Consumer
Challenge
Panel

CCP20 Submission to the Australian Energy Regulator (AER) regarding:

AER: Draft Regulatory Investment Test for transmission - application guidelines, July 2018

AER: Draft Regulatory Investment Test for distribution - application guidelines, July 2018

AER: Explanatory statement to the draft RIT application guidelines, July 2018

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1. Introduction

The Australian energy market is in the midst of a period of unprecedented changes in technology, in energy supply options and usage patterns. Moreover, these changes are also occurring in the context of a rapid increase in consumers' energy costs, community concerns about the reliability of supply and in the face of considerable uncertainties around government policies. For instance, in its recently published Integrated System Plan (ISP) AEMO stated:[1]

> *AEMO's modelling confirms that the NEM is at a critical point, and infrastructure planning decisions made over the next two years will shape the future of the east coast energy systems for decades to come.*

The energy regulatory bodies and the network service providers (NSPs) face an ongoing challenge to anticipate and respond to these developments.

The Consumer Challenge Panel (CCP20) recognises that the AER's current review of the application guidelines for the Regulatory Investment Tests for transmission (RIT-T) and distribution (RIT-D), is only one component of the overall policy, regulatory, market and consumer responses to these challenges. Recent developments illustrate the rapidly changing policy and regulatory developments that will frame the current and future roles of the RITs. For example:

COAG Energy Council 10 August 2018 stated:

> *Ministers also asked that in addition to the consultation on the current ISP that is underway, the ESB should identify a work program (including possible changes to the RIT-T) and convert the ISP to an actionable strategic plan. The ESB Chair should take the lead on its delivery and report back to the December 2018 meeting.*

This will also overlap with the AEMC Coordination of generation and transmission investment review:[2][3]

> *A key consideration … is who is best placed to manage risk…The Commission does not necessarily think it is appropriate for consumers to bear the costs associated with centralised resources (e.g. large-scale generation and transmission). This risk is likely to be better placed with the generation and transmission businesses themselves.*

The RIT process, therefore, needs to balance stability and consistency of policy and a level of flexibility in the environment of changing energy needs and government policy developments. CCP20 recommends that the AER implement a framework for monitoring the application and operation of the RIT to support continuous improvement (at least in key areas such as application to replacement expenditure and implementation of ISP projects) and to inform adaption to market and policy changes.

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[1] AEMO, *Integrated System Plan*, July 2018, p 10.

[2] https://www.aemc.gov.au/markets-reviews-advice/reporting-on-drivers-of-change-that-impact-transmi

[3] AEMC ,*Discussion Paper, Coordination of Generation and Transmission Investment*. April 2018, p 64.

As an example, the premature death of the National Energy Guarantee under the Morrison Government and talk of exiting the Paris Climate Accord creates uncertainty over the future structure of the ISP and renewable generation in general.

Not withstanding these changes, CCP20 considers that the AER's current review of the RIT guidelines provides an opportunity to enhance the way in which the network service providers (NSPs) make prudent and efficient investment decisions in the long-term interests of consumers including an 'unbiased' assessment of non-network alternatives to network capacity expansion.

Section 2 below highlights some of the key comments raised by CCP20 in response to the AER's Issues Paper. Section 3 discusses a number of issues arising from the Draft Guidelines and from the discussions in the AER's Public Forum held in August 2018. In particular, we make further comment on:

1. The identified need and the importance of framing this in consumer centric terms
2. The interaction of the RIT and AEMO's Integrated System Plan (ISP) I
3. The approach to the high impact low probability (HILP) events
4. Application of the RIT to replacement capital expenditure (repex) and defining he 'base case'
5. Relationship between the RITs and other regulatory processes, such as the annual planning reports (APRs)
6. Engagement of customers and other stakeholders in the multiple RIT processes
7. Third party contributions and the assessment of the cost threshold test for RITs
8. Third party contributions and the evaluation of net-benefits under the RITs
9. Other matters including treatment of land and easements; wholesale energy prices and changing consumer expectations; post guideline reviews; application of 'regret theory', potential value of propose/respond model for RITs and treatment of large IT investments.

