

[TIRreview@aer.gov.au](mailto:TIRreview@aer.gov.au)

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## SUMMARY

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 and pay billions in energy bills every year with increasing energy costs either absorbed by the business, making it more difficult to maintain existing levels of employment or passed through to consumers in the form of increases in the prices paid for many everyday items.

The EUAA very supportive of the development of this guidance note. We have been critical of the poor record AEMO and TNSPs have in the estimation of capex for major projects across the whole ISP/RiT-T/Contingent Project Application (CPA) 'supply chain'.

Given the intent of the note is to:

*"...promote the efficient delivery of actionable ISP projects, and ensure consumers pay no more than is necessary for these large projects, consistent with the National Electricity Objective"*

it still leaves all the earlier stages of the ISP and RiT-T open to what we consider is under estimate bias and decisions that are not consistent with the NEO. For example:

- In the case of the 2020 ISP and the seemingly arbitrary 30% increase in the Final ISP costs, This increase occurred after stakeholder comments, including those of the EUAA, about the costs in the Draft ISP meaning consumers had no opportunity to engage on the higher cap-ex and its impact on net benefits.
- The recent experience of capex increases for Project Energy Connect.

Without a focus on these areas, the Guideline may end up being used to efficiently implement inefficient projects. In this context we note work underway to address the ISP and RiT-T stages:

- AEMO developing a transmission cost database for the 2022 ISP
- the rule change that the EUAA and other organisations have recently submitted to the AEMC to, subject to certain conditions, require the re-starting of the RiT-T process if capex increases above a threshold percentage
- the desire of the AER to extend this guideline to the RiT-T in the future; we would encourage the AER to do this as quickly as possible to both non-ISP CPA projects and to all RiT-T projects subject to an agreed threshold value.

With this context, we make the following comments on the three sections of the draft guideline - application process, staging and ex-post reviews:

### Application process

The proposals around increased TNSP transparency and consumer engagement in preparing the CPA are welcome. However, in practice we think that, without the appropriate level of resources being made available to consumer advocates (we make some suggestions), the proposed level of engagement will not occur. This will cause the guidance note to fail to achieve its major objective. Consumers will continue to rely on the AER review as they do now – but with the AER having the additional leverage of reviewing against this guidance note.

### Staged CPA applications

We support the proposed procedures at a high level as presented. The proof will be in the implementation so we await to see how specific examples will be considered.

### Ex post measures

The guideline should result in the ‘reasonable expectation’ bar in the Capital Expenditure Incentive Guideline to be lot higher than what it was when the Guideline was first introduced in 2013. We also encourage the AER to provide some worked examples of how an ex post review resulting in a prudent and efficient capital cost lower than actually incurred, might impact on CESS payments.

There will be some increase in what TNSP’s would call the ‘regulatory burden’. We consider this is well worth the additional effort and cost in the TNSPs regulated revenues. The cost is miniscule compared with the potential for reduced capital costs and stranded assets that consumers will bear.

Throughout the discussion we will refer to the Draft Guidance Note (‘guidance note’) and the Draft Guidance Note Covering Letter (‘covering letter’).

## **GUIDANCE NOTE SCOPE AND WHY IT MATTERS**

### Introduction

ISP actionable projects go through a number of stages where capital costs are estimated – when it is first introduced into the ISP, when preparatory activities have been completed, the PADR, the PACR and finally the contingent project application (CPA). The focus of this guidance note is getting the best capital cost estimate and the most efficient allocation of risk between TNSP and consumers at the CPA stage.

However, capex estimation problems exist right along the ISP/RiT-T process. The AER recognises this and we understand they are considering how this guidance note might be extended to non-ISP CPAs and all RiT-T projects. We would encourage the AER to proceed as soon as possible in these areas with application subject to a reasonable cost threshold.

We discuss two initiatives that will go some way to addressing the residual risks not dealt with in this guideline – the AEMO Transmission Cost Database being developed as part of the 2022 ISP and a rule change that the EUAA and others have submitted to the AEMC around capex estimation in the RiT-T.

