

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. This 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.

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). Consistent with the requirements of clause 5.15.3(g), this document sets out our draft determination on the 2021 cost thresholds review. We are seeking submissions on the draft determination by 15 October 2021. We propose that subject to any submissions, 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.

Our approach to determining updated cost thresholds

To assess whether the cost thresholds remain appropriate, we have 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.¹ 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 is provided in the 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 ² (%)
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
AER draft decision: Proposed cost escalator	6.0

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.

Overall, we consider 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.

¹ AER, Final determination, 2018 Cost threshold review.

² 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.

Draft Determination

Consistent with the requirements of clause 5.15.3(g), this section sets out our draft determination on the 2021 cost thresholds. In making this draft determination, we have:

- 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).

Table 2 and 3 set out our draft determination on the cost thresholds for both transmission and distribution network service providers, respectively.

Transmission cost thresholds

Table 2 Draft determination — Transmission cost threshold amendments

Cost threshold	Current value (\$m)	2018 unrounded threshold (\$m)	Escalator applied* (%)	2021 unrounded threshold (\$m)	Proposed 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	0.2
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	7
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	46

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

Distribution cost thresholds

Table 3 Draft determination — Distribution cost threshold amendments

Cost threshold	Current value (\$m)	2018 unrounded threshold (\$m)	Escalator applied* (%)	2021 unrounded threshold (\$m)	Proposed 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 combine the information in its DAPR for assets it expects to retire or de-rate.	0.2	0.20	6	0.22	0.2
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	6

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	12
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	24
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	2

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

Submissions

Clause 5.15.3 of the NER outlines the consultation process we must follow when reviewing certain cost thresholds that apply to the RITs and APRs. Consistent with those requirements, we invite interested parties to review the matters raised in this draft determination and provide written submissions within the consultation period.

We are requesting written submissions by the close of business on **15 October 2021**

We prefer stakeholders send submissions electronically to: AERinquiry@aer.gov.au

Alternatively, stakeholders can mail submissions to:

Ms Stephanie Jolly
General Manager, Market Performance
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

We prefer all submissions be publically available to facilitate an informed and transparent consultation process. We will therefore treat submissions as public documents unless otherwise requested.

We request parties wishing to submit confidential information to:

- Clearly identify the information that is subject of the confidentiality claim; and
- Provide a non-confidential version of the submission, in addition to the confidential one.

We will place all non-confidential submissions on our website at www.aer.gov.au. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy.