

# 2021 RIT and APR cost thresholds review

## Cost thresholds review

We, the Australian Energy Regulator (AER), are responsible for the economic regulation of electricity transmission and distribution services in the National Electricity Market (NEM), as well as some gas transportation services. We also monitor compliance with and are responsible for enforcement of the National Electricity Law and National Gas Law.

Every three years, the National Electricity Rules (NER) require us to review cost thresholds applicable to the regulatory investment tests for transmission and distribution, as set out in clause 5.15.3. The objective of the review is to revisit whether the cost thresholds that are applied by network businesses to determine their network planning obligations remain appropriate given changes in input costs.

On 30 July 2021, in accordance with clause 5.15.3 of the NER, we initiated a review of those cost thresholds (2021 cost thresholds review). On 10 September 2021 we published the draft determination for the 2021 cost thresholds review which was followed by 6 weeks of stakeholder consultation, concluding on 15 October 2021.

Consistent with the requirements of clause 5.15.3(j) of the NER, this document sets out our final determination for the 2021 cost thresholds review. The revised cost thresholds set out in this decision will take effect on 1 January 2022.

## What are the RIT and APR cost thresholds?

Under NER clause 5.15.3, the cost thresholds that we must review relate to the regulatory investment test for transmission and distribution (RIT-T and RIT-D, or collectively 'the RITs') and annual planning reports (APRs). Investments over these thresholds are subject to higher levels of consultation and higher standards of stakeholder engagement, reflecting their impact.

The RIT-T and RIT-D are cost benefit tests that network service providers (network businesses) must apply before making major investments in the network. The purpose of the RITs is to identify the investment in the network which maximises the present value of the net economic benefit for all those who produce, consume and transport electricity in the NEM.

The cost thresholds related to the RIT-T and RIT-D determine whether:

- A network business must undertake a RIT
- A network business may skip the draft report stage of the RIT process; and
- A distribution business can include its final project assessment report as part of its Distribution Annual Planning Report (DAPR) (rather than needing to produce a separate report).

Other cost thresholds under NER clause 5.15.3 relate to the transmission and distribution annual planning reports (the TAPRs and DAPRs, or collectively 'the APRs') that network businesses must publish each year. An APR highlights opportunities and limitations in parts of a specific network for which the network business is responsible, as well as forecasting possible developments over the minimum planning period (five years for distribution and ten years for transmission).

The cost thresholds that relate to the APRs determine whether:

- a network business can combine information in its APR for assets it expects to retire or de-rate;
- a distribution business is required to include, in its DAPR, committed investments that address an urgent or unforeseen network issue.

The regulatory investment test (RIT) and annual planning report (APR) cost thresholds effectively determine the level of stakeholder engagement that is required of network service providers (network businesses) in the RIT and APR processes.

The purpose of the thresholds is to balance the importance of ensuring a robust economic assessment of network investment planning decisions against the importance of avoiding disproportionate regulatory burdens on network businesses.

## Draft Determination

On 10 September 2021 we published our draft determination for the 2021 cost thresholds review.

To assess whether the cost thresholds remain appropriate, we assessed whether there has been a change, since our last 2018 review, in input costs for projects to meet network investment needs. This is similar to the approach used in our 2018 cost threshold review.<sup>1</sup> Our assessment entailed:

- Examining changes in price indexes, including measures of the consumer price index and gross domestic product implicit price deflators.
- Using the change in these indexes as a proxy for input cost changes to ascertain the range of estimated cost variations and using our regulatory judgement to make a determination on the change in input costs.

We favoured this approach, similar to our 2018 review, over a more full scale review of precise changes in transmission and distribution network project costs given the regulatory burden it would impose on both network businesses and us. For administrative simplicity, we rounded changes to the nearest million. We also rounded down where the increase in input costs resulted in a pre-rounded variation figure of approximately halfway between two rounded figures (for example, \$1.5 million would be rounded down to \$1 million).

The indexes that we included in our quantitative analysis of input cost changes along with the changes in those indexes since June 2018 are provided in Table 1. We have used these economy wide indexes, rather than industry-specific or sector specific indexes (e.g. producer price indexes, which we also considered using), as the basis of our determination of cost input changes as these:

- Are better measures of overall price movements across the entire economy
- Are commonly used and understood
- Are less volatile than industry-specific indexes; and
- In the absence of precise measures, provide a reasonable proxy for changes in input costs.