While we have generally supported the AER's position on most of the items listed above, we have included a number of suggestions that should further enhance these processes. Of particular and most immediate concern to CCP20 are the following:

- The AER's guideline does not adequately capture CCP20's suggestion that the 'identified need' should be expressed in terms of consumer benefits and that there should be a 'hold point' at this early stage to ensure the RIT complies with this.
- Further development of the replacement RIT requirements, particularly given repex is now the major component of capital expenditure for many NSPs (noting that the AER has recently issued further guidance on efficient replacement.
- Effective consumer and stakeholder engagement, while required in the guidelines, faces many practical challenges, and CCP20 recommends that the AER undertake further consultation with NSPs and stakeholders to explore ways to enhance this process.
- Establish a process for ongoing review of the RIT guidelines in the context of the objectives of the RIT. Future developments may, for instance, include the expenditure on non-network projects, particularly information and communication technology which is becoming a significant component of many of the NSPs' regulatory proposals.

Notwithstanding our comments on these issues, however, CCP20's overall view is that the AER has undertaken a thorough process to enhance the RITs. We consider that the alignment of the RIT-T and RIT-D guidelines, and the very useful examples of the application of the RIT's, will assist the engagement of third parties in the overall processes as well as the AER's evaluation of the performance of the RITs over time.

As highlighted above, the RIT's operate in an increasingly complex environment and regular monitoring of the performance of the RIT guidelines is essential in ensuring they remain relevant to stakeholders and to achieving outcomes that are in the long-term interests of consumers.

2. Key comments from the AER's Issues Paper, April 2018

CCP20 highlighted in its previous submission:[4]

> *…the application guidelines must not only set out the technical requirements of a RIT application. The guidelines must move towards a more 'customer centric' process that ensures a more successful engagement with consumers and industry stakeholders.*

In that submission, CCP20 also set out eight 'important features' that should be reflected in the guidelines. Some of these features are contextual rather than specific, but nonetheless are important in framing the guidelines. Others are more directly related to the form of the guideline. CCP20's list included the following:[5]

1. Seek consistency, integration and clarity of 'process flow' with other regulatory instruments
2. Encourage more creative and effective ways of engaging providers of non-network services as key customer of the RIT process
3. Include the principles of strategic procurement partnerships in the guidelines
4. Reduce the complexity, volume and administrative overhead of the RIT and related processes including the Annual Planning Reviews
5. Ensure the guidelines address the problem that 'needs to be fixed'
6. Recognition of benefits beyond the specific network constraint
7. The guidelines assist the allocation of risk, indemnity, long-term costs and performance
8. Consider the application of contingent projects in the guidelines.

3. Comments on the Draft Guidelines

In this submission, CCP20 highlights the areas where we consider the AER has materially advanced the long-term interests of consumers. We also discuss a number of areas in the guidelines where CCP20 considers the guidelines would benefit from further development.

In addition, this submission provides further feedback to the AER on a number of topics that appear to be controversial amongst some stakeholders.

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[4] CCP20, *Final Response to the RIT Issues Paper*, April 2018, p 3.
[5] Ibid,, pp 3-6.

3.1 The Identified Need

Our submission to the AER's Issues Paper emphasised the importance of articulating the identified need from a consumer perspective and recommended a 'hold point' in the process to reflect this importance (p15).[6] We welcomed the AER commitment to a 'hold point' as set out in the AER's Explanatory Statement:[7]

> *We agree with this view. We will follow up with RIT proponents who do not clearly state an identified need in accordance with the provisions in section 3.1 of the RIT application guidelines.*
>
> *We will check that the identified need is appropriately articulated after stage 1 of the RIT application process (project specification consultation report for RIT–T and draft project assessment report for RIT–D). If the identified need is poorly specified, we will request the NSP re-publish their draft/ consultation report, correcting the error, or we will report the compliance breach as part of our compliance monitoring role (see section 2.1 of this explanatory statement).*

However, we are very concerned that the concept does not in fact appear in the draft guidelines and that the AER does not appear to have any enforcement powers to make it happen.

