



Australian Energy Market Commission

## **DRAFT RULE DETERMINATION**

# **NATIONAL ELECTRICITY AMENDMENT (MATERIAL CHANGE IN NETWORK INFRASTRUCTURE PROJECT COSTS) RULE**

### **PROPONENT**

ERM Power, Energy Users Association of Australia (EUAA), Major Energy Users Inc., AGL, Delta Electricity

7 JULY 2022

**RULE**

## INQUIRIES

Australian Energy Market Commission  
GPO Box 2603  
Sydney NSW 2000

E [aemc@aemc.gov.au](mailto:aemc@aemc.gov.au)

T (02) 8296 7800

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## ABOUT THE AEMC

The AEMC reports to the Energy Ministers' Meeting (formerly the Council of Australian Governments Energy Council). We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the Energy Ministers' Meeting.

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## VALE DAVID HEADBERRY

The AEMC wishes to acknowledge the passing of David Headberry on 12 November 2021. David was a representative for the Major Energy Users Inc, who are one of the joint proponents of this rule change. David was a principles-based and passionate advocate for reforms that were in the best interests of consumers – and always had their interests at the forefront of his mind in any engagement with the Commission. He worked collaboratively with the Commission and was an active contributor to many of our rule changes & reviews. David leaves a lasting legacy in energy policy and reform.

## SUMMARY

- 1 The Australian Energy Market Commission (AEMC or Commission) has made a draft rule to amend the National Electricity Rules (NER) in relation to the 'material change in circumstances' (MCC) provisions for the Regulatory Investment Test (RIT).<sup>1</sup> Under the current MCC provisions, the RIT must be reapplied where, in the reasonable opinion of the RIT proponent, there has subsequently been a material change in circumstances which means that the preferred option identified through the RIT is no longer the preferred option.
- 2 The draft rule seeks to add clarity to the process for determining whether a material change in circumstances has occurred by requiring certain RIT proponents to develop reopening triggers which, if met, would require the RIT proponent to consider if and how to reconsider the extent to which the previously identified preferred option is likely to remain the most net beneficial option in light of the changed circumstances.
- 3 The draft rule additionally seeks to improve cost estimate accuracy by clarifying the rules governing the guidelines for RITs in order to support strengthened guidelines for cost estimate development.
- 4 The draft rule has been made in response to a rule change request submitted by the Energy Users Association of Australia (EUAA), Delta Electricity, Major Energy Users Inc, ERM Power Limited (now Shell Energy Operations) and AGL Energy (the proponents). The rule change request sought to improve stakeholder confidence in the RIT process by amending the NER to require a RIT proponent to reapply the RIT process if, following completion of the RIT, project costs were to increase by more than a fixed percentage, unless an exemption was granted by the Australian Energy Regulator (AER).

### Features of the more preferable draft rule

- 5 The Commission's draft determination is to make a more preferable draft rule, with the key features of the draft rule being that it:
  - requires all RIT proponents to consider whether there has been a material change in circumstances, including a change in the identified need, for the project subsequent to the completion of the RIT
  - requires RIT proponents (other than AEMO) of projects with an estimated cost of greater than \$100 million to develop reopening triggers which would clearly indicate whether there was subsequently a material change in circumstances, such as a change to the credible options considered in the RIT or to the ranking of these options
  - requires RIT proponents, if they consider either there has been a change to the identified need or a reopening trigger has been triggered, to inform the AER and propose a course of action
  - allows the AER to reject and modify the RIT proponent's proposed course of action

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<sup>1</sup> References in this document to the Regulatory Investment Test should be taken as referring to both the Regulatory Investment Test for Transmission and the Regulatory Investment Test for Distribution.

- requires proponents of contingent projects to state in their application to have their revenue determination amended to provide for additional expenditure whether or not there has been a change in the identified need or a reopening trigger has been triggered, provide supporting analysis, and (if relevant) outline the course of action that was undertaken
- clarifies the rules governing the AER guidelines for RITs to support strengthened guidelines for cost estimate development.

6 The more preferable draft rule is different to the proponents' rule change request in that it requires certain RIT proponents to develop reopening triggers to determine whether the preferred option is no longer the most net beneficial option, instead of introducing a standing reapplication requirement that would be triggered by project costs increasing by more than a particular percentage. Further, the more preferable draft rule allows RIT proponents, if they consider that a material change in circumstances has occurred, to propose the course of action that should follow, as opposed to the default course of action involving reapplication of the RIT.

## Benefits of the more preferable draft rule

7 Having regard to the issues raised in the rule change request, the Commission is satisfied that the more preferable draft rule is likely to better contribute to the achievement of the National Electricity Objective (NEO), particularly with respect to the efficient investment in electricity services for the long-term interests of consumers of electricity. The draft rule:

- **Promotes economic efficiency** by providing Network Service Providers (NSPs) with guidance on what is a 'material change in circumstances', to inform decision making as to when the RIT should be reapplied or further analysis undertaken. The reopening triggers developed by RIT proponents will provide greater certainty as to what circumstances could indicate that the preferred option is no longer the most net beneficial option. This should help address stakeholder concerns about the transparency of the operation of the current MCC provisions, and how enforceable they are in practice. Guidance provided by the AER in the RIT application and Cost Benefit Analysis (CBA) guidelines will help RIT proponents develop these reopening triggers.
- **Promotes efficient outcomes for consumers by balancing the timely and economic delivery of network projects** through ensuring that reapplication of the RIT is a last resort. The requirement for proponents of major projects to propose the course of action that should follow if a material change in circumstances has occurred will allow RIT proponents to propose more appropriate, more timely and less costly courses of action than full reapplication of the RIT (which is currently the default course of action under the current MCC provisions). Similar to its role under the current MCC provisions, the AER will be able to test this proposed course of action to promote the efficient delivery of network projects.
- **Minimises practical implementation and compliance costs** for NSPs since it is already common practice for RIT proponents to conduct sensitivity testing and outline boundary values for key input assumptions at which the preferred option changes.

Further, since the AER's role under the more preferable draft rule is in substance similar to its current role, it would not impose an additional administrative burden on the AER.

## Implementation and transition

8 The Commission considers that the rule should commence operation 12 months after publication of the final rule, and that the AER be required to update and publish the RIT application guidelines and CBA guidelines prior to the commencement date, under transitional arrangements.

9 The new requirements of the draft rule relating to reopening triggers would not apply to projects for which a Project Assessment Draft Report (PADR) or Draft Project Assessment Report (DPAR) had already been published by the commencement date.

## Interaction with the Transmission planning and investment review

10 The Material change in network infrastructure project costs rule change is being undertaken concurrently with the AEMC *Transmission planning and investment review*. The Review seeks to determine whether the regulatory framework is sufficiently flexible to support the timely and efficient delivery of major transmission projects under the current step-change growth required to transition to net zero, while ensuring these investments are in the long-term interests of consumers.

11 There are some issues being explored in the Review, particularly under Stage 3, which will complement the rule change. Stage 3 of the Review is examining, amongst other things, whether there is the potential to improve the balance of timeliness and rigour in the economic assessment process including an examination of issues related to the assessment of costs and benefits of major investments. Accordingly, the RIT- T and CPA process and associated guidelines will be examined further under the Review. When considering possible alternatives to the economic assessment process, the Review will be cognisant of the changes proposed in this draft determination.

## Consultation

12 The Commission welcomes submissions on this draft determination and the more preferable draft rule by **1 September 2022**.

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# 1 MATERIAL CHANGE IN NETWORK INFRASTRUCTURE PROJECT COSTS RULE CHANGE REQUEST

## 1.1 The rule change request

On 20 January 2021, the Energy Users Association of Australia (EUAA), Delta Electricity, Major Energy Users Inc (MEU), ERM Power Limited (now Shell Energy Operations) and AGL Energy (the proponents) made a request to the Australian Energy Market Commission (AEMC or Commission) to make a rule change relating to material changes in network infrastructure project costs (rule change request). The rule change request seeks to restore confidence in the Regulatory Investment Test (RIT) process by ensuring that the RIT is reapplied when a significant increase in network project costs occurs after completion of the RIT, unless otherwise determined by the Australian Energy Regulator (AER).

The remainder of this chapter outlines:

- the current arrangements for the application and reapplication of the RIT
- the rationale for the rule change request
- the solution proposed in the rule change request
- an overview of the rule change making process, and
- the consultation process for this draft determination.

## 1.2 Current arrangements

### 1.2.1 Purpose of the RIT - identify the preferred option to meet an identified need

The RIT is a cost benefit analysis (CBA). The purpose of the RIT is to identify network investments that maximise the present value of net economic benefits in the market. Before investing in a significant transmission or distribution project to meet an identified need on the network, a proponent must consider all credible options (including potential non-network solutions) to meet that need, before selecting the option that maximises the net economic benefit across the market. This reduces the risk that consumers will pay for inefficient investments and promotes efficient investment in the long-term interests of consumers.

In this determination document, the RIT is used to describe a number of sets of arrangements that are used for both transmission and distribution projects, in the form of the Regulatory Investment Test for Transmission (RIT-T) and Regulatory Investment Test for Distribution (RIT-D). A RIT-T proponent or RIT-D proponent is required to apply the RIT-T or RIT-D (as applicable) to any project which has the purpose of meeting an identified need.

There are a number of exceptions to the requirement to complete a RIT, including where the estimated capital cost of the most expensive option to address the identified need which is technically and economically feasible is less than \$7 million for transmission projects or \$6

million for distribution projects,<sup>2</sup> where the project is to address an urgent or unforeseen network issue, involves maintenance work that is not intended to augment the network, or is needed to address inadequate levels of inertia or system strength (and there is less than 18 months in which to complete the work).<sup>3</sup>

### 1.2.2 The RIT process comprises three key stages

The process to be followed by RIT proponents is set out in Chapter 5 of the NER, with RIT proponents firstly being required to publish a specification report – the Project Specification Consultation Report (PSCR) for transmission projects, and a non-network options report for distribution projects. This report outlines, among other things, a description of the identified need and all credible options that address this need.

This initial report is consulted on, and submissions are taken into account when developing the draft RIT report – the Project Assessment Draft Report (PADR) for transmission projects, and the Draft Project Assessment Report (DPAR) for distribution projects.<sup>4</sup> This report outlines, among other things, each credible option assessed and the proposed preferred option.<sup>5</sup>

The draft RIT report is consulted on by stakeholders, after which the RIT proponent must publish a final RIT report – the Project Assessment Conclusions Report (PACR) for transmission and the Final Project Assessment Report (FPAR) for distribution. This final report must, among other things, outline any submissions received in relation to the draft RIT report.

### 1.2.3 Need to reapply the RIT if there has been a material change in circumstances

If a RIT proponent has published a final RIT report and still wishes to undertake the project, the NER requires that the proponent - unless otherwise determined by the AER - must reapply the RIT to the project if 'there has been a material change in circumstances which, in the reasonable opinion of the RIT-T [or D] proponent means that the preferred option in the project assessment conclusions report [or final project assessment report] is no longer the preferred option.'<sup>6</sup> These provisions are hereafter referred to as the 'material change in circumstances (MCC) provisions'.