Cost estimation classes, the RIT-T process and the current problem

A commonly used metric for the accuracy level of these capex forecasts is that developed by the Association for the Advancement of Cost Engineering (AACE)<sup>1</sup>

ESTIMATE CLASS	Primary Characteristic	Secondary Characteristic		
	MATURITY LEVEL OF PROJECT DEFINITION DELIVERABLES Expressed as % of complete definition	END USAGE Typical purpose of estimate	METHODOLOGY Typical estimating method	EXPECTED ACCURACY RANGE Typical variation in low and high ranges at an 80% confidence interval
Class 5	0% to 2%	Concept screening	Capacity ordered, parametric models, judgment, or analogy	L: -20% to -50% H: +30% to +100%
Class 4	1% to 15%	Study of feasibility	Equipment factored or parametric models	L: -15% to -30% H: +20% to +50%
Class 3	10% to 40%	Budget authorization or control	Semi-detailed unit costs with assembly level line items	L: -10% to -20% H: +10% to +30%
Class 2	30% to 75%	Control or bid/tender	Detailed unit cost with forced detailed take-off	L: -5% to -15% H: +5% to +20%
Class 1	65% to 100%	Check estimate or bid/tender	Detailed unit cost with detailed take-off	L: -3% to -10% H: +3% to +15%

Table 1 – Cost Estimate Classification Matrix for Process Industries

The following table summarises current AEMO/TNSP practice in terms of the AACE ‘Class’ of capex estimate generally used at each stage though these classes are not mandated in any way<sup>2</sup>.

Intended usage of the database					
Stage	Future ISP Projects	Future ISP Projects with Preparatory Activities	Project Assessment Draft Report (PADR) in development or completed	Project Assessment Conclusions Report (PACR) completed	Contingent Project Application (CPA) and ISP Feedback Loop
Example Projects	Network expansion options and candidate REZs in early stages	QNI Medium and Large, CQSQ, New England REZ etc	HumeLink, Marinus Link, Central-West Orana, VNI West		PEC, VNI Minor (NSW works)
Price certainty (Draft)	Class 5/4	Class 4/3	Class 4/3	Class 4/3	Class 3/2
Source of ISP Estimate	Database	TNSP	TNSP	TNSP	Not required for ISP

The 2020 ISP asked consumers to accept the large investments (anywhere between \$10b-\$20b) recommended in the Optimal Development Path because the modelling shows large net benefits. Yet this modelling was based on simplistic capital cost estimates. The Draft 2020 ISP provided only a simple spreadsheet to explain the capex assumptions with no supporting information and no indication of where in the range the actual capex input \$ number was used in the modelling. Following criticism of this approach, including by the EUAA, AEMO increased all capex estimates by 30% in the Final ISP, but again offered no explanation for why the revised levels were accepted.

<sup>1</sup> See [https://web.aacei.org/docs/default-source/toc/toc\\_18r-97.pdf?sfvrsn=4](https://web.aacei.org/docs/default-source/toc/toc_18r-97.pdf?sfvrsn=4); the ‘sample’ stamp is because full details are only available by subscription.

<sup>2</sup> From a presentation to an AEMO ISP engagement webinar on development of the AEMO Transmission Cost Database 20<sup>th</sup> January 2021 based on a report from MMB Group to AEMO [https://aemo.com.au/-/media/files/electricity/nem/planning\\_and\\_forecasting/inputs-assumptions-methodologies/2021/Transmission-Cost-Database-Phase-1-Report.pdf](https://aemo.com.au/-/media/files/electricity/nem/planning_and_forecasting/inputs-assumptions-methodologies/2021/Transmission-Cost-Database-Phase-1-Report.pdf)

This lack of documentation did not deter AEMO’s conclusion in the final 2020 ISP that all the actionable projects (which included AACE Class 4 and 5 cost estimates with variations up to -50% to +100%) should be built, some as soon as possible, given the claimed consumer benefits<sup>3</sup>.