Further, the guidance on Identified Need in section 3.1 of the Explanatory Statement does not even include the word *consumer*, let alone take on board our emphasis to frame the identified need from a consumer perspective.

3.2 The interaction of the RIT-T process and AEMO's Integrated System Plan (ISP)

We note that the ISP was released in July 2018, around the same time as the Draft Guidelines. The potential implications for the RIT process have been articulated by COAG Energy Council on 10 August 2018 where RIT changes were flagged (emphasis added):

> *Ministers also asked that in addition to the consultation on the current ISP that is underway, the ESB should identify a work program (**including possible changes to the RIT-T**) and convert the ISP to an actionable strategic plan. The ESB Chair should take the lead on its delivery and report back to the December 2018 meeting.*(emphasis added)

This will also overlap with the AEMC's Coordination of generation and transmission investment review[8][9]:

> *A key consideration … is who is best placed to manage risk….The Commission does not necessarily think it is appropriate for consumers to bear the costs associated with centralised resources (e.g. large-scale generation and transmission). This risk is likely to be better placed with the generation and transmission businesses themselves.*

CCP20 agrees with the AER's position that ISP results and assumptions should be critical **inputs** to RIT-Ts. We understand AEMO's desire to 'fast track' projects through RIT but **do**

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[6] *AER, Explanatory* statement, Draft revisions of the application guidelines for the regulatory investment tests, July 2018, p 15.
[7] Ibid, p 55.
[8] https://www.aemc.gov.au/markets-reviews-advice/reporting-on-drivers-of-change-that-impact-transmi
[9] AEMC, *Discussion Paper, Coordination of Generation and Transmission Investment*. April 2018, p 64,

not agree with the broader view that the RIT process is a barrier to efficient investment in reasonable timeframes

In our view, the challenge is not necessarily about whether a project identified in the ISP should proceed, rather the RIT discipline ensures the best option for addressing the need is selected using ISP inputs. Future iterations of the ISP might provide the evidence that allows RITs to follow the existing process at a faster pace.

However, this 'faster pace' should not be at the expense of the NSP following the key elements of the RIT including defining the 'identified need' in terms of consumers' long-term interests, an appropriate stakeholder engagement program and a reasonably opportunity for non-network service providers to contribute meaningfully to the process.

3.3 The approach to high impact, low probability (HILP) events

The AER's draft guideline now includes guidance on how RIT proponents can account for HILP events via the scenario analyses steps. This follows the COAG EC's recommendation that the RIT-T application guidelines[10]:

> *be updated by the AER to provide greater clarity to better accommodate high impact, low probability events such as the 'black system' event experienced recently in South Australia. Current methodologies may need to be adapted to better weight high impact, low probability events in line with public expectations regarding mitigation in light of the long term lifespan of these assets.*

In our response to this issue, CCP20 suggested that the existing framework should be able to accommodate HILP events through network security standards and the appropriate selection of parameters.[11]

The submissions and comments at the AER's stakeholder workshop (August 2018) indicated that some networks and the ENA consider that the HILP events are in fact underweighted in the 'normal' cost-benefit analysis, an issue that was also raised by the COAG Energy Council in their 2017 RIT review. It was suggested by the ENA amongst others, that this outcome could be addressed by allowing the proponent to 're-estimate' the Value of Customer Reliability (VCR) as a multiple of typical VCR values such as those provided by AEMO.

Taken at face value, CCP20 does not support the ENA's approach. In particular, the approach raises the risks of arbitrary selection of VCR estimates and/or of 'goal seeking' analysis, i.e., proposing a VCR value that delivers a net benefit for the preferred option.

CCP20 considers that there is a role for including HILP events as part of the scenario testing in the RIT process - where it is logical to do so and there is reasonable supporting data on which to define the HILP event and to assign reasonable probabilities to such an event.

For example, a 'scenario' in which a HILP event involved a loss of supply to a supply region for six months is not a credible option to include in the cost benefit study, if there are ameliorating factors such as high levels of redundancy in the network, multiple supply points and the network has been maintained to meet the relevant supply standards. The probability weighting of such an event should be zero.