The MCC provisions give examples of what may constitute a material change in circumstances. They may include, but are not limited to, a change to the key assumptions

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2 See clause 5.16.3(a)(2) of the NER for RIT-Ts and clause 5.17.3(a)(2) for RIT-Ds. While both provisions refer to \$5 million, this value is subject to variation in accordance with a cost threshold determination. Under the AER's most recent cost threshold determination (which took effect on 1 January 2022), the value of this threshold is now set at \$7 million and \$6 million for transmission and distribution projects respectively. See: AER, *Final Determination - Cost thresholds determination*, November 2021.

3 Ibid.

4 This stage is not required for projects that have been identified as being 'actionable' under the Integrated System Plan.

5 The RIT proponent is not required to publish a PADR or DPAR (as is applicable) if, among other things, the estimated capital cost of the proposed preferred option is less than \$46 million and \$12 million respectively: clauses 5.16.4(z1), 5.16A.4(m), 5.17.4(n)(2) of the NER; AER, *Final Determination - Cost thresholds determination*, November 2021.

6 Clauses 5.16.4(z3), 5.16A.4(n) and 5.17.4(t) of the NER. The PACR is the final report in the RIT-T while the final project assessment report (FPAR) is the final report in the RIT-D. The AER has discretion to determine that the RIT does not have to be reapplied when there has been a material change in circumstances.

used in identifying the need described in the final RIT report, or the credible options assessed in the final report.<sup>7</sup> The MCC provisions (with respect to distribution projects) were introduced in 2012,<sup>8</sup> and were extended to transmission projects in 2017.<sup>9</sup>

#### 1.2.4

#### **Many significant RIT projects also go through the contingent project process**

Many of the most significant projects assessed under the RIT subsequently undergo additional assessment through the contingent project process, and it is helpful to understand the two different processes.

As set out in rules 6.6A and 6A.8 of the NER, the contingent project mechanism can be used for large discrete projects where there is uncertainty as to whether or not they will be required during an NSP's upcoming regulatory control period.

Contingent projects are not included in the NSP's ex ante revenue allowance. However, the definition of the contingent projects and their accompanying trigger events form part of the NSP's regulatory determination. A trigger event is commonly the successful completion of a RIT.

The AER must determine that a project is a contingent project if it is satisfied that, among other things, the proposed capital expenditure for the project is not provided for in the forecast capital expenditure for the relevant regulatory control period and the capital expenditure exceeds either \$30 million or five per cent of the value of the maximum allowed revenue for the relevant NSP.

Since the introduction of the Integrated System Plan (ISP), contingent projects also include actionable ISP transmission projects for which (among other things):

- a PACR has been published
- the RIT-T proponent has received confirmation from the Australian Energy Market Operator (AEMO) that the preferred option addresses the relevant identified need specified in the 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
- the cost of the preferred option set out in the CPA does not exceed AEMO's cost assessment.<sup>10</sup>

Where the trigger event for an actionable ISP project or other contingent project has occurred, the relevant NSP will apply to the AER to amend its revenue determination. The AER will publish the NSP's Contingent Project Application (CPA) and invite submissions from stakeholders on the application. The AER will then determine, among other things, the total capital expenditure that is reasonably required to undertake the project.

<sup>7</sup> See clauses 5.16.4(z4), 5.16A.4(o) and 5.17.4(u) of the NER.

<sup>8</sup> AEMC, *Rule Determination: National Electricity Amendment (Distribution Network Planning and Expansion Framework) Rule 2012*, 1 October 2012.

<sup>9</sup> AEMC, *Rule Determination: National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017*, 18 July 2017.

<sup>10</sup> Clause 5.16A.5 of the NER

Importantly, the AER's assessment is intended to determine the expenditure reasonably required for the purpose of undertaking the contingent project. It does not revisit the analysis used to determine whether the project would be the most net beneficial option that would usually have been previously undertaken through a RIT.

### 1.3 Rationale for the rule change request

In the rule change request, the proponents noted that AEMO's 2020 Final ISP Report highlighted that each major transmission project identified in the Draft ISP had incurred at least 30 per cent increase in cost from initial estimates, and suggested that the potential for further cost increases existed as these projects were to move through their respective RIT processes.<sup>11</sup>

In the view of the proponents, the issue of rising costs for transmission projects was further highlighted by the increase in costs of Project Energy Connect (PEC) and the Eyre Peninsula upgrade that occurred between completion of the RIT-T and the application for funding. In the case of the Eyre Peninsula upgrade, costs increased by 21 per cent and, in the case of PEC, costs increased by approximately 60 per cent.<sup>12</sup>

However, despite this increase in costs for PEC, the RIT-T proponent did not consider that there had been a material change in circumstances under the NER that may have required the reapplication of the RIT-T. The proponents noted that the decision as to what is a 'material change' rests solely with the project proponent, not the AER.

In the view of the proponents, these cases where material increases in project costs have occurred following application of the RIT-T raise questions as to whether the current Rules remain fit for purpose and whether they are able to meet the challenges created by the expected transition in the NEM and the associated development of a large number of significant scale and cost transmission projects.<sup>13</sup>

According to the proponents, "allowing capital costs to significantly increase after the application of the RIT is a poor outcome from a governance perspective and negatively impacts consumer and stakeholder confidence that the RIT framework is achieving its stated purpose".<sup>14</sup>

### 1.4 Solution proposed in the rule change request

The rule change request proposed that, unless otherwise determined by the AER, RIT-T proponents would be required to reapply the RIT-T if there had been a material change in costs following completion of the RIT-T. Under this change, which would apply for both actionable ISP projects and non-ISP projects, a material change in costs would be defined as:

- 15 per cent or more for projects costing less than \$500 million in total

<sup>11</sup> ERM et al., *Rule change request*, p. 4.

<sup>12</sup> ERM et al., *Rule change request*, p. 4.

<sup>13</sup> ERM et al., *Rule change request*, p. 4.

<sup>14</sup> ERM et al., *Rule change request*, p. 2.

- 10 per cent or more for projects costing more than \$500 million in total.<sup>15</sup>

Similar changes were proposed for distribution projects, in that a RIT-D proponent would be required to reapply the RIT-D if there had been a material change in costs following completion of the RIT-D. However, for distribution projects, a material change in costs would be defined as:

- 15 per cent or more for projects costing less than \$200 million in total
- 10 per cent or more for projects costing more than \$200 million in total.

Under the proposed approach, if a material cost increase were to occur, a proponent would need to reapply the RIT, or apply to the AER to waive the reapplication requirement, regardless of whether the ranking of the preferred option had changed. The AER would have 30 business days, following publication of the revised capital expenditure cost to make and publish a determination exempting a RIT proponent from the requirement to reapply the RIT.

Under the proposed rule, the AER would have the discretion to waive the requirement to reapply the RIT, including where projects are below the threshold of:

- \$150 million for transmission network projects and
- \$50 million for distribution network projects.<sup>16</sup>

The rule change proponents also requested a transitional rule requiring ElectraNet to reassess PEC by updating the PACR.<sup>17</sup>

The rule change request contained a further requirement that cost estimates for final RIT reports should be based on a class 2 estimate from the AACE international cost estimate classification (i.e. a detailed feasibility study). The rule change proponents considered that this would help mitigate the risk that RITs would subsequently have to be reopened under the proposed material change definition.<sup>18</sup>

## 1.5 The rule making process

On 19 August 2021, the Commission published a notice advising of its commencement of the rule making process and consultation in respect of the rule change request.<sup>19</sup> This rule change is being considered concurrent to the Transmission Planning and Investment Review (TPIR), given its focus on issues central to the transmission planning and investment process. A consultation paper was published collectively for both the rule change and the TPIR. Submissions closed on 30 September 2021.

The Commission received 28 submissions as part of the first round of consultation. In making this draft determination and draft rule, the Commission has considered all issues raised by

<sup>15</sup> ERM et al., *Rule change request*, p. 5.

<sup>16</sup> The wording of the rule change request refers to the requirement to reapply the RIT being “automatic” when higher cost projects (those exceeding the thresholds listed here) are subject to material cost increases. However, the drafting appended to the rule change request retains the existing discretion conferred on the AER whereby a proponent is required to reapply the RIT in the event of a material change in circumstances, “unless otherwise determined by the AER”. Thus, under the proposed drafting, the requirement to reapply the RIT would not be “automatic”, since it could still be waived by the AER (regardless of project size).

<sup>17</sup> ERM et al., *Rule change request*, p. 10.

<sup>18</sup> ERM et al., *Rule change request*, p. 9.

<sup>19</sup> This notice was published under s.95 of the *National Electricity Law (NEL)*.

stakeholders in submissions. Issues raised in submissions are discussed and responded to throughout this draft rule determination.

## 1.6 Consultation on draft rule determination

The Commission invites submissions on this draft rule determination by 1 September 2022.

Any person or body may request that the Commission hold a hearing in relation to the draft rule determination. Any request for a hearing must be made in writing and must be received by the Commission no later than 14 July 2022.

Submissions and requests for a hearing should quote project number ERC0325 and may be lodged online at [www.aemc.gov.au](http://www.aemc.gov.au).

## 2 DRAFT RULE DETERMINATION

### 2.1 The Commission's draft rule determination

The Commission's draft rule determination is to make a more preferable draft rule.

The more preferable draft rule involves requiring RIT proponents to inform the AER of any material change in circumstances and propose a course of action (if any) which can be approved or rejected and modified by the AER. In addition, the more preferable draft rule requires RIT proponents of major projects to develop reopening triggers which, if met, would constitute a material change in circumstances and require the RIT proponent to consider if and how to reconsider the extent to which the previously identified preferred option is likely to remain the most net beneficial option in light of the changed circumstances.

The more preferable draft rule also clarifies the rules governing the guidelines for RITs in order to support strengthened guidelines for cost estimate development

Further, the Commission has made recommendations in this draft determination for the AER to consider how the guidelines governing RITs should be strengthened to promote the development of more robust cost estimates

Further information on the legal requirements for making this draft rule determination is set out in Appendix B.

In relation to the rule's application in the Northern Territory, the Commission has determined to make a uniform rule (rather than a differential rule). Further information is contained in section 3.2.3.

### 2.2 Rule making test

#### 2.2.1 Achieving the NEO/NGO/NERO

Under the NEL the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO).<sup>20</sup> This is the decision making framework that the Commission must apply.

The NEO is:<sup>21</sup>

to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

#### 2.2.2 Making a more preferable rule

Under s.91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having

<sup>20</sup> Section 88 of the NEL.

<sup>21</sup> Section 7 of the NEL.

regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO.

In this instance, the Commission has made a more preferable draft rule. The reasons are summarised below in section 2.4 and detailed further in chapters 3 to 6.