*“...the ISP undertakes a comprehensive review of the changes that are occurring in the electricity system and identifies the series of supply and network investments that can best meet consumer expectations of affordable and reliable electricity.*

*...the ISP identifies strategic investments in transmission infrastructure and renewable energy zones (REZs), which when coupled with low-cost firming resources, will be the most cost-effective way to add generation capacity and balance variable resources across the NEM.”*

But AEMO did note that:

*“In progressing these projects, it is critical that the cost of building transmission lines is tightly managed to ensure consumers derive these benefits,”*

This is proving to be a challenge with the experience of Project Energy Connect (PEC) being frequently highlighted:

Milestone	Capex \$b
PACR, AER 5.16.6 <sup>4</sup> review and Draft ISP <sup>5</sup>	\$1.53b
Final ISP <sup>6</sup>	\$1.99b
Transgrid/Electranet contingent project application <sup>7</sup>	\$2.36b
AER Draft decision on the CPA <sup>8</sup>	\$2.15b

The AER 5.16.6 review in January 2020 concluded that on the basis of the \$1.53b cost, net benefits were \$269m vs Electranet’s estimate of \$924m. Prior to submitting its CPA, Electranet argued that, despite costs increasing to ~\$2.4b, there were still net benefits and the project should proceed. From an external stakeholders’ perspective, the maths don’t seem to add up.

<sup>3</sup> Press Release of AEMO Managing Director and CEO “AEMO’s 20 year development for the National Electricity Market” 30 July 2020 <https://aemo.com.au/newsroom/media-release/isp-2020>

<sup>4</sup> See <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/contingent-projects/electranet-sa-energy-transformation-regulatory-investment-test-for-transmission-rit-t/final-decision>

<sup>5</sup> See <https://aemo.com.au/energy-systems/major-publications/integrated-system-plan-isp/2020-integrated-system-plan-isp/draft-2020-isp-archive>

<sup>6</sup> See <https://aemo.com.au/en/energy-systems/major-publications/integrated-system-plan-isp/2020-integrated-system-plan-isp>

<sup>7</sup> See <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/contingent-projects/transgrid-and-electranet-%E2%80%93-project-energyconnect-contingent-project/initiation>

<sup>8</sup> See <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/contingent-projects/transgrid-and-electranet-%E2%80%93-project-energyconnect-contingent-project>

Similar issues have also been seen in the case of the Eyre Peninsula Upgrade. The capex in the AER’s 5.16.6 review in April 2019 of \$240m<sup>9</sup>, increased to a contingent project application to \$290m in May 2020 and the AER approved \$280m (all \$2017/18) in September 2020<sup>10</sup>.

AEMO has initiated a workstream as part of the 2022 ISP to develop a transmission cost data base. This should assist in improved estimation, particularly at the Future ISP projects stage, but also at the other RIT-T stages as TNSPs input updated costs to future ISPs.

The EUAA along with other stakeholders (ERM Power, Delta Electricity, Major Energy Users and AGL) have recently submitted a rule change to the AEMC. It proposes that, subject to certain conditions, where the capex for an actionable ISP project increases by a threshold \$ amount that the RIT-T process is re-started.

The AER is looking to potentially extend the draft guideline to the RIT-T process.

Together all three initiatives should substantially address the gap in the guidance note.

### Summary

Capital cost estimation problems will continue to exist in all the other stages. This makes it possible that projects get to the CPA stage that should not have reached that stage had better capex estimates been available which would have indicated no net benefits. We hope that the guidelines do not end up being use to efficiently implement an inefficient project with negative net benefits.

## **APPLICATION OF THE GUIDANCE NOTE**

The guidance note will not be binding on TNSPs or the AER. Nevertheless, we would encourage the AER to apply a comprehensive and detailed interpretation of their expectations. If a TNSP does not meet the expectations then it should not be surprised that the CPA is rejected.

We note the AER’s response in the covering letter on coverage:

*“We note that many of the expectations in this guidance note are transferable to the preparation and assessment of CPAs for non-network projects.”*

and support the guidance note applying to non-network projects given the ISP will be comparing network and non-network options. We expect with the forecast rapid change in relative economics between network and non-network solutions, that non-network solutions will become a much stronger competitor to network solutions in the medium to longer term. The same issues of transparency, engagement, project management, risk identification and so on apply to non-network solutions.

The EUAA would encourage the AER to move quickly to expand the coverage of this guidance note to non-ISP projects.