While the appropriate estimation of the probability of an HILP event (as outlined in the Draft Guideline) is the primary mechanism for 'weighting' a HILP scenario, CCP20 accepts that

[10] COAG Energy Council, *Review of the Regulatory Investment Test for Transmission*, 6 February 2017, p. 37.
[11] CCP20, *Final Response to the RIT Issues Paper*, April 2018, p 17.

there might be instances where the network (also) adopts a different VCR. However, if the network proponent considers using a non-standard VCR, then:

- the reasons for this decision must be transparent
- the proponent must discuss this change with relevant consumers and other stakeholders early in the process
- supporting evidence must be provided for such a change
- the chosen VCR is tested via 'reverse engineering' to identify what input assumptions would be required and if these assumptions are 'reasonable'
- the analysis should identify and include in the cost benefit analysis alternative, lower cost, mitigation strategies could be adopted to reduce the stated risk.

In its review of the RIT-T, the COAG Energy Council cited the 'black system' event in South Australia as an example of an HILP event that is typically "widespread and prolonged in nature".[12] The Council considered that the RIT-T might not adequately accommodate such an event. CCP20 agrees that it may be difficult to capture the impact of these events based on probability modelling, particularly in the instance of RIT-T for interconnectors. However, when these events do occur, the causes are usually multifactorial – for instance, AEMO has concluded in its final report on the SA 'black system' event, that it was unlikely to have occurred if the control settings on the wind farms in question had been better known and/or more resilient. AEMOs conclusions include the following:[13]

> *Wind turbines successfully rode through grid disturbances. It was the action of a control setting responding to multiple disturbances that led to the Black System. Changes made to turbine settings shortly after the event has removed the risk of recurrence given the same number of disturbances.*
>
> *Had the generation deficit not occurred, AEMO's modelling indicates SA would have remained connected to Victoria and the Black System would have been avoided…*

Given this and the multiple other factors contributing to the black system event, along with the relatively low-cost actions available to restore power and minimise the probability of a similar event in the future, it is not at all clear how such major events should be modelled in the context assessing network investment via a RIT process.

Similarly, AEMO's preliminary report on the separation of Queensland and SA systems that occurred on the 25 August 2018, illustrates the difficulty in modelling major system events. The initial event is believed to be caused by a simultaneous trip of two adjacent single circuit transmission lines due to a single or simultaneous lightning strike. AEMO considers this to be a "highly improbably occurrence".[14]

The event resulted in separating Queensland region from the rest of the NEM, which in turn resulted in separation of the SA region and under-frequency load shedding (UFLS) in NSW, Victoria and Tasmania regions. A total of some 95,000 customers were affected (all in NSW)

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[12] COAG Energy Council, *RIT-T Review*, 2017, op cit, p 36.

[13] AEMO, *Black System South Australia 28 September 2016 – Final Report*, March 2017, p. 7. Notwithstanding the loss of transmission towers and the islanding of SA, up to 90% of load was restored within 8 hours, and all customers supply was restored by 11 October. A full description of the series of events that resulted in separation of the SA power system from the rest of the NEM is set out on pp 6-7.

[14] AEMO, *Preliminary Report – Queensland and South Australia system separation on 25 August 2018*, 7 September, 2018, p 4.

plus industrial and Alcoa and Tomago potlines. All load was restored within 2 hours and 17 minutes.[15]

Again, it is difficult to assess how such an HILP event can be captured given the widespread outcomes of what was regarded as a highly improbable event. What is clear, however, is that the proposals such as unilateral changes to the VCR for modelling any specific network project are not likely to reflect the actual situations and are open to arbitrary selection decisions by the NSP.

For these reasons, CCP20 supports the AER's 'conservative' approach to inclusion of HILP events based on:[16]

- including a reasonable scenario where the HILP event occurs
- costing the impact of the HILP event occurring, including involuntary load shedding and a 'reasonable' forecast of the value of electricity to customers
- weighting the economic impact of the event be a 'reasonable' estimate of its probability of occurring (which may include a higher VCR).