### 2.2.3 Rulemaking in the Northern Territory

The NER, as amended from time to time, apply in the Northern Territory, subject to modifications set out in regulations made under the Northern Territory legislation adopting the NEL.<sup>22</sup> Under those regulations, only certain parts of the NER have been adopted in the Northern Territory.<sup>23</sup>

As the more preferable draft rule relates to parts of the NER that apply in the Northern Territory, the Commission is required to assess whether to make a uniform or differential rule (defined below) under Northern Territory legislation.

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant MCE statement of policy principles, a different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule. A differential rule is a rule that:

- varies in its term as between:
  - the national electricity system, and
  - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems,

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

To the extent that the proposed rule relates to:

- parts of the NER that currently do not apply in the Northern Territory, the Commission has not assessed the rule against the additional elements required by the Northern Territory legislation; and
- parts of the NER that apply in the Northern Territory, the Commission has assessed the draft rule against additional elements required by the Northern Territory legislation.<sup>24</sup>

The Commission has determined to make a uniform rule as it does not consider that a differential rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule.

22 These regulations under the NT Act are the *National Electricity (Northern Territory) (National Uniform Legislation) (Modifications) Regulations 2016*.

23 The version of the NER that applies in the Northern Territory is available on the AEMC website at [NTNER Version 87 Summary - AEMC Energy Rules](#).

24 From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. See the AEMC website for the NER that applies in the NT.

## 2.3 Assessment framework

In assessing the rule change request against the NEO, the Commission has considered the following principles:

- **Outcomes for consumers:** Assesses whether the regulatory arrangements promote and adequately balance the timely and efficient delivery of network projects.
- **Economic efficiency:** Assesses whether the solution promotes efficient investment in, and use of, electricity services in the long-term interests of consumers with regard to:
  - *Efficient risk allocation:* allocating risk (and costs) to parties best placed to manage them and who have the incentives to do so will support efficient decision making
  - *Effective price signals/incentives:* effective incentives are needed to support service providers in making efficient and timely investment decisions
  - *Information provision/transparency:* service providers require clear and adequate information to inform decision making in an evolving market
  - *clear, consistent, predictable rules:* a stable regulatory environment creates confidence in the market and will encourage investment and innovation through the transition and beyond.Evaluates whether the solution provides service providers with a reasonable opportunity to recover at least their efficient costs.
- **Implementation:** Considers the complexity of implementing a solution, i.e. whether it will require law and rule changes or other jurisdictional legislative changes. Assesses the costs of implementing a solution (practical implementation and compliance costs). Evaluates the timing of costs and benefits.
- **Flexibility:** Assesses whether the solution is consistent with the long-term direction of energy market reform. Evaluates whether the solution is flexible enough to accommodate uncertainty regarding unknown technological, policy, and other changes that may eventuate.
- **Decarbonisation:** Considers whether market arrangements will enable the decarbonisation of the energy market.

## 2.4 Summary of reasons

The more preferable draft rule made by the Commission is attached to and published with this draft rule determination. The key features of the draft rule are that it:

- requires all RIT proponents to consider whether there has been a material change in circumstances, including a change in the identified need, for the project subsequent to the completion of the RIT
- requires RIT proponents (other than AEMO) of projects with an estimated cost of greater than \$100 million to develop reopening triggers which would clearly indicate whether there was subsequently a material change in circumstances, such as a change to the credible options considered in the RIT or to the ranking of these options

- requires RIT proponents, if they consider either there has been a change to the identified need or a reopening trigger has been triggered, to inform the AER and propose a course of action
- allows the AER to reject and modify the RIT proponent's proposed course of action
- requires proponents of contingent projects to state in their application to have their revenue determination amended to provide for additional expenditure whether or not there has been a change in the identified need or a reopening trigger has been triggered, provide supporting analysis, and (if relevant) outline the course of action that was undertaken
- clarifies the rules governing the AER guidelines for RITs to support strengthened guidelines for cost estimate development.

The more preferable draft rule differs from the proponents' rule change request in that it:

- requires certain RIT proponents to develop reopening triggers that can be used to identify circumstances in which the preferred option may no longer be the most net beneficial option, instead of implementing a reapplication trigger if project costs increase by a particular percentage
- allows RIT proponents, if they consider that a material change in circumstances has occurred (such as a reopening trigger being triggered), to propose a course of action, as opposed to the default course of action involving reapplication of the RIT
- requires all RIT proponents to consider whether there has been a change to the identified need and additionally require proponents of projects with an estimated cost greater than \$100 million to develop reopening triggers, instead of requiring proponents to reapply the RIT and the AER to waive this requirement if project costs are less than \$150 million and \$50 million for transmission and distribution projects respectively
- clarifies the rules governing the guidelines for RITs in order to support strengthened guidelines for cost estimate development (in relation to cost estimate classification systems and any role for contingency allowances), instead of requiring cost estimates for the final RIT report to be based on a particular cost estimate class
- does not include a transitional rule to require ElectraNet to re-assess PEC by updating the PACR, since the new requirements of the draft rule relating to reopening triggers would not apply to projects for which a PADR or DPAR had already been published by the commencement date.

Having regard to the issues raised in the rule change request and during consultation, the Commission is satisfied that the more preferable draft rule is likely to better contribute to the achievement of the NEO. The draft rule:

- **Promotes economic efficiency** by providing Network Service Providers (NSPs) with guidance on what is a 'material change in circumstances', to inform decision making as to when the RIT should be reapplied or further analysis undertaken. The reopening triggers developed by RIT proponents will provide greater certainty as to what circumstances could indicate that the preferred option is no longer the most net beneficial option. This should help address stakeholder concerns about the transparency of the operation of the

current MCC provisions, and how enforceable they are in practice. Guidance provided by the AER in the RIT application and Cost Benefit Analysis (CBA) guidelines will help RIT proponents develop these reopening triggers.

- **Promotes efficient outcomes for consumers by balancing the timely and economic delivery of network projects** through ensuring that reapplication of the RIT is a last resort. The requirement for proponents to propose the course of action that should follow if a material change in circumstances has occurred (for example, where a reopening trigger has been triggered) will allow RIT proponents to propose more appropriate, more timely and less costly courses of action than full reapplication of the RIT (which is currently the default course of action under the current MCC provisions). Similar to its role under the current MCC provisions, the AER will be able to test this proposed course of action to promote the efficient delivery of network projects.
- **Minimises practical implementation and compliance costs** for NSPs since it is already common practice for RIT proponents to conduct sensitivity testing and outline boundary values for key input assumptions at which the preferred option changes. Further, since the AER's role under the more preferable draft rule is in substance similar to its current role, it would not impose an additional administrative burden on the AER.

Further detail on the more preferable draft rule can be found in chapters 3 to 6 below.

## 3 REOPENING TRIGGERS TO PROVIDE TRANSPARENCY AROUND WHAT WOULD BE A MATERIAL CHANGE

This chapter discusses stakeholder feedback, and presents the Commission's analysis and conclusions, regarding problems with the current MCC provisions, the proponents' proposed cost increase reapplication trigger, and an alternative proposal to require RIT proponents to develop 'reopening triggers'.

### 3.1 Issue

There are concerns from some stakeholders, including the rule change proponents, that the current MCC provisions are not effective. The Commission is not aware of any instance in which a RIT proponent has reapplied the RIT in response to a material change in circumstances, nor any determination by the AER to waive the requirement to reapply the RIT.<sup>25</sup> That the relevant provisions have not been used raises a threshold question as to whether the current approach is fit for purpose.

The requirement to reapply the RIT is only triggered under the current provisions if the project proponent forms the view that circumstances have changed to the point where the preferred option is no longer the preferred option. It is reasonable to assume that a proponent would be reluctant to form this opinion and trigger the reapplication requirement because doing so may involve repeating a lengthy and resource-intensive process. This has important implications for the robustness of this part of the regulatory framework.

While the AER could waive the requirement to repeat the whole RIT or require only part of the process to be repeated, the default position in the NER is that the proponent 'must reapply the regulatory investment test'.<sup>26</sup> A RIT proponent will have no certainty as to how the AER will respond to a request for a determination to waive part or all of the reapplication requirement.

If a proponent does not consider that circumstances have materially changed, there is no recourse available if stakeholders have a different view.<sup>27</sup> The dispute resolution provisions that relate to the RIT are only available for a 30-day period following publication of the PACR or the Final Project Assessment Report (FPAR, for distribution projects) and only apply to matters in the RIT. They do not deal with matters relating to the CPA (for example, if the costs outlined in the CPA are significantly higher than those in the RIT).<sup>28</sup>

As outlined above in section 1.4 above, the proponents proposed a deterministic cost increase reapplication trigger, where if project costs increased by a certain percentage, the

<sup>25</sup> AEMC, *Consultation Paper: Transmission Planning and Investment Review*, 19 August 2021, p. 50.

<sup>26</sup> AEMC, *Consultation Paper: Transmission Planning and Investment Review*, 19 August 2021, p. 56.

<sup>27</sup> This is different to the situation where a statutory authority forms a view with which stakeholders disagree. In such cases, the authority's decision may be open to challenge on the ground that it is manifestly unreasonable, or through a dispute resolution process.

<sup>28</sup> See clause 5.16B(c) of the NER.

proponent would be required to reapply the RIT, unless otherwise determined by the AER. The proponents were of the view that the NSP should not be the one to decide if there has been an MCC. Their deterministic proposed rule allowed the AER to decide whether reapplication is required instead of allowing the NSP to make this decision.

The consultation paper raised the possibility of an alternative decision rules approach, referred to hereafter as the 'reopening trigger approach'.<sup>29</sup> This approach was suggested as an alternative to adopting a 'one size fits all' cost increase reapplication trigger. It would instead involve requiring proponents to include in their PACR or FPAR bespoke 'decision rules'.

Such rules could enable RIT proponents to test, once market costs are revealed, whether the preferred option remains preferred, or whether another credible option should be re-examined. For example, the PACR could specify that, if the cost of the preferred option were to increase by X% (following market testing) and/or the cost of the second option reduce by Y% (e.g. based on producer price indexes or market data), then the outcome of the RIT should be revisited.

## 3.2 Stakeholder views

### 3.2.1 Problems with the operation of the current MCC provisions

Several stakeholders raised concerns with how the current MCC provisions operate, including their enforcement.

Tesla recommended additional governance and guidance to support NSPs seeking fair and transparent costs across proposals.<sup>30</sup> It stated there may be a gaming risk, where some service providers may strategically discount the actual capital and operational costs to gain preferred project status (i.e. win the RIT net benefits test), only to adjust cost estimates upwards at the contracting stage, citing 'external factors', and with the knowledge that NSPs and government policy makers may have already committed and be unwilling to reverse course, despite the cost escalations.

Further, Energy Australia suggested that the current drafting of the MCC provisions allows a situation where there is a material change in circumstances following completion of the RIT, including to the extent that preferred options are affected, but the proponent does not notify the AER.<sup>31</sup> It considered that this is an undesirable outcome and enforcement of these provisions would be problematic.