<sup>9</sup> See <https://www.aer.gov.au/system/files/AER%20-%20Eyre%20Peninsula%20Electricity%20Supply%20Options%20RIT-T%20Determination.pdf>

<sup>10</sup> See <https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20-%20ElectraNet%20-%20Eyre%20Peninsula%20Reinforcement%20contingent%20project%20-%20September%202020.pdf>

## CONTINGENT PROJECT APPLICATION PROCESS

We strongly support the intent of the draft guideline in requiring a significant increase in consumer engagement leading up to the TNSP's CPA. Our comments focus on the what we see as the limitations on what that engagement might produce compared to what the AER ideally would like to see.

We support in concept the strong focus on pre-lodgement engagement but doubt it be able to achieve what we think the AER is hoping to achieve

The Draft places heavy emphasis on extensive pre-lodgement consultation with the TNSP expected to provide considerable information on consultation in two main areas:

- understanding the projects costs, benefits and risks, and procurement processes, and
- route selection

Our comments focus on the former. TNSPs are expected to meet the principles set out in the AER's Consumer Engagement Guideline for Network and Service Providers<sup>11</sup>. The Draft sets out what TNSPs are expected to provide and examples of 'meaningful' pre-lodgement consultation. The engagement would cover details around:

- project management and governance,
- procurement planning, preparation, execution and contracting strategy,
- risk identification, cost assessment and management, and
- cost estimates.

Our extensive experience in network consultation around the NEM would suggest that there are very few advocates who would have the necessary skills, experience and time to engage in any detail around these matters. These are complex matters that only seasoned professionals can deeply engage on. Given the difference in skills and experience between the TNSP presenting and the consumer advocates listening, engagement may not get past the 'inform' stage on the IAP2 spectrum when for this engagement to meet the AER's expectation it would need to be at the 'involve' if not 'collaborate' part of the spectrum. Where consumer advocates seek to raise an issue, it may be difficult for them to dispute the response provided by the TNSP.

All this is in the context of very limited resources available to consumer advocates. They are more likely to concentrate that limited funding on those issues they feel they can make a contribution to. The EUAA has the expertise to be involved in these engagements, but not the resources to be able to do more than one at a time.

We agree with the comment in the covering letter that the AER (p.5):

*"...expect(s) the TNSP to consider the appropriate format for facilitating stakeholder engagement and understanding, having regard to the size and potential complexity of actionable ISP projects."*

and we are sure TNSPS will seek to do just that. However, lots of workshops with lots of consumer participants with only limited knowledge and understanding of the complex issues being addressed is unlikely to produce the robust testing of the TNSP's project the AER's seems to be expecting.

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<sup>11</sup> See <https://www.aer.gov.au/node/22552>

We would encourage the AER look to provide more detail around what it expects TNSPs to provide consumers to ensure they have the appropriate skills and resources to participate in this engagement. This could include:

- specific training in project management, procurement etc
- sessional payments to participate in the engagement
- funding to seek independent expert analysis of what the TNSP is proposing
- providing a deterministic standard for the cost estimate the TNSP is actually consulting on (we discuss this further below).

Building consumer advocate capability will not happen quickly. We are looking here at an investment in the future to increase the ability over time. In the absence of that assistance, consumers will continue to rely heavily on the AER CPA review to ensure capital expenditure is prudent and efficient.

#### *We get no comfort from the material change provisions of the rules*

The covering letter addresses the concern stakeholders have around costs increasing after the PACR but there being no further cost benefit assessment using these revised costs. The AER's response (p.6):

*“Where there are significant changes in cost forecasts after the RIT-T, we consider there are mechanisms to manage this in the NER, such as the material change in circumstances clause and actionable ISP project trigger event...”*

This is referring to the material change provision in clause 5.16A.4(n) of the rules. Where there is a 'material change' in circumstance which 'in the reasonable opinion of the RIT-T proponent' means that the preferred option identified in the PACR is no longer the preferred option, then the RIT-T needs to be started again.

The problem for consumers is that it is the TNSP that decides this, not the AER. The experience from PEC was that despite costs increasing ~60% from the PACR, Electranet judged that benefits also increased by a similar amount so there was no material change.

Given the large reduction in benefits in the AER's 5.16.6 assessment compared with what Electranet had claimed in its consumer engagement, we had no confidence in Electranet's own revised CBA. While the AER had its doubts about that conclusion, it was very constrained in the action it could take. In our view the material change clause cannot protect consumers from potentially inefficient projects getting to the CPA stage where the only focus is on costs, not net benefits.