As noted previously the reasonable forecasts of the value of electricity and the estimates of probability must be transparent and justified by the network with reference to realistic scenarios of the extend, timing and period of the network failure.

We would support the AER seeking to clarify any ambiguity in the rules as part of the work underway by the Energy Security Board (ESB) responding to the Energy Council request of 10 August.

3.4 Application of the RIT for replacement projects, including the 'base case'

CCP20 strongly supports the AER progressing its work to define best-practice asset replacement planning and the application of improved economic assessments to asset replacement decisions.

We also support the AER clarifying the meaning of the 'base case' for assessment of projects. In particular, we agree with the AER's view as summarised in its Explanatory Statement to the RIT Guidelines:[17]

> *Our view is that the base case for repex projects should include credible BAU expenditure on maintenance to manage safety risk, environmental risk and equipment protection, but to the extent this expenditure meets legal obligations or is consistent with efficient industry practice.*

CCP's experience to date is that the comparison of 'credible options' is distorted when the RIT includes a non-credible, do nothing, base case. In particular, when a NSP's base case is equivalent to 'do nothing', the net benefits of the credible options cluster together making a clear interpretation of the options and the sensitivity of outcomes to small changes in the inputs difficult to interpret. The AER's approach as set out in the Draft Guideline will ensure a more realistic modelling of the base case and provide greater clarity on the relative net benefits of the various options.

The examples provided for the application of the RIT in cases where large assets are to be retired or replaced are useful. However, there are many different cases and applications for the replacement of assets that remain a 'grey area', including:

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[15] Ibid, p 3. The event occurred at 13.11 on the 28th August, and all load was restored by 15.28 on the same day.
[16] AER, *Explanatory Statement*, op cit, pp 32-33.
[17] AER, *Explanatory statement*, op cit, p 29.

- replacement for 'safety' reasons
- the replacement of a fleet of similar assets, such as protection equipment, as part of a coordinated programme to address risk of failure where the programme value exceeds the RIT cost thresholds but the individual items do not;
- the treatment of costs in applications where some form of smaller ongoing investment in monitoring or inspections is required to maintain safety or functionality

We note that the AER has released a draft Transmission Annual Planning Report Guideline[18] on 3 September 2018 and also an 'Industry practice application note for asset replacement planning' on 7 September[19]. We expect both of these are relevant to the repex aspects of the RIT Guidelines Review but time has not allowed for these to be reviewed in that context. We encourage the AER to ensure that all related documentation is easily referenced from the final RIT guidelines.

3.5 Engagement of consumers & other stakeholders in RIT proposals

CCP20 has already indicated its support to the use of the AER's 2013 Consumer Engagement Guideline as a guide to NSP's in developing their RIT consultation processes. We do note, however, that a large number of RITs may be 'on foot' at any one time, as indicated by the current activity by distributors in NSW.

It is clear that seeking engagement by consumers and non-network service providers on a range of RIT proposals, and on a case-by-case basis, is not efficient and presents a risk that the engagement is both inefficient and ineffective. The risk of stakeholder fatigue needs to be carefully considered as part of this review.

The guidelines should support, or in fact encourage, a mechanism where multiple RITs can be considered as a 'parcel of like proposals' in cases where the market or community response could be common across the proposals.

In these cases where a number of similar proposals are active, we believe that the scope of the engagement could be better defined to enhance the efficiency for the utility, the market, potential service provides and the community.

One option would be to reinforce the relationship between the TAPR / DAPR and the RIT consultation processes.

CCP20 considers it would be useful for the AER to undertake further consultation and/or joint workshops with NSPs, consumer groups and non-network service providers to explore different approaches to stakeholder engagement in the RIT processes to address this important issue of consumer fatigue in the face of the expanding requirements for RITs.

As an interim measure a public list, regularly updated, that summarises current RIT proposals, and the expected costs of the projects, and the progress and timing of the process, would at least provide an accessible mechanism that would complement existing web-site content and cross reference the NSPs' Annual Planning Reports (APRs).