In contrast, some stakeholders suggested that there was no need to change the current MCC provisions. According to the CEC, the economic regulation undertaken by the AER already exists as a safeguard against inefficient costings, further reducing the need for reapplication.<sup>32</sup> This requires NSPs to justify any material changes to the AER.

<sup>29</sup> This Commission has denoted what was previously referred to as 'decision rules' in the consultation paper as 'reopening triggers' to differentiate this approach from the decision rules AEMO uses for the Integrated System Plan (ISP). See AEMC, *Consultation Paper: Transmission Planning and Investment Review*, 19 August 2021, p. 53.

<sup>30</sup> Consultation paper submissions: Tesla, p. 9.

<sup>31</sup> Consultation paper submissions: Energy Australia, p. 11.

<sup>32</sup> Consultation paper submissions: CEC, p. 5.

### 3.2.2 Re-opening trigger approach

Stakeholders generally supported the reopening trigger approach outlined in the consultation paper over deterministic cost increase reapplication.<sup>33</sup> Other stakeholders considered that the reopening trigger approach warranted further investigation.<sup>34</sup>

Jemena was of the view that the proponents' proposed approach (which considers whether project costs have increased) is too limited, as it does not consider more broadly whether the preferred option is no longer preferred (which involves consideration of both costs and benefits).<sup>35</sup> TasNetworks stated that the reopening trigger approach allows the characteristics of each project to be considered in identifying particular changes in circumstances that would warrant a reapplication of the RIT.<sup>36</sup> Further, by exposing the proposed reopening triggers to stakeholder consultation before finalisation in the PACR, such arrangements would promote transparency by clarifying the circumstances in which a reapplication of the RIT-T would be undertaken.

In contrast, some stakeholders suggested that there is no need to introduce a reopening trigger approach to modify the current MCC provisions. AEMO noted that the AER has regulatory oversight as to whether the RIT reapplication obligation has been met.<sup>37</sup> When a material change occurs, RIT proponents often test the impact of that change and publish those results to demonstrate that the RIT preferred option has not changed.<sup>38</sup> Where the preferred option remains unchanged, RIT proponents are under no obligation to publish these results but typically recognise the benefits of addressing these matters directly with stakeholders and the AER to demonstrate the economic viability of projects and continued stakeholder support.<sup>39</sup>

Further, AEMO considered that the AER currently has the right to test whether the RIT proponent has satisfactorily met the RIT reapplication obligation by way of the AER's compliance and enforcement role. Similarly, a stakeholder can raise concerns with the AER that a material change in circumstances may result in the preferred option no longer being preferred for a particular RIT assessment. If the AER considers there is merit, the AER can require the RIT proponent to demonstrate compliance with the RIT reapplication obligation.

In their submission to the consultation paper, the proponents stated that the reopening trigger approach set out in the consultation paper would unnecessarily complicate the process.<sup>40</sup> The proponents submitted that this approach could risk introducing unnecessary complexity around definitions, requiring complex legal drafting that may provide scope for NSPs to avoid the desired impact of the rule change.

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33 See, for example: Consultation paper submissions: Citi Power, Powercor & United Energy, p. 2; ENA, p. 27; TasNetworks, p. 8.; Ergon and Energex p.9.

34 See, for example: Consultation paper submissions: AEC, p. 4; Energy Australia, p. 12.

35 Consultation paper submissions: Jemena, p. 7.

36 Consultation paper submissions: TasNetworks, p. 8.

37 Consultation paper submissions: AEMO, p. 20.

38 See, for example: ElectraNet, *Project EnergyConnect; Updated Cost Benefit Analysis*, 14 September 2020.

39 Ibid.

40 Consultation paper submissions: Proponents' submission, p. 12.

### 3.2.3 **Re-opening trigger approach reflects typical practice in RITs**

According to the ENA, Ergon Energy and Energex, and Jemena, the reopening trigger approach outlined in the consultation paper is similar to the threshold analysis typically undertaken in a RIT.<sup>41</sup> That is, RITs already include sensitivities around the impact on the option ranking if material elements of the underlying analysis change. AEMO explained that RIT assessments typically explore boundary assumptions, including for example, the cost above which the preferred option is no longer the most net beneficial.<sup>42</sup> AEMO highlighted that AER guidelines encourage the inclusion of this additional analysis and provide discretion as to the extent and form of sensitivity testing. Accordingly, the reopening trigger approach would simply formalise this discretionary advice from the AER.<sup>43</sup> AEMO noted that many RIT assessments to date have included boundary value analysis and therefore reopening triggers are not necessary.

### 3.2.4 **Difficulty making 'decision rules'**

As part of the consultation process, the AEMC met with a number of stakeholders, including AEMO and the ENA.

AEMO staff considered if the proposed reopening trigger approach required RIT proponents to develop mechanistic 'decision rules', that is, they would be framed as 'if X happens, then Y is now the preferred option', akin to the decision rules AEMO makes for the ISP (to determine whether a project should progress to the next stage). Such rules may be difficult to develop for large projects, where a multitude of factors could influence whether the preferred option is no longer preferred.

### 3.2.5 **Guidance to help make reopening triggers**

ENA staff considered that providing guidance to NSPs to help them make decision rules may be beneficial. They suggested that this guidance should be incorporated into existing guidelines, should be principles-based and explain clearly the purpose of decision rules.

Conversely, AEMO staff were of the view that developing guidance for drafting decision rules might be complex and could risk limiting the way decision rules could be drafted. Accordingly, it may not be appropriate to amend the relevant guidelines to provide guidance on making decision rules.

## 3.3 **Analysis**

### 3.3.1 **The current MCC provisions should be more transparent**

The transparency of the operation of the current MCC provisions, and how enforceable these provisions are in practice have been raised as issues by the proponents and some stakeholders. The Commission considers that the current MCC provisions are unlikely to be fit-for-purpose because:

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41 Consultation paper submissions: ENA, p. 27; Ergon Energex, p. 9; Jemena, p. 8.

42 Consultation paper submissions: AEMO, p. 21.

43 Consultation paper submissions: AEMO, p. 21.

- A 'material change in circumstances' is not clearly defined. The rules only provide two examples, which are arguably the most extreme forms of a MCC (a change in key assumptions used in identifying the identified need or the credible options assessed in the PACR/FPAR).
- The MCC provisions confer discretion on the RIT proponent to form a view as to any MCC, without any guidance. Further, it is unclear whether the proponent can be required to turn its mind to whether the preferred option is still preferred at any particular point in time after publication of the PACR/FPAR.

Some stakeholders suggested that it is unnecessary to revise the current MCC provisions since there are other mechanisms that address the impacts of cost increases. For example, the ENA and CEC stated that the CPA process and AEMO's feedback loop mechanism address the impact of cost increases.<sup>44</sup> In a similar vein, the AER stated that it is important to understand the effectiveness of existing safeguards in the actionable ISP framework, particularly the feedback loop.<sup>45</sup>

The Commission considers that these mechanisms are important safeguards, but do not fully address the specific issue that the current MCC provisions seek to address – ensuring that the preferred option identified through the RIT process remains the preferred option after a material change in circumstances. Neither the CPA process or the feedback loop for actionable ISP projects provide a check to ensure that the preferred option remains preferred.

The feedback loop, for example, confirms that any increase in costs does not change the project's status as being on the optimal development path identified by AEMO.

The CPA process involves estimating project costs for the preferred option (once it has been selected) more accurately in order to calculate how much revenue needs to be recovered from consumers.

The Commission considers that there is a need to revise the current MCC provisions. The question that follows is whether the deterministic cost increase reapplication trigger approach proposed by the proponents, or an alternative approach such as the reopening trigger approach, is preferable.

### 3.3.2 Reopening trigger approach is preferable

The Commission considers the reopening trigger approach is preferable as under the reopening trigger approach, both costs and benefits are considered in the analysis, instead of solely cost increases. Further, the reopening triggers that proponents would be required to develop would be tailored to the project in question, and would be sufficiently flexible to accommodate any uncertainty surrounding the nature of future projects.

Providing flexibility is considered to be important given both the uncertainty surrounding the nature of future projects, and input cost uncertainty across the supply chain which may continue to grow.

<sup>44</sup> Consultation paper submissions: CEC, p. 5; ENA, p. 27.

<sup>45</sup> Consultation paper submissions: AER, p. 8.

Under this approach, reopening triggers would be developed by RIT proponents to help determine whether there has been a material change in circumstances. These reopening triggers would be outlined in the PADR/DPAR and consulted on as part of the RIT process. This would promote transparency surrounding how proponents determine whether there has been a material change in circumstances. As stakeholders would be able to comment on draft reopening triggers before being finalised in the PACR/FPAR, RIT proponents would be encouraged to develop robust reopening triggers, ultimately promoting better outcomes for consumers.

Instead of making mechanistic 'decision rules', similar to those made by AEMO for staged actionable ISP projects the Commission proposes that reopening triggers would be broader than these decision rules. Reopening triggers would identify changes to variables that would warrant revisiting whether the preferred option remains net beneficial (as opposed to indicating that a specific option is now the preferred option). The Commission considers that multiple triggers could apply to a single project. The number of triggers should reflect the complexity of the project and cover a variety of circumstances. Several examples of reopening triggers are outlined in the box below.

#### **BOX 1: EXAMPLES OF REOPENING TRIGGERS**

**Example 1:** If the capital costs of Option A (the preferred option) increase by 20%, then the preferred option should be reconsidered and further analysis should be conducted to confirm that it remains the most net beneficial option.

**Example 2:** If non-network capital costs decrease by 10%, Option B would become the preferred option.

**Example 3:** If forecast load growth in Areas 1 and 2 decreases by 20%, further analysis should be conducted to investigate whether Option C is now a credible option and if the preferred option has subsequently changed.

Source: AEMC

The Commission notes stakeholder submissions that the reopening trigger approach reflects threshold analyses that are already commonly undertaken in a RIT. For example, under the AER's CBA guidelines for actionable ISP projects, proponents are given the discretion to illustrate 'boundary values' for important input assumptions at which the preferred option changes.<sup>46</sup> The Commission also notes that sensitivities were considered in the RITs for the HumeLink, Eyre Peninsula, and Project EnergyConnect projects, as well as for several non-ISP reliability projects.<sup>47</sup>

<sup>46</sup> AER, *Cost benefit analysis guidelines: Guidelines to make the Integrated System Plan actionable*, August 2020, p. 33.

