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Danielle Beinart  
Director  
Australian Energy Market Commission  
GPO Box 2603  
SYDNEY NSW 2001

Level 16, 567 Collins Street  
Melbourne, VIC 3000  
PO Box 16182  
Melbourne, VIC 3000  
T +61 3 9173 7000  
F +61 3 9173 7516  
[www.jemena.com.au](http://www.jemena.com.au)

Lodged via the [AEMC website](#)

Dear Danielle,

### **AEMC's consultation on the material change in network infrastructure project costs proposed rule change**

Jemena Electricity Networks (**JEN**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**) consultation on material changes in network infrastructure project costs. We strongly support the AEMC's continued work developing and refining the National Electricity Rules (**NER**) in consultation with stakeholders. Updating the framework will ensure that the regulatory framework is fit-for-purpose and facilitates outcomes that are in the long-term interests of consumers.

The proposed material change in network infrastructure project costs rule change (**proposed rule change**) proposes that, unless an exemption is granted by the Australian Energy Regulator (**AER**), network service providers (**NSPs**) must reapply a regulatory investment test (**RIT**) if, following completion of the RIT, the estimated cost of a transmission or distribution project materially increases.<sup>1</sup> Under current arrangements, RITs are only reapplied when the project proponent considers there has been a material change in circumstances that means the preferred option identified in the final RIT report is no longer the preferred option.

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<sup>1</sup> AEMC, *Material change in network infrastructure project costs information sheet*, August 2021, p. 1.

Overall, JEN considers that the proposed rule change to reapply the entire RIT is overly onerous and is likely to cause significant project delays, leading to deliverability issues and the potential for system security and reliability impacts. The existing requirements, combined with some minor modifications such as reassessing projects' cost-benefit and sensitivity analysis, are more reasonable and would help avoid project implementation delays. We outline our concerns with several key aspects of the proposed rule change and provide our responses to the consultation questions in attachment A.

If you have any questions regarding this letter, please contact Spencer Little on 03 9173 8830 or [spencer.little@jemen.com.au](mailto:spencer.little@jemen.com.au).

Kind regards,

[Signed]

Matthew Serpell  
Manager Electricity Regulation  
Jemena Electricity Networks



# Jemena Electricity Networks (Vic) Ltd

**Submission on the AEMC's consultation  
regarding material changes in network  
infrastructure project costs**



## Table of contents

<b>Abbreviations .....</b>	<b>iii</b>
<b>1. Proposed rule change.....</b>	<b>1</b>
1.1 Project costs and materiality threshold .....	1
1.2 Existing rule requirements .....	2
1.3 The existing regulatory framework meets the requirements.....	3
1.4 Role of the AER.....	4
<b>2. Response to consultation questions.....</b>	<b>5</b>

## Abbreviations

AACE	Association of Cost Engineering
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
CESS	capital expenditure share scheme
DNSPs	distribution network service providers
EBSS	efficiency benefit share scheme
JEN	Jemena Electricity Networks
NER	National Electricity Rules
NSPs	network service providers
REFCL	rapid earth fault current limiter
RIT-D	regulatory investment test for distribution
TNSP	transmission network service providers
VBRC	Victorian Bushfire Royal Commission

## 1. Proposed rule change

Jemena Electricity Networks (**JEN**) welcomes the opportunity to respond to the Australian Energy Market Commission's (**AEMC**) consultation on material changes in network infrastructure project costs. We strongly support the AEMC's continued work developing and refining the National Electricity Rules (**NER**) in consultation with stakeholders. Updating the framework will ensure that the regulatory framework is fit-for-purpose and facilitates outcomes that are in the long-term interests of consumers.

The proposed change in network infrastructure project costs rule change (**proposed rule change**) proposes that, unless an exemption is granted by the Australian Energy Regulator (**AER**), network service providers (**NSPs**) must reapply a regulatory investment test (**RIT**) if, following completion of the RIT, the estimated cost of a transmission or distribution project materially increases.<sup>1</sup> Under current arrangements, RITs are only reapplied when the project proponent considers there has been a material change in circumstances that means the preferred option identified in the final RIT report is no longer the preferred option.

