

9 April 2021

Mr Sebastian Roberts  
General Manager  
Transmission and Gas  
Australian Energy Regulator

Via email: [sebastian.roberts@aer.gov.au](mailto:sebastian.roberts@aer.gov.au)

Dear Sebastian

**Re: Preliminary Position - Contingent Project Application - Project EnergyConnect**

Further to my letter of 17 March 2021 responding to the AER's Preliminary Position on ElectraNet's contingent project application for Project EnergyConnect (the Project), the purpose of this letter is to provide additional information in relation to the assessment of the project risk allowance to assist the AER in making a final contingent project decision on the Project.

In its assessment of project risks and potential cost saving opportunities on the Project, the AER found that:

- ElectraNet's risk assessment overstates the likelihood of each risk occurring, as the upper bound of the likelihood range assigned to each risk has been used to calculate the risk cost (likelihood multiplied by consequence) for each item. This overstates the probabilities that the risks will occur and is not consistent with the approach ElectraNet has applied in previous contingent projects. On this basis the AER proposes to apply the mid-point of the assigned likelihood range to provide a more reasonable estimate of risk costs for the project. This results in an overall reduction of approximately \$7.1m (\$2017-18) to the total project risk allowance.
- In relation to project risks that may result in potential cost savings to the project, the likelihood of these savings being realised is greater than ElectraNet has proposed on the basis of line design and construction efficiencies that are expected to be realised. On this basis the AER proposes to assign each of these risks to a higher likelihood category, with an assigned probability based on the mid-point of the likelihood range. This results in an overall reduction of approximately \$4.6m (\$2017-18) to the total project risk allowance.

The outcome of this assessment is a reduction in the total project risk allowance from 3.5% of project value to less than 1% of project value.

We respond to these findings with the further information below.

### Treatment of project risk

In its Preliminary Position, the AER has separately considered risk items that are expected to reduce project costs and excluded these amounts from its revised estimate of total project risk cost.

However, this overstates the total risk allowance and appears inconsistent with the recent guidance the AER has provided in its Guidance Note for the Regulation of Actionable ISP Projects, which states that:

There are also project risks and efficiencies that lead to cost reductions, and these should be equally considered.<sup>1</sup>

The Guideline also makes it clear that the AER expects:

the TNSP to demonstrate the outcomes of each risk assessment, including:

...

- whether the risk has a positive or negative impact (or both) on project costs<sup>2</sup>

ElectraNet's inclusion within the project risk allowance of risks that may have a positive or negative impact on the final delivered project costs of Project EnergyConnect is consistent with this methodology. These items should therefore be taken together in considering the total project risk allowance.

We reiterate that a total risk allowance of less than 1% (i.e. a total of \$4.5m) is not reasonable for a greenfield line project of this scale and complexity, and would deny ElectraNet the reasonable opportunity to recover the efficient costs of delivering the project<sup>3</sup>.

We propose the adjustments outlined below to deliver a risk allowance more commensurate with these expected costs, in a manner consistent with ElectraNet's established methodology.

### Adjustments to project risk allowance

ElectraNet acknowledges the apparent inconsistency in the calculation of risk costs in its contingent project application compared to the approach applied to previous contingent projects, which has generally involved applying probabilities that correspond with the mid-point of the likelihood range associated with each particular risk.

However, it is important to recognise that ElectraNet consistently applied a probability corresponding with the upper end of the respective likelihood range to each risk item that could result in an increase or decrease in project costs in the calculation of project risk cost.

We believe upside and downside risk should be treated equally, in line with the recent guidance from the AER. We have therefore updated the project risk assessment by reducing the probability of each risk to the mid-point of the respective likelihood range for both risks that could result in an increase or decrease in project costs<sup>4</sup>.

---

<sup>1</sup> AER, [Guidance Note: Regulation of Actionable ISP Projects](#), 31 March 2021, p17.

<sup>2</sup> Ibid, p18.

<sup>3</sup> The Risk Engineering Society recommends a 5-10% contingency level (on a P50 basis) for a project such as Project EnergyConnect that is at a pre-tender stage.

<sup>4</sup> For risks expected to increase project costs this results in an average probability of 21%, while for risks expected to decrease project costs this results in an average probability of 28%.

For risks that could decrease project costs, this adjustment has been made relative to the original CPA risk rating. We disagree with the likely extent of opportunity for cost savings that EMCa advised and the resulting re-categorisation of these risks to a higher likelihood category in the AER's Preliminary Position.

The adjustments we have made result in a consistent application of ElectraNet's risk methodology in accordance with our established practice.

We have also applied the following adjustments to reflect the updated information provided in our response of 17 March 2021:

- Exchange rate risk has been removed (as a symmetrical risk) as proposed by the AER; and
- The probability of two risks that have now been fully realised has been updated to 100%. This results in an increase in risk cost of approximately \$1.3m relative to the AER's assessment<sup>5</sup>.

We enclose updated project risk registers that reflect these adjustments for both risks that could result in a positive or negative movement in project costs. This supporting information is provided on a confidential basis as it includes information that is commercially sensitive in nature at this time.

The updated risk registers result in a project risk allowance of approximately 2.5% (or \$12.0m) which is still a very minimalist risk allowance for a greenfield line project of this scale and complexity to provide ElectraNet with a reasonable opportunity to recover the efficient costs of delivering the project.

ElectraNet again appreciates this opportunity to provide further information to inform the AER's final decision on ElectraNet's September 2020 contingent project application for Project EnergyConnect.

As noted in our response of 17 March 2021, we are also responding separately to the remaining outstanding issues raised in the AER's Preliminary Position paper.

Please direct any queries you may have to Simon Appleby in the first instance on 08 8404 7324.

Yours sincerely



Rainer Korte  
**Group Executive Asset Management**

Encl.

---

<sup>5</sup> These risks were identified on a confidential basis in our response of 17 March 2021. As noted in that response, one of these realised risks is expected to result in a project cost impact of up to \$19m, which falls well outside the range of the original risk assessment. The updated risk register now contains a risk cost of approximately \$1m for this item at an updated probability of 100%, which falls well short of the expected impact.