5.16.6, and risks continuing to incur regulatory process costs and extending the timeframes for

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[21] AER – Draft RIT-T Application Guidelines, p. 40-41.

[22] AER, Draft RIT–T, May 2020, subparagraph 20(b) and paragraphs 21–23

[23] See for example Powerlink *PSCR Addressing the secondary systems condition risks at Cairns*, 5 May 2020, https://www.powerlink.com.au/sites/default/files/2020-05/Project%20Specification%20Consultation%20Report%20-%20Addressing%20the%20secondary%20systems%20condition%20risks%20at%20Cairns.pdf.

[24] AER - Draft RIT-T Application Guidelines, p. 74-75.

non-ISP RIT-Ts. Energy Networks Australia encourages the AER to review whether this guidance remains necessary.