<sup>47</sup> ENA, RIT-T Economic Assessment Handbook for non-ISP RIT-Ts (26 October 2020), p 58; TransGrid, Reinforcing the NSW Southern Shared Network to increase transfer capacity to demand centres (HumeLink): Project Assessment Draft Report (10 January 2020), pp 31, 49; TransGrid, Reinforcing the NSW Southern Shared Network to increase transfer capacity to demand centres (HumeLink): Project Assessment Conclusions Report (20 July 2021), pp 34, 54; ElectraNet, Eyre Peninsula Electricity Supply Options: Project Assessment Conclusions Report (18 October 2018), p 66; Project Energy Connect, Project Assessment Conclusions Report (13 February 2019), p 107; TransGrid, Maintaining Reliable Supply to the North West Slopes Area: RIT-T Project Assessment Draft Report (18 February 2022), pp 39, 52; TransGrid, Maintaining Reliable Supply to the Bathurst, Orange

As it is common for RIT proponents to conduct threshold analyses, the Commission considers that requiring them to develop reopening triggers that reflect these analyses would not be likely to be overly difficult or burdensome. Effectively, these reopening triggers would simply reflect the analysis that many RIT proponents are already conducting and promote increased transparency surrounding this process.

The Commission considers that a positive requirement should be imposed on certain RIT proponents requiring them to consider whether a reopening trigger has been met at a particular point in time after publication of the PACR/FPAR. This would address stakeholder concerns surrounding the operation and enforceability of the current MCC provisions.

### 3.3.3 Existing guidelines should provide guidance on reopening triggers

The Commission considers that guidance should be provided to RIT proponents in existing AER guidelines (i.e. the RIT-T and RIT-D application and CBA guidelines)<sup>48</sup> to help them identify and develop reopening triggers. However, the Commission considers that such guidance should not be extensive or prescriptive, to enable RIT proponents to develop reopening triggers appropriate to each project. It should be limited to outlining the purpose for which reopening triggers should be developed, listing examples of reopening triggers, and ensuring they comprise identifiable and measurable circumstances and are clear.

This guidance should be provided in existing guidelines to minimise the complexity to proponents in preparing their RITs, and for stakeholders navigating the guidelines, and any associated administrative burden on the AER.

## 3.4 Conclusions

The Commission's draft determination (subject to the further considerations outlined in chapters 4 and 5 below) is to:

- require certain RIT proponents to develop reopening triggers to help them determine whether the preferred option is no longer the most net beneficial option
- require these RIT proponents to outline these reopening triggers in the PADR/DPAR (as is applicable) for consultation
- require these RIT proponents to consider whether any reopening triggers have been triggered
- require the AER to update the RIT application and CBA guidelines to provide guidance to RIT proponents in relation to developing reopening triggers.

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and Parkes Areas: RIT-T Project Assessment Draft Report (18 February 2022), pp 39, 51.

<sup>48</sup> See clauses 5.16.2 (RIT-T application guidelines), 5.17.2 (RIT-D application guidelines) and 5.22.5 (Cost Benefit Analysis Guidelines).

## 4 CONSEQUENCES OF A MATERIAL CHANGE IN CIRCUMSTANCES

This chapter discusses stakeholder feedback, and presents the Commission's analysis and conclusions, regarding the case for full reapplication of the RIT when a material change in circumstances has occurred, what other consequences might follow instead, and who should make this decision.

### 4.1 Issue

The consequences that should follow if the RIT proponent considers that a material change in circumstances has occurred (such as where a reopening trigger has been triggered) now need to be considered.

The current MCC provisions require that the proponent must, in the event of an MCC, reapply the RIT unless otherwise determined by the AER. TA proponent has no certainty as to whether the AER will waive the requirement to reapply the RIT, either in part or in full.

A related issue is who should be responsible for determining the consequences that should flow if there has been an MCC. While the proponent will be most familiar with the project's costs and benefits and thus may be best placed to identify if the ranking of the preferred option has changed, it may naturally be reluctant to reapply the RIT or could be seen to have a conflict of interest. The AER is impartial and focused on consumer protection. As such, the AER may be considered the more objective judge of whether reapplication of the RIT, in some form, is warranted.

The proponents' proposed rule required the RIT proponent to reapply the RIT if there has been a particular percentage increase in project costs, unless otherwise determined by the AER. RIT proponents would be required to publish revised total project cost forecasts. The AER would have 30 days after publication of the revised project cost to determine whether reapplication of the RIT is not required.

The potential alternative to the rule change request outlined in the consultation paper involved the proponent providing updated analysis to the AER (if a reopening trigger has been triggered). Requiring publication of such modelling (both high level findings and underpinning data) would help restore confidence in the RIT process. Engagement with stakeholders could also occur at this time. This would allow interested stakeholders, potentially including proponents of other credible options, to engage with the NSP and the AER and ensure that the process is appropriately robust and the RIT's conclusion sound.

## 4.2 Stakeholder views

### 4.2.1 Reapplication of the RIT should be a last resort

A number of stakeholders stated that the NSP should only reapply the RIT as a last resort.<sup>49</sup> Jemena and Neoen, for example, considered that the proponents' proposed rule change to reapply the entire RIT to be overly onerous and likely to cause significant project delays, deliverability issues and net total cost increases.<sup>50</sup>

Citi Power, Powercor & United Energy supported the potential alternative approach that the AER could request a proponent to justify why, after the NSP identified that a MCC had occurred, the preferred option remained the most net beneficial option.<sup>51</sup> According to Jemena, a targeted approach, such as reassessing cost-benefit and sensitivity analysis, would be more reasonable and help to avoid any delays to project delivery.<sup>52</sup> The ENA further considered that a reasonable safeguard for consumers would be for the AER to be able to require NSPs to justify their view that a MCC had not occurred.<sup>53</sup>

In their submission to the consultation paper, the proponents stated that the AER should be able to exercise its discretion in determining what 'reapply' would mean on a case-by-case basis.<sup>54</sup> This could involve requiring the RIT proponent to redo the PACR with revised costs and undertake stakeholder engagement to determine whether the preferred option remains the most net beneficial option.

### 4.2.2 Who should decide whether a RIT should be reapplied?

A number of stakeholders suggested that the RIT proponent is best placed to determine whether the RIT should be reapplied. APA and AusNet, for example, considered that it is important that decisions regarding the preferred option and whether a RIT should be reapplied remains with the RIT proponent.<sup>55</sup> AusNet considered that the RIT proponent will have the most up-to-date and accurate information on the costs, risks and customer expectations and is therefore best placed to decide:

- whether the preferred option has or is expected to have changed;
- whether there has been a material change in the circumstances surrounding the project since the RIT was conducted;
- the additional costs and delays which may be incurred by re-applying a RIT; and
- the additional customer value likely to be realised from re-applying a RIT.<sup>56</sup>

According to AusNet, if these decisions do not remain with RIT proponents, they would face additional risks and uncertainty.

49 Consultation paper submissions: Citi Power, Powercor & United Energy, p. 2; ENA, p. 5; Jemena, p. 10; Neoen, p. 14.

50 Consultation paper submissions: Jemena, p. 10; Neoen, p. 14.

51 Consultation paper submissions: Citi Power, Powercor & United Energy, p. 2.

52 Consultation paper submissions: Jemena, p. 10.

53 Consultation paper submissions: ENA, p. 5.

54 Consultation paper submissions: Proponents' submission, p. 9.

55 Consultation paper submissions: APA, p. 14; AusNet Services, p. 4.

56 Consultation paper submissions: AusNet Services, p. 4.

The AER noted that it does not have a role in assessing RITs, and therefore does not have full visibility of the costs and benefits contained in RITs.<sup>57</sup> The AER suggested this should be kept in mind in determining the appropriate decision-maker under the proposed rule change.

Notwithstanding AusNet's view above that these decisions should remain with proponents, it stated that if additional AER oversight is required to improve customer outcomes and provide additional customer safeguards, where a proponent has determined the RIT need not be re-applied, the proponent could be required to inform the AER of the reasons underpinning its decision.<sup>58</sup> The AER should then have 20 business days to accept the RIT proponent's decision or, having carefully considered the material that has been submitted, instruct the proponent to re-apply specific aspects of the RIT (such as the cost benefit analysis). In making its decision, the AER should have regard to the costs that a proponent had incurred throughout the RIT process.

In contrast, the AEC and ECA stated that, if the decision as to whether the RIT should be reapplied were to remain with the proponent, the AER should at least have the right to test the RIT proponent's judgment.<sup>59</sup> Several stakeholders went further, suggesting that the AER (rather than the RIT proponent) should be responsible for deciding whether the RIT needs to be reapplied. Energy Grid Alliance and the PIAC, for example, argued that NSPs do not have any incentives to acknowledge a MCC or decide to reapply the RIT.<sup>60</sup> The fact that there has been no instance where a proponent has reapplied the RIT supports this argument in their view.

#### 4.2.3

#### **Providing additional analysis and further consultation**

Ergon Energy and Energex considered that the AER should have the ability to require RIT proponents to justify their views through the RIT process in relation to whether the RIT must be reapplied.<sup>61</sup> According to AEMO and the ECA, any additional analysis and modelling undertaken should be published and subject to public consultation.<sup>62</sup> This would be important, in their view, in ensuring transparency for consumers and wider stakeholders.

Energy Australia was of the view that any additional analysis required to be published should reflect the same level of detail as released in RIT assessments e.g. modelling inputs and outputs, but limited to core scenarios or sensitivities to demonstrate whether preferred options had changed.<sup>63</sup>

AusNet argued that where additional analysis and modelling is required by the AER, the requirement to publish and consult on that information must be carefully considered.<sup>64</sup> Consultation should only be required if the impact of the delay on the project (including cost)

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57 Consultation paper submissions: AER, p. 8.

58 Consultation paper submissions: AusNet Services, p. 4.

59 Consultation paper submissions: AEC, p. 4; ECA, p. 9.

60 Consultation paper submissions: Energy Grid Alliance, p. 39; PIAC, p. 13.

61 Consultation paper submissions: Ergon Energy and Energex, p. 8.

62 Consultation paper submissions: AEMO, p. 22; ECA, p. 10.

63 Consultation paper submissions: Energy Australia, p. 13.

64 Consultation paper submissions: AusNet, p. 5.

is minimal, and there is a reasonable likelihood that stakeholders will engage with the additional material.

In contrast, APA suggested that the AER should have a more limited role (if any) if a reopening trigger has been triggered. It considered that, if a reopening trigger has been triggered, this should not result in the reapplication of the RIT or any need to provide updated analysis to the AER.<sup>65</sup> Instead, reopening triggers should trigger an update to the analysis underpinning the RIT and consultation with stakeholders about the findings.

#### **4.2.4 Concerns that the rule change proposal will cause delays in project delivery**

In addition to the concerns raised by stakeholders in relation to requiring any additional analysis to be subject to consultation, some stakeholders submitted that changes of the type contemplated by the rule change request could create substantial delays to necessary transmission network upgrades and could hinder the clean energy transition.<sup>66</sup> The CEFC, for example, emphasised the importance of investment certainty and argued that new mechanisms to reapply the RIT and reduce the base case investment at a later date would reduce investor confidence and increase risk. It considered that this would harm timely delivery of projects and ultimately increase costs for consumers.<sup>67</sup>

### **4.3 Analysis**

#### **4.3.1 In the first instance, the RIT proponent should decide whether the RIT should be reapplied (as a last resort)**

The Commission agrees with stakeholder submissions that the RIT proponent is best placed to determine whether a RIT should be reapplied. The proponent will have the most up-to-date and accurate information on costs, benefits and customer expectations. The Commission acknowledges that the AER currently does not have a role in assessing RITs and therefore does not have complete visibility over relevant costs and benefits.<sup>68</sup> The RIT proponent is best placed to determine whether the preferred option remains the most net beneficial option, and to understand any costs and delays that might be associated with reapplying a RIT. If this decision was made in the first instance by the AER, this would be a relatively difficult decision for the AER to make due to the information asymmetry, and proponents would face additional risks and uncertainty.

