SUBMISSION

REVIEW OF CBA & RIT GUIDELINES

7 SEPT 2023

The Energy Users' Association of Australia (EUAA) is the peak body representing Australian commercial and industrial energy users. Our membership covers a broad cross section of the Australian economy including significant retail, manufacturing, building materials and food processing industries. Combined our members employ over 1 million Australians, pay billions in energy bills every year and in many cases are exposed to the fluctuations and challenges of international trade.

Overview

The EUAA was one of the proponents of the Material Change in Network Infrastructure Costs rule change. While our proposal covered both transmission and distribution projects, our focus was on large transmission projects, particularly ISP projects. Our original proposal in January 2021 highlighted the significant increase in ISP project costs over the course of the RIT-T process and leading up to the contingent project application[1]. The evidence of significant cost increases we provided in our original application and observed most recently with Humelink and Marinus, shows why we made our rule change application.

We argued that allowing the project proponent to determine whether a material change had occurred meant that consumers had no confidence that the project met the net benefits test. It is difficult to trust project proponents to undertake the assessment of material change in a transparent way given there is a significant incentive for them to continue on with the project regardless of cost increases. Compounding this is the huge information asymmetry between the proponent and consumers that makes it almost impossible for consumers to fully interrogate the complex workings of the project model.

It was no surprise to us that there has never been a material change identified by a project proponent. No matter what the cost increase, the proponents still present modelling (never in any detail to enable independent testing) to claim the project still has net benefits.

For example, we had the 2022 Draft ISP saying in December 2021 that Humelink was not part of the optimal development path at a cost 'materially above' $3.3b. Last month we had Transgrid saying it still had net benefits at a cost $4.892b.

We are disappointed in the AER's decision to take a principles-based approach rather than a prescriptive approach to the guidance amendments. But given the transitional arrangements in the AEMC's final decision, combined with State derogations in Queensland, NSW and Victoria for project assessment, we expect that the first major ISP project that the new Guidelines apply to is so long into the future that the revised rules will have little benefit to consumers in the foreseeable future no matter what approach the AER takes.

[1] https://www.aemc.gov.au/sites/default/files/2021-02/ERC0325%20Rule%20change%20request%20pending%2015Feb2021.pdf

Nevertheless, we offer the following comments for the sake of putting our views on the record and perhaps having some influence in the Guidelines application to smaller RIT-T/RIT-D projects outside of the ISP.

Re-open triggers events

We argued in our initial submission that a non-prescriptive approach will provide the proponent with too much ability to influence the selection of triggers that suit its purposes. The AER's logic for rejection of the prescriptive approach seems to be that triggers can only be assessed on a project specific basis. However, our approach to 'prescription' was not one of 'these are the triggers that must be used on all projects'. It was one of a prescriptive approach to the selection of project specific triggers.

While the changes propose that TNSPs must consult on re-opening triggers and the worked examples in Appendix B of the CBA Guideline help, they effectiveness relies on the transparency of the proponent and the ability of the proponent's customer panel to have the knowledge, expertise and time to debate them in detail with the proponent. Our extensive lived experience in network customer panels suggests this is not always the case.

In our earlier submission we provided examples of that lived experience with Electranet (PEC) and Transgrid (Humelink) where consumers on the network panels had little or no influence over what the TNSP chose to present for discussion on these projects. There is an enormous bargaining imbalance due to knowledge and control of information flow by the TNSP. Why should the AER assume all proponents will act radically differently with the revised non-prescriptive Guidelines? The AER's response to our concerns about lack of trust in project proponents to assess material changes is a very general statement (p.23):

> "We have included in the principles-based approach guidance to encourage RIT proponents to be (sic) develop triggers that are verifiable …"

The AER provides no evidence that this approach will change proponent's behaviour to produce a level playing field in the debate between the proponent and their customer panel on which triggers to use and then on how the proponent will apply those triggers.

