

REVIEW OF CBA AND RIT-T GUIDELINES

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INTRODUCTION

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade. Our membership covers most of the major gas users in the east coast gas market who all rely on reliable and competitively priced gas for their business sustainability.

BACKGROUND

The EUAA was one of the proponents of the Material Change in Network Infrastructure Costs rule change. While our proposal covered both transmission and distribution projects, our focus was on large transmission projects, particularly ISP projects. Our original proposal in January 2021 highlighted the significant increase in ISP project costs over the course of the RIT-T process and leading up to the contingent project application¹. All the evidence since then has only reinforced this.

This cost escalation, plus the rules saying it was the project proponent that determines whether a material change had occurred, meant that consumers had no confidence that the project met the net benefits test. We simply did not trust project proponents to undertake the assessment of material change in a transparent way given there is a huge information asymmetry between the proponent and consumers. It was no surprise to us that there had never been a material change despite the observed increases in project capital cost. Proponents have no incentive to do so given the potential requirement to reconsider and publish a revised PACR.

The final AEMC decision involved a number of changes to the CBA Guidelines and RIT process depending on whether the project had a cost of >\$100m. However, given:

- the transitional arrangements mean the re-opening triggers do not apply to projects that have published a Project Assessment Draft Report (PADR) or Draft Project Assessment Report (DPAR) by the commencement date (9th October 2023), and

¹ <https://www.aemc.gov.au/sites/default/files/2021-02/ERC0325%20Rule%20change%20request%20pending%2015Feb2021.pdf>

- the actual and expected derogations from national rules in NSW Roadmap, the Queensland Energy and Jobs plan and the Victorian Government’s future role for Vic Grid.

we wonder how many projects, especially large projects >\$100m the new rules would apply to. In our submission on the Commissions Draft Decision, we concluded that²:

“Given the recent trend of State Governments derogating away from the national rules, there is a high chance that the only future ISP project that could be covered by the new rules is ‘QNI major’ and only the Queensland portion. That project is not due to be commissioned until 2032-33.”

If we are correct, then we wonder about the value of this consultation process for a change in the Guidelines that will not have any significant impact for another decade and when they do the number of large projects impacted will be very small. Given the current situation of significant changes to the regulatory framework happening frequently, we wonder about the consumer benefit of this consultation. We would recommend the AER provide clarity around which ISP projects the new guidelines will apply to help consumers decide whether to continue their involvement in this review.

As we await this clarity, we offer the following comments on the questions asked with a particular focus on large transmission projects.

RESPONSES TO SPECIFIC QUESTIONS

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?

The original rule change proposed that the AER would assess whether a material change has occurred. This was because consumers had no trust in the project proponent undertaking that process in a transparent way. In our submission on the Commission’s Draft Decision, we argued that the introduction of triggers³:

“...from a good governance perspective, would have no practical impact on providing additional incentives to determine and report a material change. This is because the proponent:

- effectively controls the selection and application of the triggers e.g. while the proponent will engage with stakeholders, it is the proponents call without any dispute rights for stakeholders
- controls the CBA model and the methodology on what costs and benefits are included and how they are calculated, and
- controls what level of engagement it does with consumers on the CBA methodology.”

² See pp 5-6 <https://www.aemc.gov.au/sites/default/files/2022-09/Shell%20Energy%20EUAA%20MEU%20Inc.%20AGL%20Delta%20Electricity%20Joint%20submission%20.pdf>

³ See pp 9-10 <https://www.aemc.gov.au/sites/default/files/2022-09/Shell%20Energy%20EUAA%20MEU%20Inc.%20AGL%20Delta%20Electricity%20Joint%20submission%20.pdf>

Given we do have the triggers, we do not agree with the proposed non-prescriptive approach. Our view is that the only way for triggers to have any consumer benefit is for the approach to be prescriptive. We do not accept the AER's arguments that a non-prescriptive approach would encourage transparency, lead to robust analysis and effective engagement with stakeholders.