The Commission considers that the AER should have a role (similar to its role under the current MCC provisions), in relation to what particular consequence should flow if the proponent identifies an MCC. This is because different courses of action are likely to be appropriate depending on the nature of the change in circumstances. It would not be possible for the rules to be prescriptive in providing for every conceivable eventuality, so a flexible process is required. The Commission considers that the default consequence that

<sup>65</sup> Consultation paper submissions: APA, p. 14.

<sup>66</sup> Consultation paper submissions: CEIG, p. 15.

<sup>67</sup> Consultation paper submissions: CEFC, p. 12.

<sup>68</sup> Previously, clause 5.16.6 of the NER required the AER to make a determination as to "whether the preferred option satisfies the regulatory investment test for transmission". This clause was removed when the 'Actioning the ISP' rules came into effect and introduced the new AEMO feedback loop set out in clause 5.16A.5(b).

flows from the proponent identifying a MCC, reapplication of the RIT, is not commensurate with all types of MCC, and should only occur if absolutely required.

Therefore, aligned with its role under the current MCC provisions, the AER should be able to test the RIT proponent's proposed course of action. The Commission notes that under the mechanism set out in the draft rule, the AER would not have a role in testing the merits of a RIT proponent's view as to whether a MCC has occurred.

If the RIT proponent determines that a material change in circumstances has occurred (such as where a reopening trigger has been triggered), it would be required to inform the AER, and propose the appropriate course of action. When submitting a contingent project application, the NSP would need to state that no reopening triggers have been triggered or, if they have been triggered, that an appropriate course of action has been actioned. The AER should be permitted to request further information/analysis from the RIT proponent, and as a last resort require the full RIT to be reapplied.

The Commission considers that the CPA process can be leveraged with. The RIT proponent being required to state in its CPA that no reopening triggers had been triggered and to provide supporting analysis, which would be consulted on as part of the CPA consultation process. This would act as a check on RIT proponents, encouraging them to ensure that a material change in circumstances has occurred (such as whether a reopening trigger has been triggered) are defensible. This approach avoids creating an additional consultation process, which would add time and cost to the project delivery process.

#### **4.3.2 Guidance for the AER on whether additional analysis is required, or in the extreme case, whether the RIT should be reapplied**

The Commission considers that guidance should be included in the rules to help the AER determine whether the RIT should be reapplied in full or in part, similar to that provided in the current MCC provisions. The Commission notes that the current MCC provisions prescribe the factors that the AER must have regard to when making a determination that the RIT proponent need not reapply the RIT.<sup>69</sup> Under the revised MCC provisions, the Commission considers that the AER should be required to consider similar factors, in addition to the costs likely to be incurred and delay that would result from reapplying the RIT in full or in part.

#### **4.3.3 Time limit on the AER to decide whether the RIT proponent should follow a course of action different to that proposed**

In their rule change request, the proponents proposed that the AER would be required to publish a determination exempting a RIT proponent from the requirement to reapply the RIT within 30 days of the RIT proponent publishing the revised project cost.<sup>70</sup> AEMC staff have also discussed with various stakeholders the potential need for some time-limited bounds to be placed on the AER's ability to determine that the RIT proponent should pursue a course of action different to that which it proposed.

<sup>69</sup> Clause 5.16.4(z3), 5.16A.4(n) and 5.17.4(t) of the NER

<sup>70</sup> ERM et al., *Rule change request*, p. 8.

The Commission considers that such a time limit is required in order to reduce any potential impacts of project delays. Time limits similar to those used in the AER's process for addressing disputes in relation to the application of RITs could be applied.<sup>71</sup> The draft rule provides that, if it rejects the NSP's proposed course of action, the AER has 40 days to determine the appropriate course of action for the NSP to follow.

#### 4.3.4 Mitigating the risk of 'analysis paralysis'

In consultation with stakeholders, a concern was raised that the Commission's proposed approach outlined above may result in the NSP being required to re-do analysis multiple times. The Commission agrees that the risk of the NSP experiencing 'analysis paralysis' – that is, a continual need to rerun analysis which prevents the progression of a project – should be mitigated and that a mechanism should be included in the draft rule to combat this.

The draft rule consequently limits the requirement to consider whether a material change in circumstances has occurred (including whether any reopening triggers have been triggered) to after 6 months of the completion of the analysis (i.e. initial RIT or subsequent rerun of the analysis).

## 4.4 Conclusions

The Commission's draft determination (subject to the further considerations outlined in chapter 5) is to:

- require RIT proponents, if they determine that a material change in circumstances has occurred (which, for certain RIT proponents, may include that a reopening trigger has been triggered), to inform the AER and the proposed appropriate course of action
- permit the AER to request further information/analysis from the RIT proponent, and/or require the RIT proponent to pursue an alternative course of action
- require the AER to decide whether the RIT proponent should follow an alternative course of action within 40 days of notification of the proposed course of action
- where applicable, require the RIT proponent to state in any relevant CPA that no reopening triggers have been triggered and provide supporting analysis or, alternatively, outline the course of action that was pursued if one or more reopening triggers had been triggered
- exempt RIT proponents from considering whether a material change in circumstances has occurred (including whether a reopening trigger has been triggered) within six months of the completion of the analysis (i.e. initial RIT or subsequent rerun of the analysis).

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<sup>71</sup> See, for e.g., clauses 5.16B(d) and 5.17.5(d) of the NER.

## 5 RIT PROJECTS SUBJECT TO NEW REQUIREMENTS TO DEVELOP REOPENING TRIGGERS

This chapter discusses stakeholder feedback, and presents the Commission's analysis and conclusions, regarding what types of projects should be subject to the more preferable draft rule and whether a value threshold should be imposed.

### 5.1 Issue

In the rule change request, the proponents suggested that the proposed changes should apply to all transmission and distribution projects which require a RIT, but that the AER should have the discretion to waive the application of the provisions for smaller projects (greater than \$150 million and greater than \$50 million for transmission and distribution projects respectively).<sup>72</sup> The proponents stated that the focus of their proposed rule change was on larger projects that go through the RIT process.

The proponents submitted that it may be appropriate for these value thresholds to be indexed to preserve their real value.<sup>73</sup> Further, the proponents submitted that it was not their intention to require the AER to undertake a review of every project given the associated administrative costs.

In relation to whether the proposed rule change should apply to both contingent and non-contingent projects, the proponents submitted that major non-contingent projects should be captured since the risk to consumers of a 'capex blowout' for contingent projects is equally applicable to non-contingent projects.<sup>74</sup>

As outlined in the consultation paper, in considering what projects should be captured by the proposed rule change, it is relevant to weigh up the potential impact on consumers of projects being delivered that may not be the most net beneficial option against the administrative cost and potential delay associated with revisiting the preferred option.<sup>75</sup>

It may be more appropriate to focus attention on major projects since the potential impact on consumers of a large project being delivered that is no longer the most net beneficial option after a MCC could be significant and would be more likely to outweigh any costs or delay associated with revisiting the preferred option.

Any decision as to which projects should be covered by revised MCC provisions would need to have regard for the number of projects that would be expected to meet various thresholds, and the potential impact on consumers of projects of various sizes not being captured by the MCC provisions.

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72 ERM et al., *Rule change request*, p. 10.

73 Consultation paper submissions: Proponents, p. 11.

74 Consultation paper submissions: Proponents, p. 14.

75 Consultation paper, p. 52.

## 5.2 Stakeholder views

Stakeholder views diverged in relation to whether any new requirements should apply to only contingent projects and both transmission and distribution projects, and whether these requirements should apply in Victoria.

AEMO considered that the existing RIT reapplication obligation is appropriate for contingent projects.<sup>76</sup> AEMO noted the issues raised regarding the application of this obligation to non-contingent projects but does not consider these warrant amendments to the current MCC provisions. Energy Grid Alliance stated that the new requirements should apply to all contingent and major non-contingent projects.<sup>77</sup>

Jemena submitted that for many RIT-D projects, failing to promptly undertake the RIT because of any additional consultation, for example, is likely to affect the reliability and secure operating state of the network.<sup>78</sup> The ENA submitted that applying any revised MCC provisions to distribution and lower cost transmission projects would be unreasonable given the significant difference in the issues faced by these projects, including the relative significance of the ISP and CPA processes compared to investments included in the regulatory reset.<sup>79</sup>

In a similar vein, Energy Australia submitted that the level of scrutiny should be proportional to the potential impact of projects on consumers.<sup>80</sup> For PIAC, a value threshold would prevent unnecessary administrative and regulatory burden on NSPs while ensuring that projects with the most significant potential impacts on consumers are subject to appropriate governance and approvals processes.<sup>81</sup> TasNetworks considered that decision rules should only apply to ISP projects given the magnitude of these projects.<sup>82</sup>

The Commission sought further feedback on this issue from AEMO. AEMO staff suggested that it would likely be unnecessary for any new requirements to apply to RIT-Ts undertaken by AEMO (which are not subject to the CPA process) since AEMO oversees the efficiency of investment under the existing framework for augmentations and this will continue to be the case for material changes in circumstances.

### 5.2.1 AEMC cost estimate accuracy roundtable

The AEMC hosted a cost estimate accuracy roundtable on 16 February 2022. At the roundtable, 40 attendees participated in an online poll which asked various questions in relation to the rule change request and the alternative proposal outlined in the consultation paper. The majority of poll respondents considered that 'any strengthened requirements' in relation to cost estimate accuracy and the MCC provisions should apply to contingent projects

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76 Consultation paper submissions: AEMO, p. 22.

77 Consultation paper submissions: Energy Grid Alliance, p. 40.

78 Consultation paper submissions: Jemena, p. 8.

79 Consultation paper submissions: ENA, p. 28.

80 Consultation paper submissions: Energy Australia, p. 12.

81 Consultation paper submissions: PIAC, p. 9.

82 Consultation paper submissions: TasNetworks, p. 8.

above a certain value and to ISP projects. A range of project value thresholds for contingent projects were provided, mostly between \$100 and \$500 million.

## 5.3 Analysis

The Commission has considered whether it would be proportionate to apply the new MCC provisions set out in the previous chapters in full for all RIT projects. The Commission acknowledges stakeholder concerns regarding the need to avoid adding time and cost to the RIT process, and the need to ensure that measures imposed on particular projects are commensurate with the potential impacts on consumers. Accordingly, the Commission does not consider that *all* RIT proponents should be required to develop reopening triggers as outlined in chapter 3).

