

30 September 2021

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Katy Brady
Australian Energy Market Commission (AEMC)
GPO Box 2603
Sydney NSW 2001

Via electronic lodgement

Dear Katy

**RE: Material change in network infrastructure project costs rule change request
(Project ERC0325)**

We welcome the opportunity to respond to the rule change request that proposes to require a Regulatory Investment Test (RIT) proponent to reapply the RIT if there is a material change in the estimated costs of the project.

We understand the impetus for proposed rule change is twofold: there have been RIT projects where actual project costs significantly exceed the cost estimates used in the RIT analysis. Second, it is important that customers and other stakeholders have confidence in the regulatory and economic assessment processes underpinning all network investment, including high value transmission investment. The rule change proposal seeks to foster that confidence.

Due to the Victorian transmission planning arrangements, our regulated transmission network does not plan the Victorian transmission network. Large Integrated System Plan (ISP) projects in Victoria are contestable unless classified otherwise by the Australian Energy Market Operator (AEMO).¹ AEMO is also responsible for running the RIT for these investments.² AusNet Services does not, therefore, undertake RITs for projects of the magnitude that are the focus of this rule change.³ Our regulated transmission investments are limited to asset replacements which are generally funded through *ex ante* expenditure allowances set through resets (rather than Contingent Project Applications). Consequently, we face very strong incentives to minimise the costs of these projects once our capex allowance for a regulatory period is set.

While our experience with the RIT framework to date has demonstrated its value in identifying non-network options and increasing transparency, it has also revealed significant limitations when the RIT is applied to low value projects, particularly projects where there is only a single network option or where no feasible non-network alternative exists. The cost of conducting a RIT can include the cost of running market studies, securing the necessary engineering resources and preparing RIT documentation, and can be relatively high compared to the total cost of the project that is the subject of the RIT.

¹ See NER Clause 8.11.6.

² See: <https://aemo.com.au/energy-systems/electricity/national-electricity-market-nem/nem-forecasting-and-planning/victorian-planning/victorian-transmission-network-service-provider-role> (accessed 21/09/2021).

³ For example, most of our transmission projects cost less than \$100 million.

For projects which have no credible non-network options, the cost of conducting the RIT (which is ultimately funded by customers) is likely to exceed any customer benefit from running it. This is particularly true where the project has been subject to AER and stakeholder scrutiny as part of a reset process.

The design of the RIT framework should reflect the likely costs and benefits for specific project types, and balance this against the costs of conducting that analysis. This will ensure efficient allocation of resources and that the RIT itself delivers value for money. The need to avoid a one-size-fits-all approach is recognised by the rule change proponents, who propose different criteria for determining whether a RIT should be reapplied based on which cost threshold a project satisfies.

There are other features of the operation of the RIT which, although not the direct focus of the rule change, should be considered as part of this process to ensure the RIT framework maximises customer value and ensures efficient and timely investment. Specifically, we consider there is merit in removing the obligation to conduct a RIT for:

- projects with no viable non-network options; and
- government-mandated or compliance-driven programs where only a single credible option exists.⁴

Exemptions for these projects are appropriate to ensure the right balance between transparency and cost. The very nature of some projects, such as like-for-like replacement programs⁵, indicates there is no non-network option and the RIT consultation process is highly unlikely to change that. Similarly, government-mandated and compliance-driven programs are often required to meet specific network performance or safety objectives which limit the breadth of solutions that a RIT proponent can consider. The REFCL program is an excellent example, whereby the legislative obligations imposed upon DNSPs meant the credible options were extremely limited and non-network options did not exist.

While the existing regulatory framework allows consultation to be streamlined where there is no non-network option available, the cost of running a streamlined process is not insignificant, particularly where networks must run numerous RITs each year. The potential benefit of the streamlined process (increased transparency) must be considered against the cost of undertaking a RIT, particularly where it is usual for a proponent to receive no submissions during any of the RIT consultation stages. For example, we have completed the RIT process for 13 projects (10 of which were government-mandated programs) where we identified no viable non-network options at the start of our RIT process. For all 13 projects, we received no submissions from stakeholders. This clearly demonstrates that the expected regulatory burden of undertaking a RIT for these types of projects exceeds any potential benefits. Reforms are therefore required to improve the efficiency of the process and ensure resources are focussed where there is the greatest customer benefit.

Our responses to the specific questions raised in the rule change request are in Appendix A (attached). However, our key points are summarised below:

- AusNet faces very strong incentives under the regulatory regime to minimise the costs of the infrastructure investment projects we undertake.
- Consistent with the current framework, the proponent should decide whether a re-application of the RIT is warranted under the NER (if this amendment is made by the AEMC).
- Where total capex increases by more than the amounts captured by the RIT sensitivity analysis, the proponent should evaluate whether the RIT needs to be re-applied. If regulatory oversight is required, the proponent could be required to notify the AER in writing of a decision to not re-apply the RIT and the reasons for it. The AER will have 20 business days to assess the proponent's advice and respond.

