

6<sup>th</sup> April 2018

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Submitted via e-mail to: [RIT@aer.gov.au](mailto:RIT@aer.gov.au)

Dear Mr Adams,

**Review of the Application Guidelines for the Regulatory Investment Tests**  
**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”) *Review of the Application Guidelines for the Regulatory Investment Tests – Issues Paper*.

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.

### **Introduction**

The Regulatory Investment Tests for Transmission and Distribution (“**RIT-T**” and “**RIT-D**” respectively) provide the means by which the regulated electricity network can be efficiently expanded while providing a nett benefit to customers (who ultimately pay for the expansion). The Energy Council believes that little change is required in what is a fundamentally sound process and the AER should consider concurrent work being conducted by the Australian Energy Market Commission (“**AEMC**”) and the Reliability Panel in its deliberations. Furthermore, consideration of the Australian Energy Market Operator’s (“**AEMO**’s”) *Integrated System Plan* and the treatment of Renewable Energy Zones (“**REZs**”) should be reviewed in light of the historical experience with Scale Efficient Network Extensions, as set out in Clause 5.19 of the *National Electricity Rules*.

### **Discussion**

The basic principle of RITs is that the network expansion should maximise the present value of the nett economic benefit for all those who produce, consume and transport electricity in the market.

*Question 1: Do you agree that the RITs promote the long-term interests of consumers by promoting competitive neutrality and investment efficiency? Are there other factors we should consider?*

Section 3 of the report presents an excellent discussion on the RIT’s role with respect to promoting the National Electricity Objective (“**NEO**”) through efficient decision making and promoting competitive neutrality. The Energy Council proposes a third objective: Creating a network investment framework that is predictable for competitive investors. Investors are highly aware that the value of their competitive assets can be affected by regulated monopoly investments which, if they occur in an unpredictable manner, creates unnecessary risk for those investments which will be ultimately paid by customers. If competitive investors have confidence that, say, an interconnector that may strand their generator can only be justified on clear and defensible nett benefit grounds, then this risk can be minimised.

The Energy Council supports the requirement that the RITs promote efficient network decision making, a critical component of which is the cost-benefit analysis. With regards to this, the Energy Council remains concerned that currently the proponent of the network augmentation (a) assesses and determines what input assumptions will be used in the modelling, (b) undertakes or controls the modelling work, and (c) assesses and reports on the modelling outcomes.

The Energy Council also agrees with the discussion in pages 19 and 20 on the RIT's key role in the incentive-based regulatory framework. We would also note that as the Victorian transmission planning arrangements are not incentive based, the RIT-T provides effectively the only justification for efficient expenditure.

*Question 2: Do you agree that a RIT assessment is not required where the external financial contribution results in the project falling below the cost threshold?*

No, this opens a gaming risk that external funding is used to place the project just under the threshold. If the overall cost exceeds the threshold, then a RIT should be required. As the external funding may come from a non-competitive source, such as government funding (in effect from consumers via taxes, which may be better used on other efficient infrastructure), then the RIT provides a valuable transparency measure to ensure these funds are spent efficiently.

*Question 4: What specific guidance would help distribution businesses better use their non-network options reports and non-network screening requirements to engage with non-network service providers?*

With regards to the requirements that proponents consider all credible options before undertaking major network investments, the Energy Council believes it is important that the Guidelines clearly articulate that the Request for Proposal for Non-Network Options contains only those provisions required to achieve the required objective and in particular do not contain more onerous provisions than those required of the network options. This applies to both transmission and distribution tests.

*Question 5: Do you agree that the RIT-T process accommodates the consultation required for proponents to effectively test the market, but would benefit from guidance to better align information provided in the project specification consultation report with that provided in the non-network options report under the RIT-D? Alternatively, would it be preferable to request a rule change for non-network consultation under the RIT-T to more closely mirror what the NER require for the RIT-D?*

Yes, the Energy Council believes the RIT-T would benefit from increased guidance in this area, but does not believe a rule change is required at this stage.

*Question 6: What additional guidance should the RIT application guidelines provide regarding the information network businesses should publish when they cancel RIT assessments?*

The Energy Council supports the AER's view that there would be benefit in the provision of additional information regarding the cancellation of a RIT process, including all reasons for its cancellation. Similarly, the Energy Council supports RITs only being either processed to completion or cancelled, and not suspended part way through the process with a view to recommencement from their current status at a later date.

Also, the Energy Council is concerned that in some cases the RIT-T process has been completed well in advance of the identified need. For example, the RIT-T for Regional Victoria Thermal Capacity – Ballarat and Bendigo Supply was completed in 2013 with some components of the upgrade scheduled for commencement in FY2019/20. Given the rapid observed changes in market conditions and technology, and likely cost reductions for new technology, the Energy Council believes there would be benefit in including a time limitation in the Guidelines to restrict how far ahead of an identified need the RIT-T approval process may be finalised.

*Question 7: Do you agree with our proposed approach of providing further guidance on how RIT proponents should describe an identified need?*

The Energy Council agrees with the proposed approach. A network augmentation should occur only as a result of a system-wide nett benefit, not as a means of assisting a particular generation investment. In addition, the Energy Council is concerned that identified needs will speculate on the benefit to be obtained from future network users. It is important that any allowance for future benefits takes into account the risk that such benefits will not materialise. This is also relevant to questions about the treatment of REZs.