The EUAA is a co-sponsor of a rule change that has been submitted to the AEMC, that would have the AER as the party which determines if there has been a material change.

#### *We need to get more comfort around the feedback loop*

The introduction of the feedback loop (plus the ISP Consumer Panel and the AER ISP Transparency Reviews) were designed to provide comfort to consumers who were concerned about the removal of the AER's 5.16.6 review of the TNSP's cost benefit analysis. Given the project has to go through the feedback loop prior to the CPA, and the capex in the feedback loop cannot be higher than in the CPA, any increase in capex subsequent to the PACR will be considered.

The covering letter refers to feedback from focus groups about the need to reassess costs and benefits at the CPA stage, which is not an AER role. It says:

*“The cost-benefit impact of any subsequent cost increases [after the completion of the RIT-T] would also be considered through AEMO’s feedback loop, which sets a cost limit for CPAs.” (p.2)*

*“The feedback loop, among other things, checks that the updated costs do not change the status of the actionable ISP project as being part of the optimal development path.” (p.10)*

Our concern is twofold:

(i) AEMO’s interpretation of the rules is that<sup>12</sup>:

*“Following completion of the RIT-T, a TNSP **may** seek written confirmation from AEMO to confirm that the preferred option from the RIT-T remains aligned with the optimal development path in the most recent ISP.” (emphasis added), and*

(ii) AEMO’s description of what it did for the first and only feedback loop completed so far – on VNI Minor<sup>13</sup>:

*“Feedback loop assessment requirements”*

*On 26 October 2020, TransGrid sought written confirmation from AEMO that the VNI Minor project satisfies the requirements under the feedback loop. In conducting the assessment for the purposes of the feedback loop, AEMO is required to confirm that:*

- *the preferred option identified in the RIT-T addresses the relevant identified need specified in the most recent ISP and aligns with the optimal development path referred to in the most recent ISP; and*
- *the cost of the preferred option does not change the status of the actionable ISP project as part of the optimal development path as updated in accordance with clause 5.22.15 of the NER where applicable.”*

AEMO have advised that they did not apply the ‘take one out at a time’ of TOOT approach to VNI Minor. Without this we do not know if an individual project may have negative net benefits but is still part of a positive net benefits Optimal Development Path because of the net benefits of the other projects. AEMO is now consulting on the TOOT approach as part of its 2022 ISP just released ISP Methodology Issues Paper<sup>14</sup> and we await further clarification as part of the consultation process on this Paper.

*We would appreciate more information on how the AER is going to assess risk allocation between the TNSP and consumers*

We agree with the overall approach to risk – project risk allowance does not cover all risks and the CPA determination is not meant to de-risk the project.

<sup>12</sup> See <https://aemo.com.au/energy-systems/major-publications/integrated-system-plan-isp/integrated-system-plan-feedback-loop-notice>

<sup>13</sup> See <https://aemo.com.au/-/media/files/major-publications/isp/2020/isp-feedback-loop-notice-vni-minor.pdf?la=en>

<sup>14</sup> See pp 43-44 <https://aemo.com.au/consultations/current-and-closed-consultations/isp-methodology>



The Draft uses risk and uncertainty interchangeably when they are best seen as quite different. Risk is where you can assign probabilities and uncertainty when you cannot e.g. the ‘unknown unknowns’. It would be helpful for the AER to clarify why it sees no distinction between the two.

The Draft discusses the need for transparency of contractor risks (p.16) to help the AER:

*“...to assess whether risks have been efficiently allocated to the parties best placed to manage them.”*

Yet only refers to two parties – the TNSP and the contractor when there is a third party – consumers. A TNSP might decide to put a particular risk on to contractors but pricing that risk in the contract price simply transfers that level of risk to consumers through the CPA capital cost. The contractor only bears that risk above that set in its agreement with the TNSP.

While it is great that the TNSP proactively identifies risks, has a robust risk management framework and develops strategies to monitor and manage the risks, there is no discussion around ‘what risks are the TNSP’s equity participants best placed to bear?’. How will the AER assess this in a practical, rather than conceptual, way? What is the economic justification for the risks the AER thinks should be borne by consumers? How will the AER handle a TNSP seeking a fixed price contract that effectively shifts risk to a contractor which ultimately impacts consumers through a higher capital cost?