Overall, JEN considers that the proposed rule change to reapply the entire RIT is overly onerous and is likely to cause significant project delays, leading to deliverability issues and the potential for system security and reliability impacts. The existing requirements, combined with some minor modifications such as reassessing projects' cost-benefit and sensitivity analysis, are more reasonable and would help avoid project implementation delays. Below we outline our concerns with several key aspects of the proposed rule change.

### 1.1 Project costs and materiality threshold

Under the proposed rule change, NSPs must reapply the RIT if:

- project costs for large projects (greater than \$500 million and \$200 million for transmission network service providers (**TNSPs**) and distribution network service providers (**DNSPs**), respectively) increase by 10%
- project costs for smaller projects (less than \$500 million and \$200 million for TNSPs and DNSPs, respectively) increase by 15%.<sup>2</sup>

The cost materiality threshold of \$200 million for DNSPs is very high. As a smaller DNSP, JEN is very unlikely to propose projects that would exceed this threshold. Over the past ten years, all of JEN's RITs for distribution (**RIT-Ds**) have been below \$37 million, with the single largest investment undertaken relating to the Coolaroo rapid earth fault current limiter (**REFCL**) obligation. Excluding this larger-scale project, the vast majority of JEN's RIT-D investments have been below \$25m. Therefore, the 15% cost materiality threshold outlined above would likely apply for all of JEN's RIT-Ds. In addition, delaying regulatory compliance obligations such as the REFCL program due to unforeseen project cost increases is likely to materially affect the reliability and secure operating state of the network and not deliver outcomes that are in consumers' long-term interests.<sup>3</sup>

JEN's cost estimates for RIT-Ds vary depending on the gate stage the project is at, ranging from plus or minus 30% early on in the process to plus or minus 10% to 15% as the project matures. Therefore, if the cost increase materiality threshold is applied early on in the RIT-D process, JEN anticipates that the majority of its RIT-Ds would need to be reapplied unless otherwise determined by the AER. As highlighted above, this is likely to cause significant project delays, leading to deliverability issues and the potential for system security and reliability impacts.

In addition, the proposed rule change advocates for more detailed project cost estimates, consistent with the American Association of Cost Engineering (**AACE**) International Recommended Practice and Estimate

<sup>1</sup> AEMC, *Material change in network infrastructure project costs information sheet*, August 2021, p. 1.

<sup>2</sup> Energy Users Association of Australia, Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited, *Material change in network infrastructure project costs rule change*, January 2021, p. 3.

<sup>3</sup> NER, cl. 5.17.4(v) for distribution; NER, cl. 5.16.4(z5) for transmission.

Classification.<sup>4</sup> During the AEMC's public forum on 2 September 2021, the AEMC outlined that this approach is estimated to cost between 1 and 3% of the project cost, just for one option. This level of cost estimation is overly onerous and does not seem appropriate or fit-for-purpose, as using class 2 estimates will significantly increase the costs of completing RIT-Ds.<sup>5</sup> JEN has previously developed business cases with up to six scenarios and costs could therefore increase by nearly 20% just under this requirement. Costs would increase to an even greater degree if the RIT needed to be reapplied at a later stage.

This requirement for more detailed cost estimates could also have unintended consequences that create more project cost uncertainty. For example, requiring more onerous class 2 cost estimates could bring forward the scoping stages of the RIT-D project, which creates a greater possibility of unknown and uncertain cost increases occurring as the project matures. This would subsequently increase the likelihood of the RIT-D having to be reapplied. This increase for all projects needs to be considered in the context of the harm that the proposed rule change is trying to avoid. We contend that the net economic cost of adopting this methodology outweighs the benefits.