To support this view, we offer the EUAA's 'lived experience' on the PEC and Humelink projects and draw on our submissions in the course of the AEMC considering our rule change proposal.

Electranet and Project Energy Connect Material Change

We argued that had the final CPA approved capex of \$2.3b been used in the AER 5.16.6 review, the project would not have met the rules requirement for net benefits. We commented in our initial submission⁴

"Given it was then up to Transgrid and Electranet to decide if there was a 'material change' under the rules (Clause 5.16.4(z3)), stakeholders had no opportunity to properly question their decision. All we could see was continually rising costs and the networks claiming continually rising and untested benefits so that the project always demonstrated net benefits."

In March 2021 Electranet published "PEC Review of economic assessment" reviewing the likely impact on the project of various changes in policies and assumptions⁵. This very high level 13-page report concluded that these changes had a positive \$140-\$290m impact on net benefits. Yet there was no way for consumers to independently assess the veracity of that report given (i) the RIT-T process had ended, (ii) Clause 5.16.6 had been removed from the rules for ISP projects and (iii) the huge information asymmetry between the network with its proprietary modelling and consumers.

Transgrid and Humelink

We are a long-term member of both the Transgrid Advisory Council (TAC) and its sub-committee – the Energy Transition Working Group (ETWG) - specifically set up to discuss projects like Humelink.

The role of competition benefits in the Humelink RIT-T

In our submission on the Draft Decision on our rule change we discussed Transgrid's approach on whether to include competition benefits in the RIT-T⁶:

- competition benefits were not included in the PADR published in January 2020⁷
- the PACR, published in July 2022, had an estimated capex of \$3.32b for the preferred option which it is reasonable to expect may have 'triggered' the capex trigger set as part of the PADR

⁴ See p. 6

https://www.aemc.gov.au/sites/default/files/documents/erc0325_sub_from_euaa_meu_agl_delta_shell_300921.docx.pdf

⁵ <https://www.electranet.com.au/wp-content/uploads/projects/2016/11/PEC-Review-of-economic-assessment-Final-31-Mar-2021.pdf>

⁶ See pp 10-12

⁷ See p. 18 <https://www.transgrid.com.au/media/xrzd0jv4/transgrid-hume-link-padr-amended.pdf>

- as part of the PACR, without consultation with stakeholders, the proponent assessed competition benefits after all. The significant increase in capex from PADR to PACR meant that the preferred Option 3C just exceeded the net market benefits line when competition benefits were excluded. Without competition benefits the preferred Option 3C would have only had net benefits of \$39m in a project cost of \$3.32b which itself was a (self-assessed) AACE Class 4 estimate that could increase by 50%⁸. A 1% increase capex wipes out the net benefits excluding competition benefits. A 15% increase in capex wipes our net benefits including competition benefits. Capex increased 146% from PADR to PACR.

PV, \$millions	Option 1C- new	Option 2C	Option 3C
Total net benefits, with competition benefits	335	399	491
Total net benefits, without competition benefits	(11)	(44)	39
Gross benefits	1,778	2,174	2,196
Competition benefits	346	443	451

- On these numbers Transgrid could decide that there is no material change and under the Draft, Transgrid would not be required to say anything to the AER on material change. Yet the inclusion of competition benefits was not discussed to any meaningful degree (or at all) with the TAC or ETWG.
- While Transgrid was working with its advisor, EY, to develop the methodology for calculating competition benefits, AEMO was undertaking consultation on its 2022 ISP Methodology. This included consideration of whether competition benefits should be included in the analysis. Transgrid made no submissions on the issue over the 8 months consultation period leading up to the publication of the final methodology paper in August 2021.
- AEMO’s conclusion was to not include competition benefits in the ISP because they are too difficult to measure.
- Yet Transgrid is able to develop its own methodology, not consult on it and use it to decide whether it has any obligation to inform the AER of a material change. The AER noted in its decision on Humelink early works⁹:

“We acknowledge that it would have been good practice for Transgrid to consult on competition benefits given these benefits were not included in the PADR, notwithstanding no disputes were raised on this matter. Though, we also acknowledge submissions that some stakeholders may not have been aware of the dispute resolution aspects of the process in the NER. While RIT-T proponents are not obligated to outline the dispute resolution process in the PACR, we consider it would be good regulatory practice for RIT-T proponents to notify stakeholders of the dispute resolution process in the PACR”

- We do not consider the dispute resolution clause in the NER is a suitable method of forcing a proponent to do proper stakeholder engagement in major transmission projects when it should be doing that in the normal course of best practice stakeholder engagement.

Application for early works expenditure

Our submission to the AER on Transgrid’s application¹⁰ argued that Transgrid did not fulfil the AER’s expectations for consumer consultation with the TAC (a “key stakeholder(s) that (is) interested in and can influence the project”)

⁸ See p.3 <https://www.aer.gov.au/system/files/EUAA%20HumeLink%20Stage%201%20CPA%20General%20Questions.pdf>

⁹ See p. 8 <https://www.aer.gov.au/system/files/AER%20-%20Determination%20-%20HumeLink%20-%20August%202022.pdf>

¹⁰ https://www.aer.gov.au/system/files/EUAA%20HumeLink%20CPA%20submission_0.pdf

under Section 2.2 of the AER Guideline prior to making its CPA submission to the AER. In discussions with the AER on their final decision to approve the funding at a level very close to Transgrid’s application, we were effectively told that while the AER agrees with our conclusion, the poor consultation would not lead to either a requirement on Transgrid to do more consultation or a reduction in the funds approved because that would delay the building of a project the ISP said was necessary.

The AER is confident that there proposed approach to non-prescriptive rules:

“places an appropriate and high onus on the transparency of proponent assumptions and decision rules.”

but only make a qualitative judgement without providing any specific examples of where this approach has worked.

The Commissions and AER’s approach seem to be based on a judgement that increases in due diligence to give consumers comfort that projects do in fact meet the net benefits test it seen to be not in consumers interests because it may delay the build of the required network and generation that would be a greater cost to consumers. We should simply accept the lack of rigor that would come from more prescriptive rules. We did not accept this argument in the rule change process and we do not accept it in this update of the Guidelines. Social licence and supply chain issues are driving project timetable, not the role pf prescriptive guidelines. Increased due diligence can proceed in parallel with social licence engagement.

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?

Yes, we do support a consistent cost estimation classification system and that the system be the AACE classification. We proposed using the AACE classification in our original rule change proposal¹¹. This classification is internationally accepted and AEMO and networks have increasingly referred to it in their recent capex estimates for the ISP and individual projects.

We consider it should be a binding obligation. The simple reason for this is that the recent application of the AACE classification has been subject to individual proponent self-assessment that means it is inconsistently applied. Consumers are supposed to get some level of comfort when they read AEMO or a project proponent presents a cost with reference to a particular AACE level cost. However, all we see is confusion, if not a deliberate attempt to obfuscate. Two examples:

AEMO ISP

AEMO’s application of the AACE classification began with the 2022 ISP Transmission Cost Database and has extended in the 2024 ISP with the recently published draft Transmission Expansion Options Report (TOER)¹².

¹¹ See p.9 <https://www.aemc.gov.au/sites/default/files/2021-02/ERC0325%20Rule%20change%20request%20pending%2015Feb2021.pdf>

¹² https://aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2023/2023-teor/draft-2023-transmission-expansion-options-report.pdf?la=en

The following comments draw on the submission by the ISP Consumer Panel on the TOER methodology¹³.