However, the Commission does consider that all RIT proponents (for both transmission and distribution projects) should at a minimum be required to actively consider whether there has been a change to the identified need. If the identified need has changed, then proponents of all RIT projects should be required to inform the AER and propose a course of action (which the AER can reject). This is because changes to the identified need would be of fundamental importance but would also be relatively easy to monitor (as compared to a change in the credible options, for example).

The Commission considers that only RIT proponents of projects above a certain value threshold should be required to additionally develop reopening triggers (as described in chapter 3). The coverage of these reopening triggers should include changes to the key assumptions used in identifying the credible options assessed in the final RIT report, and ranking these options. The Commission considers it appropriate to distinguish between a change in the identified need, and a change to the credible options and ranking of these options. This is because the former could be readily monitored by all proponents, whereas the latter is more difficult to monitor and administratively more burdensome. Therefore, only proponents of major projects should be required to develop reopening triggers.

As discussed in section 4.4 above, the AER will be required to consider various factors in deciding whether reapplication of the RIT is not required (where there has been a change to the identified need) or whether an alternative course of action to that proposed by the RIT proponent should be adopted (for projects above a value threshold, where there has been a change to the credible options or ranking of these). This includes the costs likely to be incurred and associated delay, as well as whether failing to promptly undertake the project is likely to impact the reliability and secure operating state of the network. The Commission considers that these considerations will mitigate any stakeholder concerns that applying the new MCC provisions to distribution projects could create reliability and security issues.

The Commission considers that a reasonable value threshold for contingent projects for the purposes of developing reopening triggers is \$100 million. This is supported by some stakeholders. The Commission acknowledges that any value threshold imposed will be to some extent arbitrary, but \$100 million will appropriately capture the majority of major contingent projects (i.e. actionable ISP projects) which could have the most significant impacts on consumers.

The Commission further considers that this \$100 million value threshold should be subject to the AER's cost threshold review under Chapter 5. This requires the AER to conduct a review of the cost thresholds used in Chapter 5 for RIT-Ts and RIT-Ds every three years. Given the scope of cost thresholds that are currently subject to the AER's cost thresholds review under Chapter 5, there seems to be no reason for excluding the proposed value threshold from the review. This would allow the AER to consider whether the threshold remains appropriate over time. Further, this will not add any time to the process since the AER must already review the existing cost thresholds.

### 5.3.1 Reporting through the CPA process

The Commission is of the view that the new MCC provisions set out in the previous chapters should apply to both contingent and non-contingent projects. However, the Commission considers that the new MCC provisions would be likely to work most effectively for RIT projects that subsequently become contingent projects. This is because, for contingent projects, the submission of the CPA is a clear event at which time consideration can be given to whether a reopening trigger has been triggered.

Consequently, proponents of contingent projects would be required to state in the relevant CPA that no reopening triggers have been triggered and provide supporting analysis or, alternatively, outline the course of action that was pursued if one or more reopening triggers had been triggered. Similarly, proponents of contingent projects below the \$100m threshold would need to state in the CPA whether or not the identified need had changed, with supporting analysis, and the course of action taken if so.

For non-contingent projects, there is no clear event equivalent to submitting the CPA. While the Commission has examined the possibility of establishing an equivalent event for non-contingent projects that could be used for reporting and consultation in a similar manner to the CPA, it considers that the administrative burden and costs associated with this would outweigh the potential benefits, especially given that it is proposed that all project proponents, including for non-contingent projects, will be subject to the AER reporting regime in the new MCC provisions.

The Commission also acknowledges that it would be difficult to distinguish in Chapter 5 between RIT projects that subsequently become contingent projects and those that do not. Applying the new MCC provisions to both contingent and non-contingent RIT projects avoids introducing undue complexity in the NER.

### 5.3.2 Applicability in Victoria

In relation to whether the new MCC provisions should apply to transmission augmentations in Victoria, the Commission considers that AEMO, as the RIT-T proponent, has different incentives to other NSPs. Under s 49 of the NEL, AEMO must carry out its statutory functions having regard to the NEO, and therefore must exercise its function as RIT-T proponent in a way that promotes efficient investment in network infrastructure for the long-term interests of consumers.

The Commission also notes that there are examples where AEMO has updated a RIT-T PACR based on changes in circumstances. For example, for the Regional Victorian Thermal Capacity Upgrade RIT-T, AEMO updated the PACR, which included a re-assessment of the third augmentation stage of the preferred option in response to proposals received from network and non-network service providers.<sup>83</sup> The Commission therefore considers that it is unnecessary to apply the new MCC provisions to transmission augmentations (i.e. those for which AEMO is the RIT-T proponent) in Victoria.

### 5.3.3 Implementation and transition

The new requirements of the draft rule relating to reopening triggers would not apply to projects for which a PADR or DPAR had already been published by the commencement date. This will avoid any need for these projects to go back to the PADR/DAPR stage to identify and consult on reopening triggers, and ensure that additional time and costs are not added to the process.

## 5.4 Conclusions

The Commission has determined to:

- require RIT proponents of all projects to consider whether there has been a change to the identified need, and to report their decision to the AER, together with a proposed course of action where required
- additionally require RIT proponents of projects with estimated project cost greater than \$100 million to develop reopening triggers (as discussed in chapter 3)
- require proponents of contingent projects to state in the relevant CPA that there has not been a change to the identified need and/or no reopening triggers have been triggered and provide supporting analysis or, alternatively, outline the course of action that was pursued if the identified need changed and/or one or more reopening triggers had been triggered
- exempt projects for which a PADR or DPAR had already been published by the commencement date of the rule from the requirements of the new MCC provisions.

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<sup>83</sup> AEMO, *2014 Victorian Annual Planning Report*, June 2014, p. 15.

## 6 STRENGTHENED GUIDELINES FOR RITS TO PROVIDE MORE ROBUST COST ESTIMATES

This chapter discusses stakeholder feedback, and presents the Commission's analysis and conclusions, regarding whether the rules governing the AER guidelines for RITs should be strengthened to promote the development of more robust cost estimates.

### 6.1 Issue

In addition to their primary proposal in relation to the MCC provisions, the proponents suggested that the RIT-T and RIT-D application guidelines should be strengthened to encourage proponents to develop robust RITs. In their view, this would ultimately reduce the likelihood that reapplication of the RIT would be needed under the current MCC provisions.

The proponents' rule change request proposed that the AER guidelines be amended to require RIT proponents to develop more rigorous cost estimates for the final RIT report. These cost estimates should be based on a class 2 AACE estimate (i.e. a detailed feasibility study). The AACE international cost estimate classification system provides guidelines for applying general principles of estimate classification to project cost estimates (i.e. cost estimates that are used to evaluate, approve and/or fund projects).

There is a question for the Commission as to whether there is a need to change the rules governing the AER guidelines that apply to RITs, in order to promote the strengthening of these guidelines and supplement the changes proposed for the MCC provisions.

### 6.2 Stakeholder views

Most submissions on this topic did not support the proponents' proposal to require class 2 AACE cost estimates for the RIT. Indeed, in their submission to the consultation paper, the proponents suggested that the rules should not require a specific class of cost estimate to be applied at the PACR/FPAR stage.<sup>84</sup> They suggested that prescribing a particular class of cost estimate might be confusing to stakeholders. Rather than imposing a prescriptive requirement in the rules which could be open to interpretation, the proponents submitted that RIT proponents should decide the level of accuracy to adopt for the purpose of calculating cost estimates (as is currently the case).

A number of stakeholders did support requiring the development of more rigorous cost estimates.<sup>85</sup> In the view of these stakeholders, improved cost estimate accuracy would reduce, but not eliminate, the risk that project costs subsequently increase.<sup>86</sup> At the AEMC's cost estimate accuracy roundtable, most poll respondents stated that there should be improved clarity in relation to cost estimate accuracy across the regulatory framework (ISP, RIT, CPA etc).

<sup>84</sup> Consultation paper submissions: ENA, p. 6; AEC, pp. 3-4; AusNet, p. 7; CEC, p. 5.

<sup>85</sup> Consultation paper submissions: AusNet, p. 3; ECA, p. 10; Origin, p. 5.

<sup>86</sup> Consultation paper submissions: AusNet, p. 3.

AEMO submitted that regulatory certainty in cost estimation accuracy at various stages in the planning and funding approval framework is more important than revising the MCC provisions.<sup>87</sup> According to AEMO, nothing in the AER guidelines currently specifies what accuracy level is expected of proponents. NSPs do not all use the AACE framework and accuracy ranges vary across RIT proponents and projects.<sup>88</sup> Introducing requirements for cost estimate accuracy should help address issues associated with changes in cost estimates at various regulatory stages by increasing certainty as to how estimates are calculated and the treatment of risk.<sup>89</sup> Further, cost estimates should include reasonable approximations for any key cost inputs.

In contrast, some stakeholders submitted that the guidelines should not specify a particular level of rigour for cost estimates<sup>90</sup> – rather, revising the MCC provisions would encourage more rigorous and realistic cost estimates during the RIT.<sup>91</sup>

## 6.3 Analysis

The RIT-T and RIT-D application guidelines, and CBA guidelines (which apply to actionable ISP projects) provide guidance on how cost estimates should be developed and applied throughout the RIT process. The Commission considers that ensuring a good, consistent standard of cost estimate accuracy would be beneficial in restoring confidence in the RIT process, and could assist in reducing the incidence of material changes.

The Commission notes that in the AER's guidance note on the regulation of actionable ISP projects that RIT-T proponents are expected to indicate the level of accuracy, or uncertainty, of the forecast costs for the project, noting that the AACE cost estimate classification system provides a useful and consistent framework.<sup>92</sup> Further, under this guidance note, RIT-T proponents are expected to ensure that cost estimates are not overly conservative – they should be realistic, reflecting the likelihood of any contingencies occurring.

Under the RIT-T application guidelines, three broad categories of costs should be captured, but the specific cost inputs within these broad categories that must be included are not specified. In relation to discount rates, these guidelines state that the AER expects RIT-T proponents to illustrate 'boundary values' for discount rates at which the preferred option changes when sensitivity testing the outcome of the cost benefit analysis. However, the demonstration of boundary values is not required. Further, in the CBA guidelines, the RIT-T proponent is given the *discretion* to illustrate 'boundary values' for important input assumptions at which the preferred option changes.

These guidelines do not specify what level of accuracy cost estimates should have, do not require the development of cost estimates for key cost inputs and that allowances should be included for contingencies, and do not *require* sensitivity analysis.

<sup>87</sup> Consultation paper submissions: AEMO, p. 21.

<sup>88</sup> Consultation paper submissions: AEMO, p. 23.

<sup>89</sup> Consultation paper submissions: AEMO, p. 21.

<sup>90</sup> Consultation paper submissions: CEFC, p. 13; PIAC, p. 14.

<sup>91</sup> Consultation paper submissions: PIAC, p. 14.

<sup>92</sup> AER, *Guidance Note: Regulation of actionable ISP projects*, March 2021, p. 7.