We used the same indexes for the transmission and distribution cost thresholds because changes in capital input costs for transmission and distribution should be similar.

Table 1 Changes to indexes considered in draft determination (% , rounded)

Index	Change since June 2018 <sup>2</sup> (%)
Consumer price index (CPI)	5.1
CPI – trimmed mean	4.5
CPI – weighted mean	4.3
Gross Domestic Product (GDP) – implicit price deflator	7.8
GDP – chain price index	9.3
<b>AER draft decision: Proposed cost escalator</b>	<b>6.0</b>

Data source: ABS Consumer Price Index, June 2021, catalogue number 6401.0; ABS Australian National Accounts: National Income, Expenditure and Product, March 2021, catalogue number 5206.0.

<sup>1</sup> AER, Final determination, 2018 Cost threshold review.

<sup>2</sup> Consistent with the 2018 cost threshold review, changes in the GDP deflator and GDP chain price index are from March 2018 to March 2021 due to unavailability of June 2021 data at the time of the review.

Overall, we considered 6 per cent to be a reasonable estimate of the change in input costs since June 2018. We formed this view having considered the simple average of the different CPI measures (headline, trimmed mean and weighted mean), and the economy-wide GDP deflators (the implicit price deflator and chain price index), which is 6.2 per cent since June 2021.

In making the draft determination, we:

- Measured changes, from June 2018 to June 2021, in the range of indexes we used to calculate input cost changes previously in our 2018 cost threshold review.
- Had regard to the range of changes by taking an average of the CPI measures and economy wide GDP deflators since 2018. We then rounded to the nearest percentage point - that is, 6.0 per cent over the June 2018 to June 2021 period.
- Applied these percentage changes to the unrounded value of the cost thresholds determined in the 2018 Cost Threshold review. We then rounded to the nearest million (or nearest \$100,000 in the case of the \$200,000 thresholds).

## Submissions

Interested parties were invited to provide written submissions on the draft determination. Submissions closed on 15 October 2021. Four submissions were received from AGL, Australian Energy Council (AEC), Clean Energy Council (CEC), and Energex and Ergon Energy.<sup>3</sup> We appreciate and acknowledge the submissions from these stakeholders.

In their submissions, AGL, AEC and CEC referred to the AEC's rule change proposal seeking to lower the \$6 million RIT-D cost threshold to \$1 million, which is currently being considered by the Australian Energy Market Commission (AEMC). AGL and the AEC recommended that the AER's 2021 cost threshold review determination be deferred until the AEMC has made its rule change determination.

We acknowledge the AEC's rule change proposal regarding the RIT-D cost threshold that is currently before the AEMC. However, we note that the AEMC has not initiated its rule change consultation process in respect of the AEC's rule change proposal, or considered any framework changes for the RIT-D or RIT-T cost thresholds. Under the current NER, we are required to undertake a cost threshold review every three years, based on whether there have been increases or decreases in input costs, and to complete that review by publishing a final determination within five weeks of the conclusion of the consultation period for the draft determination. We must therefore make our cost threshold determination in accordance with the current NER, without waiting for any AEMC decision on the proposed rule change.

The AEC also argues for a different cost threshold for distribution and transmission investments. We consider that while the scale of transmission projects is typically larger, input cost changes (including technology costs) are likely to be just as relevant to both transmission and distribution networks, and we have no evidence to suggest the thresholds for transmission network businesses is an administrative burden. Our determination therefore applies the same escalation factors to the relevant transmission and distribution network cost thresholds.