[18] www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/transmission-annual-planning-report-guidelines

[19] www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/industry-practice-application-note-for-asset-replacement-planning

3.6 The role of the NSPs' DAPR and TAPR in signalling future opportunities

The AER has emphasised that the RIT process should not be considered in isolation from other regulatory mechanisms that 'complement' the RIT. In addition to the AER' 5-year revenue determinations, the NSP's are required to:

- Conduct annual planning reviews to identify the efficient level of investment required and to then publish 'annual planning reports' (DAPRs and TAPRs for distribution networks and transmission networks respectively). The APR's must now include public information on emerging network constraints and potential options to address these constraints, network asset retirement and de-rating information.
- Following 2012 rule changes, DNSPs must engage with non-network businesses by having a demand side engagement strategy and maintaining a demand side register. following the repex.

In principle, both these developments should also facilitate greater engagement by non-network service providers in particular, in the RIT process.

However, CCP20 has not seen evidence of the networks proactively and consistently pursuing these relationships with non-network service providers and other relevant stakeholders.

We note that the AER released a draft Transmission Annual Planning Report Guideline[20] on 3 September 2018. While we acknowledge that the AER has sought to clarify not only the RIT Guidelines but also improve the consistency and usability of the DAPR and TAPR templates, CCP20 strongly encourages the AER to adopt more regular monitoring of the extent to which the guidelines and APR's are facilitating positive engagement with relevant stakeholders in addition to the recommendations in section 3.5 above.

3.7 Third party contributions – the impact of different capex funding sources on the RIT cost threshold test.

In our response to the Issues Paper, CCP20 supported the AER's approach to the treatment of third party funding from different sources. However, a number of submissions to the AER's Issues Paper, and comments made during the August Stakeholder Workshop, suggested that there was an inconsistency in the AER's treatment of third party contributions, namely:

- In determining if a project satisfies the RIT threshold, the NSP proponent is required to consider the forecast capital expenditure by the regulated NSP, **after** netting off any third party contributions to the capital cost (irrespective of whether this contribution is from within or external to the market).
- If the RIT proposal passes the threshold test, the subsequent evaluation and selection of a preferred option includes both capex and opex, and takes account of third party contributions only when these contributions are by non-electricity market participants, eg contributions by governments.

The tables below provide an example that summarises the differences between these two 'treatments' of third party contributions.

[20] www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/transmission-annual-planning-report-guidelines

Table 1: The cost threshold Test for RIT-T (RIT-T/2017 threshold of $6m) - $m capex only

	Total capex cost	Third party capex funding	NSP capex funding	Outcome against RIT-T Threshold ($6m)	Comment
Threshold Test (a)	8	3	5	RIT-T not required	Capex only. Any third party contribution eligible.
Threshold Test (b)	8	1	7	RIT required (NSP capex >$6m)	Capex only. Any third party contribution eligible.

Table 2: The application of the RIT-T - option evaluation cost base (RIT-T) - $m

Total cost	Third party funding		NSP funding	Outcome	Comment
	In 'market' participant	External			
8	3		5	RIT-T cost base $8	All project costs (capex & opex) and all 'market' contributions included
8		3	5	RIT-T cost base $5m	External funds reduce cost base & therefore increase market benefits

Notes:

(i)'Market' refers to those that "produce, consumer and transport electricity in the relevant market" (see for example NER, 5.16.1(b). These parties are called 'participant parties'.

(ii) Projects that address urgent and unforseen network issues are not subject to RIT test. (see NER, 5.16.3(a)(1) and 5.17.3(a)(1)

The conclusion drawn in some submissions is that external funds from all third-parties, including participants, should increase the net benefit of a credible option, consistent with the approach in the cost threshold test where cost contributions from any third party are regarded as reducing the regulated cost base (and by implication, increasing the net benefit). Other stakeholders argued that no third party funds, irrespective of the source, should serve to increase the net benefit of the proposal.

CCP20 does not accept that the cost threshold test and the subsequent option evaluation process in the RIT must necessarily completely align.