⁴ We raised this in the 2018 repex RIT rule change process; we maintain our view.

⁵ A replacement program is the aggregation of several individual assets being replaced in different parts of the network at a similar time.

- The RIT should not be re-applied once construction of a project commences. Re-opening a RIT during construction (even where costs have increased due to factors outside the proponents control) would result in unpalatable investment uncertainty for networks and additional costs (including project delay costs while the RIT is re-run) for customers.
- Use of a class 2 AACE estimate should not be mandated. Requiring project cost estimates to be prepared at this level of precision is not proportionate. It will impose significant additional costs on customers and for smaller projects (like the projects we tend to build), it is unlikely to achieve equivalent benefits. Importantly, greater accuracy during the early stages of a project will reduce, but not eliminate, the risk that project costs subsequently increase.

The RIT is an integral part of ensuring that the regulatory framework delivers timely investment at the least cost to consumers, and we look forward to continuing to work with the AEMC on this issue. If you have any questions regarding this submission, please contact Ian McNicol by email on ian.mcnicol@ausnetservices.com.au.

Yours sincerely

A handwritten signature in black ink that reads "C. Eddy". The signature is written in a cursive style with a long horizontal stroke underneath the name.

Charlotte Eddy
Manager Economic Regulation
AusNet Services

Response to the questions raised in the material change in network infrastructure project costs rule change request

Question	AusNet's response
<p>Q11: Who should decide whether the RIT must be re-applied?</p> <ol style="list-style-type: none"> 1. Should this decision remain the responsibility of the proponent or should it be a matter for the AER? Why? 2. If the decision remains with the proponent, should the AER have the right to test that opinion? 	<p>For all RITs, the proponent is best placed to judge whether a RIT should be re-applied. This is because the proponent will have the most up-to-date and accurate information on the costs, risks and customer expectations. The proponent is, therefore, best placed to decide:</p> <ul style="list-style-type: none"> • 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 (including, but not limited to, the estimated cost of the project); • 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. <p>Even where a proponent's project cost estimate exceeds the estimate generated by the sensitivity analysis undertaken as part of a RIT, the decision on whether to re-apply the RIT should remain with the proponent. To do otherwise would introduce additional risk and uncertainty to network businesses.⁶</p> <p>If additional AER oversight is required to improve customer outcomes and provide additional customer safeguards, where costs have increased materially more than those assessed in a proponent's sensitivity analysis, and where a proponent has determined the RIT need not be re-applied, we propose the proponent be required to write to the AER setting out its reasons for its decision. The AER should then have 20 business days to accept the 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 has incurred to reach this point in the RIT process. Any requirement to re-apply a RIT, even if that is limited to the re-doing of a very specific part of the process, will result in additional project risk, costs and potential delays.</p> <p>We also note RIT-D data will soon be available as part of DNSPs' Regulatory Information Notices. This will increase the transparency of the RIT-Ds we have conducted and give the AER greater opportunity to assess our expenditure against the expenditure we modelled in the corresponding RIT.</p>

⁶ The cost estimation process undertaken by a proponent should be sufficiently robust to test all credible options under a range of reasonable scenarios. That data is used to determine whether a change to an input variable will affect the preferred option. This process will also help the proponent identify the circumstances under which a project will no longer be a viable proposition. We note that a RIT can take over a year to complete and some change in cost should be expected.

Question	AusNet's response
<p>Q12: Cost thresholds</p> <ol style="list-style-type: none"> 1. Should the NER include a requirement to reapply the RIT, or update analysis, when costs increase above specified percentage thresholds? If so, do you have a view as to what those percentage thresholds should be? 2. Do you consider this requirement should apply to all RIT projects or only those above a particular cost threshold/thresholds? If so, do you have a view as to what the cost threshold/s should be? 3. Do you have any views regarding the suggested alternative "decision rule" approach? 4. Should updated project cost data be provided to AEMO to help improve the accuracy of the ISP? 5. Do you have any other suggestions regarding alternative ways to manage cost increases? 	<p>As outlined in the covering letter, AusNet does not undertake RITs for contestable ISP projects and has delivered very few regulated transmission projects which exceed \$150m – the threshold which is the focus of this rule change request. Our projects tend to be funded through <i>ex ante</i> expenditure allowances set through resets, rather than Contingent Project Applications. This means the regulatory allowance for our projects is often set prior to completion of the RIT and we face very strong incentives to minimise the costs of the projects we undertake to ensure they remain within the capex allowance set for the relevant regulatory control period.</p> <p>With respect to when a RIT should be re-applied, please refer to our responses to Q11 (above) and Q14 (below). Our responses to these questions outline the circumstances in which we consider a RIT should or should not be undertaken and who should make that decision.</p>
<p>Q 13: Requirements when re-applying the RIT</p> <ol style="list-style-type: none"> 1. Should the requirement to re-apply the RIT be more targeted? 2. Should any additional analysis and modelling that is required to be undertaken be published and subject to public consultation? 	<p>Yes, the circumstances in which a RIT should be re-applied should be more targeted. Please refer to our response to Q11 (above).</p> <p>Where additional analysis and modelling is required by the AER, the requirement to publish and consult on that information must be carefully considered. Consultation should only be required if the impact of the delay on the project (including cost) is minimal, and there is a reasonable likelihood that stakeholders will engage with the additional material.</p>

Question	AusNet's response
<p>Q14: Trigger to re-apply the RIT</p> <ol style="list-style-type: none"> 1. Do you have any views as to how the requirement to reapply the RIT should be given effect, including for contingent and non-contingent projects? 2. Should there be a cut-off point (e.g. once the AER approves the CPA, or once construction commences) beyond which any requirement to update analysis cannot be triggered? If so, what would be an appropriate cut-off point? Should there be a limit on how many times RIT analysis must be updated? 	<p>The RIT should only be re-applied if the proponent decides it is warranted – see our response to Q11 (above).</p> <p>As explained in our cover letter, we also consider there is merit in removing the need for, or at least developing a pragmatic exemption process to RITs for:</p> <ul style="list-style-type: none"> • projects with no viable non-network options; and • government-mandated or compliance-driven programs with no alternative options. <p>Exemptions for these projects are appropriate to ensure the right balance between transparency and cost. The very nature of some projects, such as like-for-like replacement programs, show that there is no non-network option and the RIT consultation process is highly unlikely to change that. Similarly, government-mandated and compliance-driven programs are often required to meet specific network performance or safety objectives which limit the breadth of solutions that a RIT proponent can consider. The REFCL program is an excellent example, whereby the legislative obligations imposed upon DNSPs meant the credible options were extremely limited and did not allow for non-network options. While a RIT does increase transparency, and the existing regulatory framework sometimes allows consultation to be streamlined, the potential benefit (increased transparency) of the existing regime must be considered against the cost of undertaking a RIT, particularly where it is usual for a proponent to receive no submissions during any of the RIT consultation stages. For example, we have completed the RIT process for 13 projects (10 of which were government-mandated programs) where we identified no viable non-network options at the start of our RIT process. For all 13 projects, we received no submissions from stakeholders. This clearly demonstrates that the expected regulatory burden of undertaking a RIT for these types of projects exceeds any potential benefits. Reforms are therefore required to improve the efficiency of the process and ensure resources are focussed where there is the greatest customer benefit.</p> <p>We support setting a clear, cut-off point beyond which a proponent cannot be required to re-apply the RIT, which we consider should be the time construction commences.</p> <p>We currently face strong incentives to minimise costs under the regulatory regime. Through the AER's Capital Expenditure Sharing Scheme, increases in project costs are shared by the network and its customers. We also note that any outcome that results in us having to pause construction for six to nine months to re-run a RIT, will add material costs (and risk) to a project, and customers will ultimately fund a share of the cost increase.</p> <p>We do not consider there should be a limit on the number of updates a RIT is subject to prior to the project reaching the cut-off point referred to above. Any limit would be arbitrary.</p>

Question	AusNet's response
<p>Q15: Should RIT cost estimates be more rigorous?</p> <ol style="list-style-type: none"> 1. Do you consider that the current level of rigour used for RIT cost estimates is suitable? If not, what level of rigour is appropriate? In particular, would it be appropriate to require an AACE 2 estimate (i.e. a detailed feasibility study) for each credible option? 2. If more detailed cost estimates are required at the RIT stage, should this apply to all RIT projects, or only to larger projects? If so, which projects should be subject to this requirement? 3. Do you have any other suggestions to address the issues raised in the rule change request? 	<p>It is not appropriate to require proponents to prepare detailed feasibility studies for each credible option. This is a resource intensive exercise and would significantly increase RIT costs – a class 2 AACE estimate typically costs upwards of \$1 million and can take our business 9-12 months to prepare one credible option. This represents a significant increase on our average RIT cost of \$0.2 million. To ensure the RIT costs remain proportionate to the RIT project costs and the value of the RIT for consumers, any requirement to conduct a class 2 AACE estimate should be limited to very large transmission projects, if applied at all.</p> <p>With respect to further reforms, please refer to Q14 (above).</p>