In its submission, CEC expressed the view that the \$6 million dollar threshold under NER cl. 5.15.3(d)(1), referred to in our draft determination, "is too high and does not enable the identification of low-cost solutions such as 'neighbourhood scale' batteries connected to the distribution network". It further considered that a \$500,000 threshold would be more appropriate instead. CEC also raised several concerns with the RIT-D framework in the context of the likely higher integration of variable renewable energy resources and distributed energy resources within the NEM over the next 20 years. The submission suggested that we provide additional guidance in the RIT-D application guidelines including treatment of environmental policies for replacement expenditure projects, treatment of high impact low probability events, uncertainty and risks, externalities and role of external funds in RIT-D assessments. The submission also suggested that the AER provide greater clarity including worked examples in our RIT-D

<sup>3</sup> All stakeholder submissions are available on our website at: <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/cost-thresholds-review-for-the-regulatory-investment-tests-2021/draft-decision>

guidelines around option value, scenario analysis and treatment of non-network options. CEC also recommended streamlining the RIT-D process for battery investment proposals on distribution networks.

We also acknowledge CEC's concerns and feedback about the current RIT-D framework. However, changes to the RIT-D framework including any amendments to AER's RIT-D application guidelines remain outside the scope of this review, which is limited to reviewing the cost thresholds.

In considering the issue of changes in technology costs such as battery input costs, the capital cost threshold for the purposes of undertaking a RIT-T and RIT-D refers to the most expensive credible option to meet the identified need. Therefore, in circumstances where battery costs are significantly lower than a network solution, the lower battery capital costs will be captured by the RIT-T and RIT-D.

Ergon Energy and Energex supported our approach to the cost threshold review and agreed that the indexes considered, and the associated weightings, remained appropriate. Ergon Energy and Energex also supported the proposed cost thresholds related to the RIT-D in our draft determination.

## Final Determination

Consistent with the requirements of NER clause 5.15.3(j), this section sets out our final determination for the 2021 cost thresholds review.

Our final determination is unchanged from the draft determination and is presented below in tables 2 and 3. The figures used for the calculation of changes in input costs in the draft determination (shown in table 1 of this final determination) have remained unchanged because ABS data has not been updated since the draft determination was published.

### Transmission cost thresholds

Table 2 Final determination — Transmission cost threshold amendments

Cost threshold	Current value (\$m)	2018 unrounded threshold (\$m)	Escalator applied* (%)	2021 unrounded threshold (\$m)	2021 threshold (\$m)
The threshold under NER cl. 5.15.3(b)(1A) for an asset's replacement costs, under which a transmission business can combine the information in its TAPR for assets it expects to retire or de-rate.	0.2	0.20	6	0.22	<b>0.2</b>
The thresholds under NER cl. 5.15.3(b)(2),(4) and (6) for capital costs, over which a RIT-T applies.	6	6.18	6	6.55	<b>7</b>
The threshold under NER cl. 5.15.3(b)(5) for the proposed preferred option's capital costs, under which a RIT-T proponent can skip the 'project assessment draft report' consultation step.	43	43.26	6	45.85	<b>46</b>

\*Escalator applied to the unrounded value of the cost thresholds determined in the 2018 Cost Threshold review

### Distribution cost thresholds

Table 3 Final determination — Distribution cost threshold amendments

Cost threshold	Current value (\$m)	2018 unrounded threshold (\$m)	Escalator applied* (%)	2021 unrounded threshold (\$m)	2021 threshold (\$m)
The threshold under NER cl. 5.15.3(d)(4A) for an asset's replacement costs, under which a distribution business can	0.2	0.20	6	0.22	<b>0.2</b>

# 2021 RIT and APR cost thresholds final determination

combine the information in its DAPR for assets it expects to retire or de-rate.					
The threshold under NER cl. 5.15.3(d)(1) for capital costs, over which a RIT-D applies.	6	5.57	6	5.90	<b>6</b>
The threshold under NER cl. 5.15.3(d)(3) for the proposed preferred option's capital costs, under which a RIT-D proponent can skip the 'draft project assessment report' consultation step.	11	11.13	6	11.80	<b>12</b>
The threshold NER cl. 5.15.3(d)(4) for the proposed preferred option's capital costs, over which a RIT-D proponent includes its 'final project assessment report' as part of its DAPR.	22	22.26	6	23.60	<b>24</b>
The threshold under NER cl. 5.15.3(d)(5), over which committed investments to address an urgent and unforeseen network issue must be included in the DAPR.	2	2.23	6	2.36	<b>2</b>

\*Escalator applied to the unrounded value of the cost thresholds determined in the 2018 Cost Threshold review