We have seen an indication of that in their Preliminary Positions on the Transgrid and Electranet CPAs for PEC where the AER concluded<sup>15</sup>:

*“We note that TransGrid’s forecast capex for transmission lines is higher than comparable benchmarks. This may be explained by the specific line route, line deviations, market conditions, and project specific topographical, geotechnical and other factors. However, we consider it is also likely to be influenced by TransGrid’s project delivery model and its proposal to enter into a fixed-price contract with a single supplier to design, procure and construct all of the required works. While not unreasonable, this is a conservative approach to contracting as it transfers the majority of project risk to the contractor.”*

We support efforts to assess risk allocation between the TNSP and consumers and would encourage the AER to give more details of its approach in the final guideline.

**AER should set a standard cost measure for CPAs using the AACE framework**

The covering letter notes (p.11):

*“However, we note that cost forecasts naturally progress and increase in reliability over time. At the ISP planning stage, cost forecasts have a wider range of accuracy than the CPA stage. This is because there is less information available at the ISP stage and many options being assessed, and it is costly to generate more accurate cost forecasts. In comparison, at the CPA stage, the preferred option has been selected and the TNSP is getting ready to deliver the project, so it is efficient to spend more to generate more accurate cost estimates. As such, we consider it can be efficient for the range of accuracy of cost estimates to narrow from the ISP to the RIT-T to the CPA stage.”*

<sup>15</sup> See p.3 <https://www.aer.gov.au/node/74551>

The recent MMB report for AEMO cited above on the AACE cost class shows that current practice has no narrowing of cost estimates over the RiT-T where they are Class 4(large)/3 (small) for the PADR and PACR with some narrowing for the CPA – to Class 3 for large projects.

We support the application of more deterministic guidelines on cost estimates for all stages in the figure. In the case of a CPA, based on an 80% confidence interval, the expected accuracy range of the cost estimate is -10% to -20% on the downside and +5% to +30%. This could leave a lot of potential risk for consumers to bear.

For this reason, the EUAA supports the AER specifying at least an AACE Class 2 or even Class 1 cost estimate as required for a CPA submission for an actionable ISP project. Certainly, the process proposed in the guidance note has a lot of characteristics of what would be a Class 1 estimate. Given this, we see additional benefit to consumers participating in the proposed engagement to know that they are being asked to review a Class 1 estimate. Given TNSPs can:

- seek funding in their revenue proposal for funding early works, and
- can do a staged CPA under the draft guidelines

both of which we support, as they can access the resources to present consumers with a much narrower cost estimate.

This will ensure an appropriate level of contractor data to produce a much narrower accuracy range of -5% to -15% on the downside and +5% to +20% on the upside for Class 2 and -3% to -10% on the downside and +3% to +15% on the upside. A Class 1 estimate is our experience in large scale private sector projects where no contingency is approved.

## **STAGING CONTINGENT PROJECT APPLICATIONS**

We support the concept of staging for large ISP projects. It can reduce risk to consumers if done well. When the CPA is ultimately presented for approval consumers should have more confidence around the costs, and depending on the effectiveness of the feedback loop, more confidence on the overall project net benefits.

We consider that the process outlined in the guidance note suitably robust at a high level e.g. the likely limit to two stages and only for larger ISP projects and the requirement for each stage must go through the feedback loop. The proof will be in the implementation when the AER is asked to consider staging in circumstances outside that envisaged in the draft guideline.

## **EX POST MEASURES**

We support robust ex post analysis of ISP projects.

*The Guideline should change the way the AER interprets its Capital Expenditure Incentive Guideline*

The Draft notes:

*“We also note that in undertaking an ex-post review, we can only 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 capex.” (p.29)*

We would suggest that the whole intent of the guideline is to expand the scope and quality of the matters TNSP’s consider in preparing their CPA. The ‘reasonable expectation’ bar is a lot higher than what it would have been in 2013 and a lot higher than what it has been with recent major TNSP projects. This will flow from the expectation that TNSPs will in place best practice governance measures to manage overspend.

How effective has the threat of an ex post capex review been?

