



**Answer to Question on Notice –House of Representative s Energy and Environment Committee - Modernising the Grid Inquiry**

Energy Networks Australia took on notice the following Committee question during the proceedings held in Canberra on 1 June 2017.

**Question**

*Mr Conroy MP, sought advice from Energy Networks Australia on how project cost contingencies are accounted for, as part of a transmission businesses' application of a Regulatory Investment Test.*

**Answer**

**a. Project contingencies in regulatory allowances.**

Under the regulatory rules governing the five-year regulatory allowances approved by the AER, there are no specific contingencies allowed for by the Australian Energy Regulator. This is because the regulator approves a level of allowance rather than a set of specific project costs.

**b. Project contingencies in Regulatory Investment Tests**

Before they are incorporated in the regulatory allowance discussed above, major new transmission projects (exceeding \$6 million) are subject to Regulatory Investment Tests. Such tests are specifically governed by AER regulatory guidelines and are intended to transparently test:

- if the investment need is demonstrated and,
- if so, if it can be otherwise met by a more efficient solution including a non-network solution.

When a Transmission Network Service Provider (TNSP) undertakes a Regulatory Investment Test analysis, it is often done with a material degree of uncertainty regarding the costs of a *credible option*. That uncertainty is typical of the early stages of project assessment in any infrastructure sector.

Section 3.3. of the Australian Energy Regulator's [Final](#) Regulatory investment test for transmission application guidelines (June 2010) discusses what type of costs must be included in assessing a *credible option*. The Guideline requires that:

*If the transmission network service provider establishes that there is a material degree of uncertainty in the costs of a credible option, the cost is the probability weighted present value of the direct costs of the credible option under a range of different cost assumptions.*

This process is often based on external advice, and subsequently consulted upon by Transmission Network Service Providers, or as part of a TNSP's decision analysis as part of Stage 2 of a RIT-T process, that culminates in the publication of a Project Assessment Draft Report. Some recent

assessments have considered the sensitivity of the assessment to a 25 per cent increase/decrease in assumed network costs as one key variable, as well as to sensitivities in possible discount rates amongst other factors.<sup>1</sup> Energy Networks Australia understands that should these sensitivities alter the ranking of options the TNSPs report on these outcomes and/or re-define these estimates. The recently finalised (February 2017) COAG Energy Council's [RIT-T Review](#), identified no concerns with this issue.

Sensitivity analysis of this kind in the RIT-T assessment does not result in cost inflation for the project when ultimately delivered, but is rather used for comparative analysis of different solutions under different assumptions. The capital project delivered as a result of the RIT-T is ultimately included at its *actual* cost, meaning network customers do not meet the cost of a project contingency and noting that the regulator may reduce the capital expenditure included in the RAB to address inefficient spending where the business exceeds the approved capital allowance.

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<sup>1</sup> See for instance, the joint [Ausgrid/TransGrid Powering Sydney's Future RIT-T Project Assessment Draft Report](#) (May 2017).