In the first instance, if there was to be alignment, this would imply not only a similar treatment of third-party contributions, but also that only capex would be included in the cost-benefit test of different options. Opex costs related to (for instance) implementing non-network solutions would not form part of the evaluation of options. Clearly, this is not the intent of the option evaluation process.

Secondly, the RIT is designed to further consumers' long-term interests by ensuring a NSP's regulated asset base (RAB) reflects only prudent and efficient capex. It does this by requiring all relevant projects above the RIT cost threshold, to be subjected to additional economic evaluation over and above the AER's five-year revenue determinations. At the initial stage, therefore, the focus is on costs that will be included in its regulated asset base (RAB) and which will drive current and future regulated network prices.

In contrast, once it is determined that the capex proposal exceeds the capex cost threshold for the NSP, the focus turns to the evaluation of the wider market costs and benefits of the selected credible options to meet the identified need. As stated by the COAG Energy Council in its 2016-17 review of the RIT-T:[21]

> *The RIT-T is designed to identify the most efficient regulated investment in transmission infrastructure whether intra- or inter-regional in scale, and ultimately protect consumers from paying more than necessary for their supply of electricity.*

For these reasons, CCP20 supports the AER's approach to consideration of third party contributions in the RIT. That is, we see no material contradiction arising from the different criteria used for the initial assessment of the proposal against the RIT cost threshold, and the subsequent selection of the preferred option to deliver the proposal that maximises the present value of the net economic benefit to all those who produce, consumer and transport electricity in the market. This is discussed further in section 3.8 below.

We would support the AER seeking to clarify any ambiguity in the rules as part of the work underway by the Energy Security Board (ESB) responding to the Energy Council request of 10 August.

3.8 Third-party funding – impact of funding sources on assessment of net benefits

In its Issues Paper and in the Draft Guideline, the AER's position is that as the RIT is a market-wide cost-benefit assessment, then funds that move:[22]

- between market participants in the NEM, count as wealth transfers and should not affect the calculation of the final net-benefit under the RIT
- funds from other parties outside the NEM participants should count as a reduction in the costs of the option, thereby increasing the net benefit under the RIT.

The submissions in response to the AER's proposal in the Issues Paper appear to be evenly split. Some supported the AER's position. However, other stakeholders suggested that all contributions should be treated equally, and serve to increase the net benefit of a credible option. Other stakeholders argued that no external funds should increase the net benefit of a credible option.

In CCP20's response to the AER's Issues Paper, we agreed with the AER's initial position and stated that:[23]

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[21] COAG Energy Council, *Review of the Regulatory Investment Test for Transmission, RIT-T Review,* February, 2017, p 4.

[22] See, AER, *Explanatory Statement*, p 30.

> *The guidelines should be clear that the RIT is a market wide cost-benefit analysis that reflects the costs and benefits that will accrue, ultimately to electricity consumers.*

Having considered the other stakeholder submissions, CCP20 continues to support the AER's position as set out in the Explanatory Statement and the Draft Guideline.

In particular, CCP20 agrees with the AER that the NER directs the AER to distinguish between funds transferred between market participants and funds provided by a third party such as a government body:[24]

> *The purpose of the regulatory investment test for [distribution] [transmission] is to identify the credible option that maximises the present value of the net economic benefit to all those who produce, consume and transport electricity in the National Electricity Market…*

Moreover, such a constraint around the RIT assessment to the costs and benefits to those who produce, consume and transport electricity is consistent with the direction of the NEO. That is, the focus of the NEO is on delivering outcomes in the long-term interests of electricity consumers in the NEM rather than some broader societal benefit.

To the extent a government perceives there is a societal benefit from a network investment, then the government is the party, representing that society, to contribute funds to the project. These third-party funds will in turn, decrease costs to the electricity market and provide a stimulus for a network project to proceed that might otherwise not have done.

For this reason, CCP20 agrees that payments by parties outside the market, should be recognised as contributing to the cost benefit analysis. In contrast, we agree with the AER that payments between market participants may transfer costs between market players but such payments do not (per se) alter the overall net costs of the network investment to consumers in the NEM.