The AER advises that since the start of the Capital Expenditure Incentive Guideline<sup>16</sup> in 2013, there have been no instances where an ex post review has resulted in capex being excluded from the TNSP’s RAB. The Guidelines provided some examples (p.50) of where that had occurred in other industries. The absence of it in electricity networks can either be an indication of:

- the incentive provided by the Guideline is so strong that TNSPs are great at their capital estimation, or
- the conditions under which capital can be excluded are too broad/weak to have any impact and TNSPs can game the process

We might tend towards the latter – if the 2013 guideline is so effective, why introduce this current guideline? We would suggest that both instruments available to the AER – this guideline plus the export capex review have to work in concert. It is not just the transparency and engagement obligations in the CPA process, but also the scope and powers of the AER in the export capex review, that provides the incentive for TNSPs to put in an efficient CPA.

For comparison, in the negotiate arbitrate model used in Part 23 pipeline regulation, it is not just the threat of regulation that provides leverage to gas transport buyers in their negotiations with pipeline owners. It is also the information disclosure provision in the negotiation process plus the threat of a particular prescriptive form of arbitration that provides the incentive for the pipeline owners to come to the table and do a deal.

Need a clear understanding of the application of CESS to ISP projects

We understand that in the following circumstances where a TNSP:

- has ex ante approval for a capex bucket of \$3b excluding the CP
- obtains approval for an ISP contingent project for \$2b (let’s assume that it is to be spent in the same 5 year period as the \$3b for other capex) giving a total approved capex of \$5b
- spends \$4.5b in the 5 year period of which the ISP project ends up costing \$2.5b

the TNSP would get a CESS benefit (assuming the CESS guidelines are met e.g. inter-period deferrals) on the \$0.5b with a 30%/70% TNSP/consumer share. We also understand that were the ex post review to show that the efficient level of capex for the ISP project was \$2.2b, the TNSP’s CESS calculation would be based on the \$2.2b.

We would recommend that the AER’s final guidance contain some worked examples of how an ex post review resulting in a prudent and efficient capital cost lower than actually incurred might impact on CESS payments.

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<sup>16</sup> See <https://www.aer.gov.au/system/files/1.%20AER%20explanatory%20statement%20-%20capital%20expenditure%20incentive%20guideline%20-%20November%202013.pdf>

*The AER should consider expanding the ex-post statement to include a commentary on benefits*

While the ex-post statement stems from the AER's requirement under the Rules to review a networks capex, we would encourage the AER to consider how it might, either within the existing rules or with a rule change, include commentary on the benefits. Our experience in the private sector is that it is common practice in a post project assessment to look at costs and benefits. It gives little comfort to an asset owner in a workably competitive market that they built the asset for equal to or less than they thought it would cost at the time of project sanction if the benefits are well below what was estimated at the time of project sanction.

Even though costs are incurred over a relatively short period compared to benefits that hopefully accrue over the asset life, we consider there can be significant learnings from even an early review of benefits. A key philosophical building block of the Guideline's approach to costs ('let's learn from experience') equally applies to benefits. The rules provide for ISP projects to only proceed if they have 'net benefits. We need to apply learnings on both sides of the ledger. We think that is best practice regulatory decision making to look at both sides of the ledger. Further benefit assessment could be done at regular intervals over the project life, not just at the time of the ex post cost assessment.

It is interesting to note that the two significant RiT-T reviews by independent parties – the Frontier Review of the Heywood Interconnector<sup>17</sup> project and the AER's 5.16.6 review of Project Energy Connect<sup>18</sup>, both raised serious questions around the TNSP's proposed net benefits. We think this adds weight to the argument for an ex post review of benefits as well as costs.

We hope you find this submission to be helpful. It is our intent to improve outcomes for both consumers and ISP project proponents. The more rigorous the assessment process the greater confidence consumers will have in the investments being made.

Sincerely,



Andrew Richards  
Chief Executive Officer

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<sup>17</sup> See the discussion of the report in [https://www.aer.gov.au/system/files/Heywood%20RiT-T%20determination\\_0.pdf](https://www.aer.gov.au/system/files/Heywood%20RiT-T%20determination_0.pdf)

<sup>18</sup> See <https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/contingent-projects/electranet-sa-energy-transformation-regulatory-investment-test-for-transmission-rit-t/final-decision>