## 1.2 Existing rule requirements

The NER states that if:

- an NSP has published a final project assessment report in respect of a RIT project; and
- an NSP still wishes to undertake the RIT project to address the identified need; and
- there has been a material change in circumstances that, in the reasonable opinion of the NSP, means that the preferred option identified in the final project assessment report is no longer the preferred option

then the NSP must reapply the RIT unless otherwise determined by the AER.<sup>6</sup> When making this determination, the AER must have regard to:

- the credible options (other than the preferred option) identified in the final project assessment report
- the change in circumstances identified by the NSP
- whether a failure to promptly undertake the RIT project is likely to materially affect the reliability and secure operating state of the network or a significant part of that network.<sup>7</sup>

We recommend maintaining the requirement that a RIT is reapplied if, in the reasonable opinion of the NSP, the preferred option identified in the final project assessment report is no longer the preferred option. This requirement adequately considers the broader cost-benefit analysis, including relevant sensitivity analysis, rather than just considering whether project costs have increased. We characterise this approach as considering the 'next best' alternative, i.e. that the project's analysis changed to such a degree that the next best credible option is now the preferred option.

<sup>4</sup> Energy Users Association of Australia, Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited, *Material change in network infrastructure project costs rule change*, January 2021, p. 3.

<sup>5</sup> A class 2 estimate would mean that 30-75% of the scope of the project has been defined and the expected accuracy range at an 80% confidence interval is negative 5-15% on the low side and positive 5-15% on the high side. Energy Users Association of Australia, Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited, *Material change in network infrastructure project costs rule change*, January 2021, p. 9.

<sup>6</sup> NER, cl. 5.17.4(t) for distribution; NER, cl. 5.16.4(z3) for transmission.

<sup>7</sup> NER, cl. 5.17.4(v) for distribution; NER, cl. 5.16.4(z5) for transmission.

The proposed rule change recommends adding new clauses to the requirements the AER must have regard to if project costs increase materially (as outlined above in section 1.1), specifically whether the estimated cost of the preferred option is below \$150 million for TNSPs and \$50 million for DNSPs. JEN considers that this \$50 million materiality threshold for RIT-Ds is very unlikely to ever be exceeded.

In addition, it is unclear at what stage in the RIT-D process that the AER would be triggered to determine whether or not the RIT-D needs to be reapplied. The proposed rule change outlines that RIT-Ds would need to be reopened if project costs changed materially after the final project assessment report had been published, but does not identify process the AER would be required to follow.<sup>8</sup>

However, at such a late stage in the process, many projects would already be committed and requiring the AER to run a 30 business day consultation process is likely to cause project delays and deliverability issues. JEN considers that for many RIT-D projects, failing to promptly undertake the RIT project because of this additional consultation is likely to materially affect the reliability and secure operating state of the network.<sup>9</sup>

### 1.3 The existing regulatory framework meets the requirements

The proposed rule change does not consider whether the existing requirements that NSPs account for in the current RIT process and under existing investment governance processes are sufficient to assess cost variations. For example, sensitivity analysis—including assessing project cost sensitivities—is conducted in the RIT-D process and this sensitivity analysis seeks to ensure that the preferred option remains the preferred option if material elements of the underlying analysis change. This is consistent with the NER requirements outlined above in section 1.2.

For DNSPs, the ex-ante total capital and operating expenditure frameworks aim to ensure that material cost overruns do not occur—at a total expenditure level—through the capital expenditure share scheme (**CESS**) and efficiency benefit share scheme (**EBSS**), respectively. Therefore, JEN questions whether each eligible distribution project should be micro-tested at a cost overrun threshold of 15%. Given the size of most RIT-D investments, the dynamic nature of the distribution network and the shorter time frame to implement projects to meet customers' needs, DNSPs should rely on existing investment governance processes and rule requirements when implementing RIT-D projects.

Finally, the existing regulatory framework includes measures that address inefficient expenditure. The NER states that the AER can reduce inefficient past capex if any of the following requirements are satisfied:

- the DNSP has spent more than its capex allowance (the 'overspending' requirement)
- the DNSP has incurred capex that represents a margin paid under arrangements that do not reflect arm's length terms (the 'margin' requirement)
- the DNSP's capex includes expenditure that should have been treated as opex (the 'capitalisation' requirement).<sup>10</sup>

This ex-post review mechanism also helps to ensure that DNSPs are incentivised to avoid cost overruns at a total expenditure level. Overall, the existing regulatory framework is well suited to ensure that material cost increases are avoided, ensuring that customers pay no more than necessary for a safe, reliable and secure energy supply.

<sup>8</sup> Energy Users Association of Australia, Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited, *Material change in network infrastructure project costs rule change*, January 2021, p. 3.

<sup>9</sup> NER, cl. 5.17.4(v) for distribution; NER, cl. 5.16.4(z5) for transmission.

<sup>10</sup> NER, cl. 6.2.2A(b) to (i).



## 1.4 Role of the AER

Under current arrangements, RITs are only reapplied when the project proponent considers there has been a material change in circumstances that means the preferred option identified in the final RIT report is no longer the preferred option. However, the existing RIT process includes avenues for independent review where disputes may arise. For example, in 2017 the AER reviewed a written dispute notice from the Office of the Commissioner for Kangaroo Island and the Kangaroo Island Council regarding a RIT-D in South Australia.<sup>11</sup>

The AER's current role focuses on assessing the regulatory framework and ensuring RIT proponents follow all necessary rule requirements, as well as resolving disputes relating to RITs on an exceptions basis. However, the proposed rule change would introduce new administrative functions and requirements for the AER to consider whether or not the vast majority of RITs need to be reapplied. Overall, JEN considers that the rule change's proposed solution of moving from an exception-based framework to one where the AER would have to assess a large number of potential RIT reapplications is not fit-for-purpose and does not fit the market design.

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<sup>11</sup> AER, *Kangaroo Island submarine cable RIT-D dispute*, May 2017.

## 2. Response to consultation questions

**Question 1:** Who should decide whether the RIT should be reapplied when circumstances change?

NSPs are best placed to decide whether RITs should be reapplied when circumstances change. As highlighted in our submission in section 1.2, the proposed rule change outlines that RIT-Ds would need to be reopened if project costs changed materially after the final project assessment report had been published.<sup>12</sup> Following this, the AER would be required to run a consultation process and this is likely to cause significant project delays and deliverability issues at such a late stage in the process.

**Question 2:** 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?

As highlighted above in section 1.1, the cost materiality threshold of \$200 million for DNSPs is very high. As a smaller DNSP, JEN is very unlikely to propose projects that would exceed this threshold and the 15% cost materiality threshold would likely apply for all of JEN's RIT-Ds. Notwithstanding our views that the proposed rule change should not be introduced, JEN considers the following materiality thresholds and cost increases for DNSPs are more reasonable:

- \$200+ million – 10%
- \$50 million to \$200 million – 15%
- \$25 million to \$50 million – 20%
- \$6 million to \$25 million – 25%.

**Question 3:** 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)?

Yes, as outlined above, JEN considers that the proposed rule change to reapply the entire RIT is overly onerous and is likely to cause significant project delays, deliverability issues and net total cost increases. JEN considers a more targeted approach, such as reassessing projects' cost-benefit and sensitivity analysis, is more reasonable and would help to avoid any project implementation delays.

**Question 4:** 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?

DNSPs final project assessment reports provide updated and revised cost estimates. More broadly, the final project assessment reports undertake sensitivity analysis on a range of critical parameters that underpin the

<sup>12</sup> Energy Users Association of Australia, Delta Electricity, Major Energy Users Inc, ERM Power Limited and AGL Energy Limited, *Material change in network infrastructure project costs rule change*, January 2021, p. 3.

cost-benefit analysis modelling of the RIT-D. This existing process captures any potential changes to both the cost and benefit sides of the equation, which is critical in determining whether or not the project's preferred option has changed.

**Question 5:** 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.

Yes, as outlined in section 1.3, existing investment governance processes and rule requirements reduce the need to reapply the RIT in its entirety. Each stage of the RIT-D process requires the NSP proponent to identify changes in the underlying cost-benefit analysis, which includes potential changes in project costs.

**Question 6:** 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?

As highlighted in section 1.1, the level of cost estimation suggested in the proposed rule change is overly onerous and does not seem fit-for-purpose. Using class 2 estimates will significantly increase the costs of completing RIT-Ds. Costs would increase to an even greater degree if the RIT needed to be reapplied at a later stage.

In addition, this requirement for more detailed cost estimates could also have unintended consequences that create more project cost uncertainty. For example, requiring more onerous class 2 cost estimates could bring forward the scoping stages of the RIT-D project, which creates a greater possibility of unknown and uncertain cost increases occurring as the project matures.