In achieving a good, consistent standard of cost estimate accuracy the Commission is aware of concerns that input cost uncertainty across the supply chain may increase costs and cost uncertainty. The regulatory framework needs to be flexible enough to deal with this, with the Commission needing to consider whether that flexibility is best provided in guidelines rather than via more prescription in the rules.

The question that therefore arises is whether the rules governing the RIT application and CBA guidelines need to be changed.

### 6.3.1 **Recommended changes to the guidelines and rules covering the guidelines to improve cost estimate accuracy**

The Commission acknowledges stakeholder submissions regarding the need to promote the robustness of RIT cost estimates. The Commission considers that the AER can provide guidance to RIT proponents on using a particular class of cost estimates from a particular system under the current provisions that govern the RIT application and CBA guidelines (*'acceptable methodologies for valuing the costs of a credible option'*). Notwithstanding this, the Commission considers it reasonable to clarify this in the rules. Moreover, the Commission recommends that the AER consider amending these guidelines to provide clarity in relation to cost estimate classification systems and cost estimate accuracy levels, and consider whether these should be binding on RIT proponents

As is evident from the different guidelines, the AER currently encourages RIT proponents to conduct sensitivity analyses and illustrate the boundary values for input assumptions at which the preferred option would change. Sensitivity testing and boundary values are routinely included in RIT assessments, with the boundary tests flagging the changes in costs or benefits that would impact option rankings.<sup>93</sup> Accordingly, the Commission does not consider that any clarification in the rules governing the guidelines is required in this regard. However, the Commission recommends that the AER consider amending the RIT application and CBA guidelines to *require* RIT proponents to conduct sensitivity analyses and illustrate boundary values for input assumptions at which the preferred option would change.

The Commission does not consider it appropriate to require the guidelines to specify the particular cost inputs that must be included in RITs beyond the broad cost classes the guidelines already refer to. The Commission considers that the rules should be clarified to give the AER the option to update the guidelines to provide guidance on the role of contingency allowances. Moreover, the Commission recommends that the AER consider amending the RIT application and CBA guidelines to clarify the role of contingency allowances.

<sup>93</sup> See for example: Transgrid *Maintaining Reliable Supply to the Bathurst, Orange and Parkes areas PADR* February 2022, section 7.5 (includes discussion of boundary tests for capex and discount rate assumptions), [https://www.transgrid.com.au/media/n4zlwcks/transgrid-padr\\_maintaining-reliable-supply-to-bathurst-orange-and-parkes-areas.pdf](https://www.transgrid.com.au/media/n4zlwcks/transgrid-padr_maintaining-reliable-supply-to-bathurst-orange-and-parkes-areas.pdf); Transgrid *HumeLink PACR*, section 6, section 8.4 (including boundary test conducted for the increase in Option 3C costs that would result in Option 2C becoming the preferred option – p. 56), <https://www.transgrid.com.au/media/txancvmx/transgrid-humelink-pacr.pdf>

Regarding the CPA process, the Commission notes that the AER has made a process guideline for CPAs.<sup>94</sup> This process guideline is complemented by the AER's Guidance note for the regulation of actionable ISP projects under which the AER considered cost estimate accuracy.<sup>95</sup> In section 2.2 of the guidance note, the AER encourages TNSPs, in engaging with stakeholders as they prepare their CPAs, to indicate the level of accuracy, or uncertainty in the forecast costs for the project and notes that the AACE cost estimate classification provides a useful and consistent framework.<sup>96</sup> The AER could consider whether it would be appropriate to strengthen requirements on TNSPs to use AACE cost estimates.

### 6.3.2 The AER should specify which parts of the guidelines are binding

The Commission considered that the AER should have the ability to specify which parts of the RIT-T and RIT-D guidelines are binding on RIT proponents, in the same way it does for the CBA guidelines. This would address the proponents' concern that the guidelines are not binding on proponents.

### 6.3.3 Implementation and transition

The Commission considers that the rule should commence operation 12 months after publication of the final rule, and that the AER be required to update and publish the RIT application guidelines and CBA guidelines prior to the commencement date, under transitional arrangements.

The Commission welcomes stakeholder views on the proposed implementation timeframe.

## 6.4 Conclusions

The Commission has made a draft determination to:

- clarify, in the rules governing the RIT-T and RIT-D application guidelines and the CBA guidelines, that the AER can provide guidance in relation to any acceptable cost estimate classification systems that should be used for the RIT, and any role for contingency allowances
- allow the AER to specify which parts of the RIT-T and RIT-D application guidelines are binding on proponents.

Further, the Commission recommends the AER further consider how the guidelines governing RITs could be strengthened to promote the development of more robust cost estimates.

<sup>94</sup> See <https://www.aer.gov.au/system/files/Final%20process%20guideline%20for%20contingent%20project%20applications%20-%20September%202007.pdf>

<sup>95</sup> See <https://www.aer.gov.au/system/files/AER%20-%20Final%20Guidance%20note%20-%20Regulation%20of%20actionable%20ISP%20projects%20-%20March%202021%20-%20FINAL%20FOR%20PUBLICATION%202812129318.1%29.pdf>

<sup>96</sup> See AER, *Guidance note for the regulation of actionable ISP projects*, March 2021, p. 7.

## ABBREVIATIONS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
Commission	See AEMC
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National electricity objective
NERL	National Energy Retail Law
NERO	National energy retail objective
NGL	National Gas Law
NGO	National gas objective

## A SUMMARY OF OTHER ISSUES RAISED IN SUBMISSIONS

This appendix sets out the issues raised in the first round of consultation on this rule change request and the AEMC’s response to each issue. [If an issue raised in a submission has been discussed in the main body of this document, it has not been included in this table.]

**Table A.1: Summary of other issues raised in submissions**

STAKEHOLDER	ISSUE	AEMC RESPONSE
Proponents AEC ENA Energy Grid Alliance AEMO CS Energy ECA Energy Australia	The proponents and many stakeholders were supportive of imposing a requirement on RIT proponents to provide project cost data to AEMO to improve the accuracy of the ISP.	The Commission determined that this issue is outside the scope of the rule change and is more appropriately dealt with by the TIPR.

## B LEGAL REQUIREMENTS UNDER THE NEL

This appendix sets out the relevant legal requirements under the NEL for the AEMC to make this draft rule determination.

### B.1 Draft rule determination

In accordance with s. 99 of the NEL the Commission has made this draft rule determination in relation to the rule proposed by the proponents.

The Commission's summary of reasons for making this draft rule determination are set out in section section 2.4.

A copy of the more preferable draft rule is attached to and published with this draft rule determination. Its key features are described in chapter 2.

### B.2 More preferable rule

Under section 91A of the NEL, the Commission may make a rule that is different (including materially different) to a proposed rule (a more preferable rule) if it is satisfied that, having regard to the issue or issues raised in the rule change request, the more preferable rule will or is likely to better contribute to the achievement of the NEO. In this instance, the Commission has made a more preferable draft rule. The Commission's reasons for making a more preferable rule are summarised in chapter 2.

### B.3 Power to make the rule

The Commission is satisfied that the more preferable draft rule falls within the subject matter about which the Commission may make rules. The more preferable draft rule falls within s. 34(1)(b) of the NEL, which permits the Commission to make Rules for or with respect to any matter or thing contemplated by the NEL, or which is necessary or expedient for the purposes of the NEL. The Commission considers the electricity Rule is necessary and expedient for the purposes of the NEL.

Further, the more preferable draft rule falls within the matters set out in Schedule 1 to the NEL as it relates to Items 17, 19, 26A and 26C because the more preferable draft rules relates to the:

- principles to be applied, and procedures to be followed, by the AER in exercising or performing an AER economic regulatory function or power relating to the making of determinations to amend transmission and distribution determinations for contingent projects; and
- economic framework, mechanisms or methodologies to be applied by the AER for the purposes of making determinations to amend transmission and distribution determinations for contingent projects.

## B.4 Commission's considerations

In assessing the rule change request the Commission considered:

- its powers under the NEL to make the rule
- the rule change request
- submissions received during first round consultation
- views expressed at the AEMC cost estimate accuracy roundtable held on 16 February 2022
- the Commission's analysis as to the ways in which the proposed rule will or is likely to, contribute to the NEO.

There is no relevant Ministerial Council on Energy (MCE) statement of policy principles for this rule change request.<sup>97</sup>

The Commission may only make a rule that has effect with respect to an adoptive jurisdiction if satisfied that the proposed rule is compatible with the proper performance of Australian Energy Market Operator (AEMO)'s declared network functions.<sup>98</sup> The more preferable draft rule is compatible with AEMO's declared network functions because it would not affect those functions.

## B.5 Application to the Northern Territory

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant Ministerial Council on Energy (MCE) statement of policy principles, a different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule.

A differential rule is a rule that:

- varies in its term as between:
  - the national electricity system, and
  - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of section 91(8) of the NEL.

As the more preferable draft rule relates to parts of the NEL that apply in the Northern Territory, the Commission is required to assess whether to make a uniform or differential rule (defined below) under Northern Territory legislation.

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant MCE statement of policy principles, a

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<sup>97</sup> Under s. 33 of the NEL the AEMC must have regard to any relevant MCE statement of policy principles in making a rule. The MCE is referenced in the AEMC's governing legislation and is a legally enduring body comprising the Federal, State and Territory Ministers responsible for energy. On 1 July 2011, the MCE was amalgamated with the Ministerial Council on Mineral and Petroleum Resources. The amalgamated council is now called the COAG Energy Council.

<sup>98</sup> Section 91(8) of the NEL.

different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule. A differential rule is a rule that:

- varies in its term as between:
  - the national electricity system, and
  - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems,

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

To the extent that the proposed rule relates to:

- parts of the NER that currently do not apply in the Northern Territory, the Commission has not assessed the rule against the additional elements required by the Northern Territory legislation; and
- parts of the NER that apply in the Northern Territory, the Commission has assessed the draft rule against additional elements required by the Northern Territory legislation.<sup>99</sup>

The Commission has determined to make a uniform rule as it does not consider that a differential rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule.

## B.6 Civil penalties

The Commission cannot create new civil penalty provisions. However, it may recommend to the Energy Ministers' Meeting that new or existing provisions of the NER be classified as civil penalty provisions.

The draft rule does not amend any clauses that are currently classified as civil penalty provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the Energy Ministers' Meeting that any of the proposed amendments made by the draft rule be classified as civil penalty provisions.

## B.7 Conduct provisions

The Commission cannot create new conduct provisions. However, it may recommend to the COAG Energy Council that new or existing provisions of the NER be classified as conduct provisions.

The draft rule does not amend any rules that are currently classified as conduct provisions under the NEL or National Electricity (South Australia) Regulations. The Commission does not propose to recommend to the Energy Ministers' Meeting that any of the proposed amendments made by the draft rule be classified as conduct provisions.

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<sup>99</sup> From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. See the AEMC website for the NER that applies in the NT.