While the AER may be monitoring compliance, how will it be able to judge that the TNSP has complied? Will consumers on the TNSP customer panel be able to complain to the AER, during the course of the TNSP's consultation that the TNSP is not following the Guideline? If yes, what compliance and enforcement powers does the AER have?

Given the AER has to approve or reject the RIT proponent's proposed course of action when a material change has occurred, we would propose that the AER is able to approve or reject the proponent's selection of triggers.

Cost estimation in RIT-Ts

Everyone agrees that increased cost transparency is a good thing and we support the binding requirement for transparency.

We find it difficult to believe the proposition put in some submissions, and that the AER seems to have accepted, that having a binding obligation to use a cost classification system like the AACE, '…may increase RIT costs and delay

the RIT process'. This was expressed as a judgement with no empirical evidence provided. As we argued in our submission to the AEMC on the rule change, it is factors other than a requirement to meet the AACE classification that are delaying projects.

Any delay in WRL/VNI West/Humelink which may contribute to an increase in cost is largely driven by social licence or supply chain difficulties in sourcing materials or labour. Achieving more accurate cost estimation can proceed in parallel with getting social licence and signing an EPC contract.

As the EUAA showed in its support for Transgrid's Early Works CPA for Humelink, we agree with consumers bearing the costs of obtaining a more accurate cost estimate, provided that more accurate cost estimate (which follows a better-defined project scope, execution of landowner leases, long lead items procured etc) is the final result.

Having a mandate that RIT proponents *must consider* use of the AACE cost estimate system is of little benefit to consumers if:

- the proponent can simply provide a reason for not doing so, and
- there is no recourse for consumers to appeal that decision to the AER which does not have the power to decide whether the proponent's reason is valid.

While the AER says (p.15):

> "The AEMC states that the objective of such guidance (the AER's Guidelines) is to encourage RIT proponents to develop even more robust cost estimates, which should reduce the likelihood that the reapplication of the RIT is needed as a result of a material change in circumstances."

we would suggest that the proposed Guidelines do not guarantee that outcome. Even if the proponent decides to use the AACE system and is required to explain why an estimate falls within a specified class, there is no way for consumers or the AER to test whether that explanation is robust. Again, we come back to the uneven playing field in a proponent's customer panel where these debates will occur and there is a large information asymmetry between proponent and customer panel.

Consumers may have greater clarity on what the proponent thinks are the costs at a particular point in time, but that does not guarantee that consumers have confidence in the numbers presented by the network and the ability to debate them with the proponent's engineers. The 2022 ISP Consumer Panel noted in respect of Humelink that consumers had neither in the case of Humelink's costs in the 2022 ISP[2]:

> "Transgrid's description of the HumeLink PACR was:
>
> > 'We consider our cost estimates to be 'class 4' estimates, which is in-line with the level of accuracy expected at this stage of the investment process. For example, AEMO commented during the consultation process on its transmission cost database that the cost certainty at the PACR stage is typically between -30 per cent and +50 per cent ('class 4' estimates)…'

[2] See p. 79 https://aemo.com.au/-/media/files/major-publications/isp/2021/isp-consumer-panel-report-on-2021-iasr.pdf?la=en

And then Transgrid went on to say:

> 'We consider that the capital costs used in the PACR analysis are 'P50' estimates i.e. they have a 50 per cent expected probability of cost underrun.'

So, it is unclear if the estimate is class 4 or P50 and what is Transgrid's view of the relationship between both. If it is a class 4 with that accuracy band then it is closer to the AACE Class 4 accuracy bands (-10% to –20% to +20% to 50%) than the GHD accuracy bands of ±~20%. The use of different terminology is very confusing to the reader. How are we to compare P50 with AACE class and then what accuracy range?"