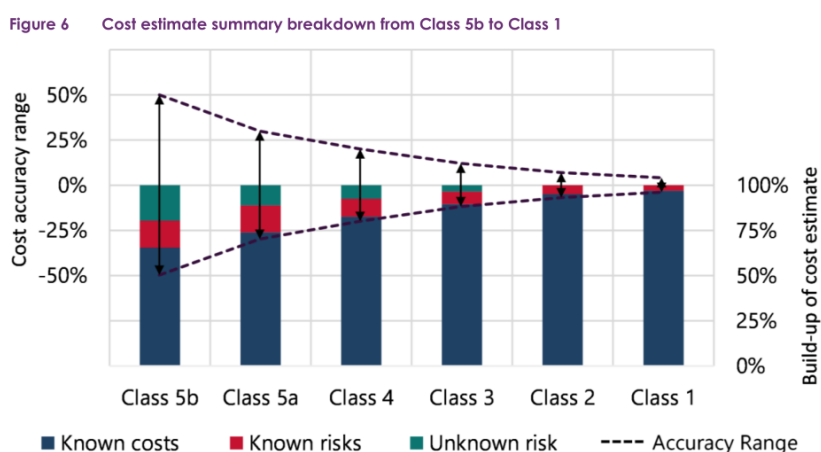
The table shows the AACE expected accuracy band¹⁴ for transmission projects has a decreasing accuracy range as the cost class moves from 5 to 1 that is explicitly non-symmetrical simply because history suggests there is a greater risk of a cost increase than a cost decrease.

Estimate Class	Expected Accuracy Range (Typical variation in low and high ranges at an 80% confidence interval)
Class 5	-50% to +100%
Class 4	-30% to +50%
Class 3	-20% to +30%
Class 2	-15% to + 20%
Class 1	-10% to + 15%

The ACCE guidance note says this (p.7):

“Depending on the technical complexity of the project, the availability of appropriate reference information, the degree of project definition and the inclusion of appropriate contingency determination, a typical Class 5 estimate for an electrical transmission substation facilities project may have an accuracy range as broad as -50% to +100% or as narrow as -20% to +30%. However, note that this is dependent upon the contingency included in the estimate appropriately quantifying the uncertainty and risks associated with the costs estimate. Research for power transmission projects has shown that industry has greatly underestimated risks and contingency for Class 5 and 4 estimates. Environmental and political risk are increasing and that becomes a particular concern when regulators require reporting of maximum costs or similar dictates to accuracy.”

AEMO has amended the AACE classification in two important ways: the accuracy band is narrower, and it is symmetrical.



¹³ See the analysis of the AEMO approach in the ISP Consumer Panel submission to the 2024 ISP Transmission Expansion Options Report <https://aemo.com.au/consultations/current-and-closed-consultations/2023-transmission-expansion-options-report-consultation>

¹⁴ See p. 7 https://web.aacei.org/docs/default-source/toc/toc_96r-18.pdf

The TEOR provides this justification for the different approach (p.25):

“The AACE International methodology typically contains accuracy bands which are skewed to the positive side, reflecting higher likelihood of cost increases than decreases as the estimate progresses. The Transmission Cost Database has been designed to include an average allowance for unknown risks which offsets the adjusted building block estimate, such that the ‘total expected cost’ resulting from the Transmission Cost Database can be used as the mid-point of a symmetrical accuracy band for ISP modelling purposes.”

The basis for these changes was advice from GHD in May 2021¹⁵. This recommended that AEMO apply a 30% risk factor for ‘unknown risks’ (for class 5b estimates) and 15% risk factor (for class 5a estimates) to derive the narrower symmetrical accuracy bands. The accuracy bands were derived statistically, yet the available data to do the statistical analysis on is almost non-existent in Q1, 2021 and do not include the surge in costs due to supply chain and social licences issues that have emerged since then. GHD acknowledges the problems with their database¹⁶:

“It is noted that the improving accuracy range as the cost estimate matures have been formed based on linear extrapolation of recent NEM projects early stage cost estimate accuracy range and the AACE RP 96R-18 optimistic accuracy range for more advanced stage cost estimate (as shown in Figure 9). We note that this representation of improving accuracy range is mostly academic and based on observation of recent NEM projects as their cost estimates matured. Given the lack of major transmission augmentation project works in the NEM in recent history and thus the absence of empirical actual cost information allowing the estimate vs actual cost analysis (with benefit of hindsight), further conclusive insight into the improving accuracy range is unavailable. As such the data in the following table should be viewed in this context. “

There is no empirical basis for the accuracy bands in any of the AACE cost classes used by AEMO.

