

7<sup>th</sup> September 2018

Mr Peter Adams  
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Australian Energy Regulator  
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Submitted via e-mail to: [RIT@aer.gov.au](mailto:RIT@aer.gov.au)

Dear Mr Adams,

**Draft Regulatory Investment Test for Transmission Application Guidelines**  
**AER Reference: 63054**

The Australian Energy Council (the “**Energy Council**”) welcomes the opportunity to make a submission in response to the Australian Energy Regulator’s (“**AER’s**”) *Draft Regulatory Investment Test for Transmission Application Guidelines*.

The Energy Council is the industry body representing 21 electricity and downstream natural gas businesses operating in the competitive wholesale and retail energy markets. These businesses collectively generate the overwhelming majority of electricity in Australia and sell gas and electricity to over ten million homes and businesses.

## **Discussion**

### Purpose of the RIT

The Regulatory Investment Test for Transmission (“**RIT-T**”) provides a structure which optimises the economic benefit of transmission infrastructure for generators, transmission network service providers (“**TNSPs**”) and consumers. The Energy Council notes commentary that frequently discusses the RITs purely as a matter between networks and consumers, whilst overlooking its other critical function: providing a predictable network development framework around which competitive investments in the energy market may be made with confidence. Section 2.1 includes a sentence referring to this key role, but only in the context of the consideration of credible options by the TNSP.

The Energy Council considers that this provision of a predictable and transparent framework in order to lower the risks of competitive investments in the energy market should be separately articulated as a specific purpose of the RIT-T.

While the overarching test is “to identify the credible option that maximises the present value of net economic benefit”,<sup>1</sup> the Energy Council would submit that within the classes of market benefit set out in Rule 5.16.1(c)(4), it is important for the RIT-T proponent to consider the capital efficiency of each credible option. While particular options may generate greater present values than others, the capital used (and hence the capital at risk) is a vital consideration to ensure that the social benefit of the transmission upgrade is maximised and not threatened by cost overruns and forecast errors. On this basis it is important that present value not be used as a simplistic tool to assess whether one credible option is preferred over another.

### Capital Cost Thresholds and External Contributions

As argued in the Energy Council’s previous submission, not recognising external financial contributions leaves the RIT-T process open to gaming by either placing a particular project beneath the RIT-T cost threshold or supplementing its business case such that it renders an uneconomic project economic. While the proposed application guidelines include internal wealth transfers between registered participants as relevant to overall project assessment, external contributions, for example from a government, are treated as exempt from consideration due to the AER’s narrow interpretation of “market” in Rule 5.16.1(b). The Energy Council argues that this asymmetric treatment is inappropriate since the funds provided, although external to the project, form

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<sup>1</sup> National Electricity Rule 5.16.1(b)

part of the societal corpus and therefore require inclusion in the overall assessment process to provide the most economically efficient outcome.

In the Energy Council's view, a network project whose costs exceed its benefit should not be developed as a prescribed (regulated) asset, regardless of the source of funds. This is a crucial underpinning of the provision of a transparent and predictable framework around which the market can invest, which formed the original intent of the RIT-T rules.

The draft position invites governments to distort the investment framework through "top-up" payments, after the cost-benefit analysis is complete. The Energy Council considers this gaming of the RIT-T. This could both strand generator investments made in good faith in the expectation that certain augmentation would not proceed, or be used to shift an investment away from the option that maximises net economic benefit. *In extremis*, it could lead to bidding wars between state governments preferring options developed within their own jurisdictions.

Where parties wish to progress investments that are unlikely to pass a cost-benefit, they also have the option of pursuing them via the funded augmentation path. This would mean that the entirety of the funding should come from that external source.

The AER should exclude external funds from the cost-benefit assessment in the guidelines, and, if it has concerns about consistency of this position with Rule 5.16.1(b), it should promote a rule change to remove the doubt.

