



Material change in network infrastructure project costs

The Australian Energy Market Commission (AEMC) has commenced consultation on a rule change request submitted by the Energy Users Association of Australia (EUAA), Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited. The request proposes that, unless an exemption is granted by the AER, a proponent must reapply the regulatory investment test (RIT) if, following completion of the RIT, the estimated cost of a transmission or distribution project materially increases. Consultation on this rule change request is being progressed as part of the AEMC's Transmission planning and investment review.

Overview of the rule change request

On 15 February 2021, the proponents submitted a rule change request to the Commission regarding the reapplication of the RIT following material changes in network infrastructure project costs.

Under the existing arrangements, the RIT must only be reapplied where, in the reasonable opinion of the project proponent, there has been a material change in circumstances which means the preferred option identified in the final RIT report is no longer the preferred option.

The rule change proponents are concerned that project costs can increase between completion of the RIT and the contingent project application (CPA) whereby the proponent seeks AER approval to recover costs from consumers. The rule change notes that this has occurred in the case of Project EnergyConnect, which experienced a cost increase of approximately 60 per cent between RIT and CPA, and the Eyre Peninsula Upgrade, which experienced a 21 per cent cost increase between RIT and CPA.

The rule change proponents consider that allowing project costs to significantly increase after the application of the RIT negatively impacts stakeholder confidence in the RIT process and is a failure of governance. To address this, the rule change proposes the following changes:

- A RIT proponent must reapply the RIT if, following completion of the RIT, its project's costs have increased by 10 per cent (for larger transmission and distribution projects: i.e. where project cost is greater than \$500m and \$200m respectively) or 15 per cent (for smaller transmission and distribution projects: i.e. where project cost is less than \$500m and \$200m respectively), unless an exemption is granted by the AER.
- The AER may determine that a proponent is not required to reapply the RIT (or is only required to repeat part of the RIT). The AER would have 30 days from the date of publication of the revised project cost estimate to make and publish its determination.
- Project EnergyConnect (PEC) should be required to update its final RIT-T report to take account of material cost increases that have occurred since completion of the RIT.
- AER guidelines should be amended to require proponents to develop more rigorous cost estimates for the final RIT report, thereby reducing the risk that the RIT will need to be reapplied as a result of material cost increases.

Issues for consultation

Chapter 5 of the *Transmission planning and investment review's* consultation paper identifies and discusses key issues arising from the rule change request. These include:

- Who should decide whether the RIT should be reapplied when circumstances change?
- If the rules are amended as proposed, what cost increase thresholds should trigger

reapplication of the RIT, and what projects should be subject to these thresholds?

- Should the requirement to reapply the RIT be more targeted, or should the current approach remain (i.e. requiring the whole RIT to be repeated unless the AER determines otherwise)?
- How would reapplication of the RIT be triggered for non-contingent projects given that there is little or no information available on the revised cost estimates of these projects?
- Are there alternative approaches that could reduce the need to reapply the RIT? For example, by identifying upfront the changes in circumstances that would alter the ranking of the preferred option.
- What level of rigour is appropriate to require in cost estimates at the RIT stage? Could the proposal to require detailed feasibility studies have unintended outcomes?

Background

Before a network service provider (NSP) can proceed with a significant transmission or distribution project, it must go through a number of regulatory processes. These include the regulatory investment test (RIT) for distribution or transmission (RIT-D or RIT-T), the purpose of which is to identify, cost and rank options for addressing an identified need. The "preferred option" is the option that maximises the net economic benefit to the market.

For larger projects where the cost or timing of the project is uncertain (known as "contingent projects"), the proponent then needs to seek AER approval (via a contingent project application or CPA) to recover the cost of the project from consumers. By contrast, smaller projects typically form part of the revenue proposal submitted by a NSP as part of the five yearly revenue reset process.

Actionable ISP projects are also required to go through the AEMO "feedback loop" to ensure that the cost of the project does not rise to the point that the project no longer forms part of the ISP's optimal development plan. This process is designed to ensure that project costs do not exceed an upper bound identified in the ISP. By contrast, the RIT is focused on the lower bound - that is, identifying the most efficient way to address an identified need. Both have an important role to play in protecting consumer interests.

Cost estimates used for the purpose of the RIT are based on preliminary scoping of projects, while cost estimates used for the CPA are more robust (involving market-testing, route finalisation, identification of environmental compliance costs etc). As a result, the estimated cost of a preferred option may change significantly following completion of the RIT. This raises the question of whether the preferred option remains preferred, or whether another credible option is now more efficient and should be pursued instead.

To date, no NSP has formed the requisite opinion that circumstances have changed to such an extent that the RIT must be reapplied. To address this, the rule change request proposes that objective cost increase thresholds be included in the relevant provisions so that reapplication of the RIT does not rely on the NSP forming the opinion that circumstances have materially changed.

Consultation process

Stakeholders are invited to make submissions by **30 September 2021** and are encouraged to use the stakeholder submissions template when providing feedback. The consultation paper and stakeholder template are available [here](#). A public forum will be held on 2 September 2021, please register [here](#).

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