*Question 8: Is there any specific guidance you would like us to provide in clarifying how RIT proponents should calculate option value, make forecasts and test different states of the world?*

The Energy Council supports the proposals listed in the dot points on page 32. Each scenario, and its weighting, should have the same burdens of proof as the core scenario, and in particular consider the case that the proposed upgrade does not deliver the physical benefits promised, as has occurred for a number of recent network upgrades (such as the 2016 Heywood Interconnector upgrade which is currently constrained by AEMO to less than its nominal upgrade value). The Energy Council suggests that forecast consistency is important, and where possible recent, publicly available forecast supply & demand data should be used, such

as that produced by AEMO for its annual *National Electricity Forecasting Report* and *Electricity Statement of Opportunities*. If such forecasts are available, the proponent should not be at liberty to substitute an alternative.

*Question 10: Do you agree that the RIT is a market-wide cost–benefit analysis? Do you agree that, as a consequence of this, funds that move between parties within the market should not affect the final net-benefit, but funds that comes from outside the market to a party within the market should increase the final net benefit?*  
Similar to the answer provided to Question 2, the Energy Council does not support the inclusion of funding that comes from outside the market to a party within the market as a means to increase the final nett benefit.

*Question 11: High impact, Low probability events guidance*

The Energy Council is concerned that undue weight may be given to low probability events which will be extremely judgemental and difficult for affected participants and consumers to challenge. Rather than investment in specific new network assets, the cost effective way to protect against catastrophic disruptions to a power system is through:

- rules and controls that ensure the power system is at all times operated within the secure technical envelope based on the prevailing conditions, supported by
- non-credible event control schemes, such as fast load or generation shedding.

These controls schemes are low cost and typically below RIT thresholds. A danger of permitting the assessment of high impact, low probability events in a standard RIT is that it may create a large amount of subjective benefit for an expensive physical asset, say an interconnector, when the same benefit more sensibly could have been achieved through an inexpensive control scheme. Indeed it may perversely discourage networks from developing such control schemes.

*Question 13: Do you support our proposal to expand our RIT application guidelines to specify that, as a default, RIT proponents should use the same discount rate when comparing different credible options?*

The Energy Council supports this approach, as it believes that the risks associated with the different options for projects will be captured by each option's individual costs and expected benefits. Varying discount rates for each option will distort the assessment.

The Energy Council proposes that a market-based discount rate be used for all investments in a RIT, including prescribed assets. It is economically incorrect to apply the regulated discount rate to network assets, as this only relates to the guaranteed capital return that a network company receives. The customer however is exposed to this *plus* the risk of the asset not being required, which parallels the risk that a market-based investor faces. The RIT, being built on the NEO, should be using a discount rate equivalent to customers' total risk, which is not the regulated discount rate.

*Question 14: What kind of additional guidance, if any, would you like the RIT application guidelines to provide on selecting an appropriate VCR?*

The Energy Council is of the view that this is an important measure and understands that AER will shortly be given an obligation to re-assess it regularly. Rather than each proponent adopting a value for their projects with little justification, the Energy Council would prefer that recent, publicly available data be referenced, to the extent possible. It is worth noting that the Reliability Panel, during its review of the System Restart Standard, determined that the regional Values of Customer Reliability are not fixed but reduce with the length of any supply interruption<sup>1</sup>.

*Question 16: Given AEMO is currently developing the Integrated System Plan (“ISP”), what additional guidance would stakeholders find useful in the RIT-T application guidelines with respect to the ISP?*

Whilst acknowledging these new policy developments, the Energy Council believes the concept of nett economic benefit enshrined in the current RIT-T remains fully relevant and should similarly be applied to REZs.

The NEM has had considerable experience with a very similar concept to REZs, Scale Efficient Network Extensions, and as such the RIT-T development process has already taken the potential for economic expansion of the network into areas of prospective generation into account. Thus it is unlikely there is a direct need for change in the RIT-T. Having responded to the *ISP Consultation Paper* dated December 2017, the

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<sup>1</sup> p.53, Reliability Panel, *Review of the System Restart Standard – Final Determination*, 15<sup>th</sup> December 2016, Sydney

Energy Council is concerned that AEMO's proposal to develop Renewable Energy Zones, although foreshadowed by the *Finkel Review*, is not yet in law, therefore the Integrated System Plan should be limited to AEMO providing recommendations to transmission providers to consider certain extensions of a national character that are likely to pass the well understood and prudent economic cost/benefit analysis of the existing RIT-T. Transmission providers then need to follow the full RIT-T process as would be applicable to any other large prescribed investment..

#### *Other Considerations*

When considering a RIT-T, it is also important that the proponent treats intra-regional constraints properly. In the first instance, it is possible that a network upgrade will be constrained by intra-regional limitations, meaning that the upgrade will not accrue the benefits expected. To calculate the full cost of the proposed upgrade, the cost of relieving the intra-regional constraints also need to be included. Conversely, the intra-regional constraints may be such that relieving them may improve the existing network sufficiently to improve consumers' outcomes and obviate the need for the main network upgrade proposed.

In addition, 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.

The Guidelines should ensure that all separable components of an augmentation are appropriately identified as RIT options. As an example, consider the removal of congestion in south-east South Australia through the decommissioning of the 132kV network loop between the Snuggery – Keith – Tailern Bend substations. The Energy Council considers this work could have been separately assessed and would have delivered a significant benefit on its own. As such, this smaller alternative should have been separately assessed as an option in the Heywood Interconnector upgrade augmentation.

#### **Conclusion**

In conclusion, the Energy Council believes that any amendment to the Application Guidelines should reinforce the need for proponents to use recent, publicly available data for their analyses, and the AER should consider work being conducted by the AEMC and the Reliability Panel before it attributes any notional system security and reliability benefits to RIT projects.

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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