Transgrid's current estimate of the Humelink cost, to be used in the Draft 2024 ISP, is $4.892b[3]. We cannot explain how $3.3b can be defined as a P50 i.e. an equal probability of an increase or decrease. Transgrid says that the accuracy range of the latest capex forecast is -5% to +12% which it describes as an AACE Class 3. Yet the AACE Class 3 has a cost estimate range (with an 80% confidence interval) of -20% to + 30%)[4]. But the Draft seems to allow Transgrid to say something like 'We choose to not use the AACE classification system and use a P50 system'. How are consumers to decide the veracity and transparency of what Transgrid provides?

In the Draft 2022 ISP, the decision rules for Humelink included[5]:

> "the total project cost (including the cost of completed early works) has materially increased from the current cost estimate of $3.3 billion."

This decision rule was deleted in the final ISP. Transgrid continues to argue that even at a cost of $4.892b the project has net benefits. There is no independent process to assess that and the only test consumers can rely on is the feedback loop which only shows whether the project is part of the Optimal Development Path, not whether it is the cheapest way of building the project. And then Transgrid still has the option of applying for a post commissioning cost pass through if the actual costs are higher than the cost used for the feedback loop.

But then there is no consistency between how a cost classification system (AACE or any other) is applied by different TNSPs. Consumers have no idea whether a self-proclaimed Class 3 from one TNSP is consistent with a self-proclaimed Class 3 from another TNSP. While the AER says (pp17-18):

> "In adopting this approach, we note that AEMO uses AACE to classify the cost accuracy of future ISP projects and cross-check the level of accuracy of cost estimates developed by TNSPs."

there are important limits to AEMO's ability to undertake this task at more detail than a high level analysis. AEMO describes its process as[6]:

(a) TNSP provided cost estimate for each project option.
(b) AEMO estimated cost in parallel, using the Transmission Cost Database.

[3] See Table 8 p.30 https://aemo.com.au/-/media/files/major-publications/isp/2023/2023-transmission-expansion-options-report.pdf?la=en
[4] See https://web.aacei.org/docs/default-source/toc/toc_96r-18.pdf
[5] See p. 66 https://aemo.com.au/-/media/files/major-publications/isp/2022/draft-2022-integrated-system-plan.pdf
[6] See p.29 https://aemo.com.au/-/media/files/major-publications/isp/2023/2023-transmission-expansion-options-report.pdf?la=en

(c) AEMO compared estimates and worked with the TNSP to resolve or understand any significant differences in cost components or risk allowances. Importantly, as discussed in Section 2.2, the Transmission Cost Database is used for developing estimates for conceptual Class 5 projects. When used for comparing against TNSP estimates, it is used to enable a further understanding of the breakdown of differing costs as given by the TNSP and for further benchmarking of the tool itself.

While TCD is gradually expanding its data with inputs from a range of projects, it is focussed on Class 5a and 5b estimates and there is no requirement on TNSPs to follow AEMO's cost classification checklist[7]. The result of the cross check in the 2023 Transmission Expansions Options Report was that AEMO ended up going with the estimates they received form the TNSPs.

Sensitivity analysis

We support the AER's decision to mandate sensitivity testing for projects over $100m.

Summary

The EUAA's focus in our rule change has always been on large transmission projects flowing from the ISP. The evidence since our initial proposal in early 2021 has vindicated our concerns around the risks to consumers in rapidly increased project cost estimates. While we appreciate that the proposed changes will have some benefits to consumers, we think they will be limited given the transmission proponent will still retain significant power to influence the outcome with little AER oversight.

Members of a proponent's consumer panel may have a lot more information but there will still be a very uneven playing field in any negotiation over the selection and application of triggers and determination of material change. But given that the application of the Guidelines is likely to be quite small and only at or beyond the end of the current decade, it probably does not matter.

Do not hesitate to be in contact should you have any questions.

Andrew Richards
Chief Executive Officer

[7] See Appendix A1 https://aemo.com.au/-/media/files/major-publications/isp/2023/2023-transmission-expansion-options-report.pdf?la=en