#### High Impact, Low Probability Events

The Energy Council understands that some stakeholders favour weighting high impact, low probability events ("HILP") to account for a perceived social "premium" that consumers would be willing to pay to avoid such events. To the Energy Council's mind attributing such a weighting to such events is misleading, inappropriate and a distortion of the RIT-T assessment process, to the detriment of the broader stakeholder group captured by the Rules assessment process.

It should be noted that it is extremely difficult to anticipate the modes of failure associated with such events. Whilst the building of new transmission assets may remove some modes, they also create new ones that are difficult to anticipate. As a general rule, the greater the reliance on transmission in the National Electricity Market, the more inherently exposed it is to major network disruption. For example, the event that led to the South Australian system black of September 2016 would likely have been survivable had the pre-contingent Heywood flow been limited to its capacity prior to the 2016 Heywood upgrade. Yet this event was not captured in the Heywood RIT-T, as the mode of failure was not anticipated.

Had it been anticipated, the appropriate action would however not have been to reduce the RIT-T benefits, but to include in the project a low cost control scheme or similar.

This example provides learnings for all network investments and HILP events. They are highly unlikely to be fully foreseen, and for those that are, the appropriate solution is through control schemes and operational practices, rather than the building of assets. Therefore the guidelines should be very cautious in their allowances for any claims with respect to HILP events, perhaps by requiring the proponent to demonstrate that no other solution to the event is feasible and that the project cannot create a new mode of failure.

#### Whole-of-Network Planning in the RIT-T

While Rule 5.15.2(a) contemplates a group of options satisfying an identified need, the relationship between the options forming the group needs to be proven and strong. It is not acceptable for weakly-linked projects to be considered *in toto* for the purposes of economic assessment so that options which would not be justified separately are approved by using a strong option's returns.

It is also apposite for any credible option to include in its costs the related augmentation required to support the "headline" project. In addition, proponents should consider whether these related augmentations may be separable and provide significant benefit in their own right.

Where a project relies on market developments well into the future, the proponent should have an obligation to justify, on the basis of up-to-date credible scenarios, that its project remains justifiable. AEMO's Integrated System Plan provides broad guidance, but its future identified projects should not be assumed as committed

for the purposes of a current RIT-T. The additional cost in developing such justification is very small compared to the level of investment made in such network projects, and, in turn, their impacts on competitive projects.

#### Credible Options

According to Rule 5.16.4(b)(3), the non-network option developed must meet the technical characteristics of the identified need. The Energy Council supports the concept that all the credible options presented must be comparable in scope. However there remains a difficulty in achieving the best overall economic outcome if the comparison is to be made on a project with significant technical characteristics. In this case it may be difficult to design a non-network option which is truly comparable. Instead a better solution may be for a series of non-network options to be commissioned over a period of time, particularly if the market or local environment is undergoing, or likely to undergo, change during the period of the staged commissioning.

#### Other Considerations

As outlined in the Energy Council's previous submission, it is important that when the costs of the proposal are tallied, the costs of the outage to existing network assets to facilitate the upgrade are included. The Energy Council has observed instances where significant outages of existing network infrastructure have been required to deliver a network infrastructure upgrade, recalling particularly the 2016 Heywood upgrade. The Energy Council believes that where the network augmentation will include a requirement for outages of existing network infrastructure, the Guideline should require the costs of the upgrade include an assessment and inclusion of market costs associated with these outage requirements.

#### **Conclusion**

In conclusion, the Energy Council is supportive of the refinement of the Application Guidelines as proposed by the AER, but notes that there are a number of areas where the Guidelines could add more detail to ensure that RIT-T assessment outcomes are the most beneficial for stakeholders and society as a whole.

Any questions about this submission should be addressed to the writer, by e-mail to [Duncan.MacKinnon@energycouncil.com.au](mailto:Duncan.MacKinnon@energycouncil.com.au) or by telephone on (03) 9205 3103.

Yours sincerely,



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