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Mr Tom Leuner
General Manager, Markets
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Submitted by email: AERInquiry@aer.gov.au

Dear Tom,

Re | Draft – Regulatory Investment Test for Transmission

AEMO welcomes the opportunity to respond to the AER's Draft Regulatory Investment Test for Transmission (RIT-T) and looks forward to continuing its involvement in this consultation process. We consider that that the AER's guidance on the RIT-T increases certainty for people applying and responding to RIT-T assessments.

The matters raised in this submission largely focus on those items considered to warrant further guidance by the AER in its Explanatory Statement. Our assessment is that the matters raised in our submission to the Issues Paper dealing with climate change policies, options valuation and general equilibrium analysis have been addressed.

This submission focuses on the following issues:

- The market modelling method required of TNSPs;
- Distinction between scenarios and sensitivity analysis and its application; and
- Cost and benefits allocation.

If you have any questions on any matters raised in our submission please do not hesitate to contact Louis Tirpcou on (03) 8664 6615.

Yours sincerely

David Swift
Executive General Manager, Corporate Development

Attachment: Submission - Regulatory Investment Test for Transmission

Market Modelling

Clause 12 of the RIT-T requires that all assessments must be conducted using market dispatch modelling methodology, unless reasons can be provided why this is not necessary. AEMO agrees that there may be some occasions where market dispatch modelling may not be necessary. However, AEMO notes that clause 13 requires TNSP's to estimate benefits outside its region using market dispatch modelling. AEMO assumes that this clause is intended to be drafted to apply to those situations which are not subject to the earlier exemption in clause 12 and request that the AER clarify the wording.

AEMO also believes that the clause 12 modelling exemption could be equally applicable to the decision of competition benefits which requires modelling of 'participant bidding behaviour'. This definition may exclude dynamic efficiency benefits that arise from a generator's decision to invest based on its contract position or its retail business.

Scenario Modelling

The AER is proposing amendments to the RIT-T clauses dealing with scenarios and sensitivity testing. While there are no set rules on what constitutes a scenario or a sensitivity, historical treatment may provide some guidance to the AER on how the RIT-T could be drafted to provide guidance whilst still enabling flexibility.

AEMO has flagged in its National Transmission Network Development Plan (NTNDP) Consultation Document five scenarios that it will model for its inaugural NTNDP. These are:

Scenario 1 - Fast rate of change;

Scenario 2 - An uncertain world;

Scenario 3 - A decentralised world;

Scenario 4 - Oil shock and adaptation; and

Scenario 5 - Slow rate of change.

These scenarios take five quite different views of how the world may eventuate over the NTNDP's forecast horizon[1]. A sensitivity test, on the other hand, would consider how robust the options to address constraints are in each of these scenarios, and ultimately guide a decision maker on which investment to proceed with and when.

If AEMO was applying a regulatory test using each of these scenarios it would conduct sensitivity testing on, among other matters, the effect on the selection of an option to changes in input costs, discount rates and the value of customer reliability. However, that is

[1] More information can be found in our NTNDP Consultation paper (http://www.aemo.com.au/planning/0418-0002.pdf

not to say that each of these sensitivity elements is not in itself a separate scenario. For example, a scenario may deal with volatility in aluminium or copper prices.

Cost allocation

Clause 11 of the RIT-T discusses the treatment and allocation of prescribed and other services in a RIT-T assessment. While AEMO understands that the intention is to prevent any incorrect allocation of costs between prescribed and negotiated services, the effect is that those elements that do not fall into the definition of a prescribed transmission service may not be taken into account, thereby imposing higher overall costs on consumers. This may also be inconsistent with the definition of market benefits which includes capital cost savings, including generation assets, as a benefit.

An example of this can be seen in the construction of or augmentation to a transmission line, which satisfies the RIT-T that generators connect to. Generator connection assets are treated as negotiated services under the National Electricity Rules (NER). If the transmission line were constructed in such a way as to increase the cost of the generator's connection, such as increasing the distance from the generator, these changes in costs on the negotiated service should be taken into account in the assessment. If such an occasion were to arise AEMO would consider all of the costs and benefits associated with an investment decision, not just those that would be allocated to consumers, through the transmission charging regime, as a prescribed service. If the net benefit to all parties was lower due to the additional, not prescribed costs, being higher, AEMO would be unlikely to proceed with that option.

Other matters

On page 9 of its explanatory statement, the AER has asked for comment on whether the RIT-T should reference documents such as the ACIL Tasman 'Fuel resource, new entry and generation costs' report to deal with greenhouse gas intensity factors. AEMO considers that the RIT-T should refer to reputable data and information sources and be flexible enough to refer to up to date sources, but need not reference specific reports given that they are likely to change over time.