Transgrid

Transgrid make the following statement in their Humelink PACR¹⁷:

“We consider our cost estimates to be ‘class 4’ estimates, which is in-line with the level of accuracy expected at this stage of the investment process. For example, AEMO commented during the consultation process on its transmission cost database that the cost certainty at the PACR stage is typically between -30 per cent and +50 per cent (‘class 4’ estimates) or -20 per cent and +30 per cent (‘class 3’ estimates). ... We consider that the capital costs used in the PACR analysis are ‘P50’ estimates, i.e., they have a 50 per cent expected probability of cost overrun.”

We are confused and would appreciate the AER’s advice on what level of AACE cost accuracy Transgrid means here. There is no explicit reference to the AACE standards, only implicit by the use of the word ‘class’. The level of cost accuracy is self-assessed. Is the Transgrid Class 4 self-assessment meant to be the same as the AEMO Class 4

¹⁵ https://aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2021/transmission-costs-for-2022-isp/transmission-cost-database-ghd-report.pdf?la=en

¹⁶ See p. 30 https://aemo.com.au/-/media/files/stakeholder_consultation/consultations/nem-consultations/2021/transmission-costs-for-2022-isp/transmission-cost-database-ghd-report.pdf?la=en

¹⁷ See p.24 <https://www.transgrid.com.au/media/rxancvmx/transgrid-humelink-pacr.pdf>

accuracy band, which is different from the ‘official’ AACE accuracy band¹⁸. Does Transgrid self-assess that Class 4 accuracy band as P50? If so, how?

CONCLUSION

Not only should the requirement be binding but the AER should set out the principles on how the AACE classification should be applied to avoid proponents self-assessing their compliance which results in inconsistent application across projects.

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?

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?

Yes, a binding obligation should be imposed on project proponents to conduct sensitivity testing for the same reasons that a binding obligation should apply regarding use of the AACE cost classification.

Yes, the AER should provide more explicit guidance on the role of contingency allowances for all RIT-T/RIT-D projects.

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.

Yes, the Guidelines should require increased transparency on cost estimation methodology, including key input and assumptions. This is essential part of the proponent providing an AACE class estimate that is consistent with, and comparable across, all RIT-T/RIT-D projects for every proponent.

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?

The EUAA is a strong supporter of proponents undertaking extensive early works in parallel with the RIT-T as this is a key to enabling more accurate costs estimates as the project proceeds through the RIT-T stages. The more early works the greater the confidence that consumers have that a project continues to have net benefits through the RIT-T process.

¹⁸ See p. 7 https://web.aacei.org/docs/default-source/toc/toc_96r-18.pdf

We also support the AEMC recommendation for the AER to provide more explicit guidance on what should constitute early works under the AEMC's general definition. Given our recommendation above that cost estimates at the PACR should be at least an AACE Class 3 level of accuracy in both capex and opex, the AER scope of early works should be that required to achieve this level of cost accuracy. This would cover both the traditional engineering aspect as well as social licence and biodiversity components. Transgrid estimated biodiversity costs at 28% of total Humelink costs¹⁹. Landowner compensation may be a significant part of opex costs depending on how the compensation is paid.



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¹⁹ See p. 5 <https://www.aer.gov.au/system/files/EUAA%20HumeLink%20Stage%201%20CPA%20General%20Questions.pdf>