CCP20 would, however, like to see some further elaboration of the examples in the Guideline. For instance, the Guideline could include discussion on how the interpretation of external funding in the RIT guideline relate to existing policies on customer and generator capital contributions and include a new example of these. We would also support clarifying any ambiguity in the rules as part of the work underway by the Energy Security Board (ESB) responding to the Energy Council request of 10 August.

3.9 Other matters

a) Land and easement values

We recognise that in many cases networks will acquire easements or other property assets as part of a network development strategy. These acquisitions may reflect concerns about rising property prices, or establishing a community expectation well before the time when physical assets are to be constructed.

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[23] CCP20, *Final Response to RIT Issues Paper*, April 2018, p 8.

[24] See NER, 5.16.1(b) & 5.17.1(b) for transmission and distribution respectively. For the avoidance of doubt, in the instance of a *reliability corrective action*, the credible option that maximizes the present value of net economic benefit may be negative – see 5.16.1(c)(12) & 5.17.1(c)(9)(v).

The existence of these easements, or land acquired for future substations (etc) can influence future asset investment in a number of ways, such as a sunk cost when considering alternatives. This can influence the commercial and social assessment of investment options.

It will be useful to the examples in the guidelines to include examples of how sunk costs such as land assets that have been acquired previously, can be considered in the RIT process.

b) Impact of distribution investments on wholesale energy prices and emerging community expectations

With the expansion of generation assets embedded into distribution networks, the issue of the responsibility of distributors in supporting renewable generation and its impact on customer energy prices is emerging. Similarly, some communities expect that the removal of network constraints to permit energy flows that in some ways provide a wider community impact, such as microgrids or local energy trading, is a responsibility of networks.

Some distributors see a regional accountability to support renewable energy hubs as part of local energy markets.

The AER should consider how these social expectations and broader impacts on energy markets should be accounted for when distributors plan for new investments or the replacement of large assets.

c) Post guideline reviews and in process measures

The RIT process needs to balance stability and consistency or policy and a level of flexibility in the environment of changing energy needs and government policy developments. CCP20 recommends that the AER implements a framework of monitoring the application and operation of the RIT framework to support continuous improvement and adaption to a market and policy changes.

As an example, the expected cancellation of the National Energy Guarantee creates uncertainty over the future structure of the ISPs and renewable generation in general.

d) How could 'Regret Theory' be applied ? Is it relevant ?

We note the emerging references to the concept of 'Regret Theory' as part of the RIT discussion. We understand that regret theory as used in behavioural economics, states that people anticipate regret if they make the wrong choice, and they take this anticipation into consideration when making decisions on investments. Fear of regret can play a significant role in dissuading an investor from taking an action, or can motivate an investor to take an action depending on the outcome of past decisions.[25]

Arguably, from a network's perspective, regret theory suggests that a NSP may tend to overestimate the benefits of a network investment compared to the greater uncertainty associated with non-network investments or to the option of extending the life of existing investments at lower cost.

[25] See for instance, Investopedia, https://www.investopedia.com/terms/r/regrettheory.asp

However, in the energy market, it is consumers who usually bear the costs and risks of over or under investment. In particular, one reason why network investment is less risky for a network than alternatives is that the NEM rules ensure that consumers rather than investors bear the long-term risks of over-investment.

To the extent that the ENA and some NSPs refer to regret theory in the context of RIT processes, CCP20 is of the view that wider consultation on the symmetrical application of the theory would be required prior to the AER incorporating 'Regret Theory' in the guidelines or as part of its Explanatory Statement to the final RIT guidelines.

e) Could the RIT reflect a propose – respond model much like a determination?

CCP20 notes that the propose-respond model of engagement may be appropriate in some cases for major network investment. This would more closely mimic the AER's role in regulatory determinations and allow for formal consultation around a proposal (equivalent to the PADR consultation phase), draft decision, revised proposal (the PACR stage) and a final determination.

This would also enhance certainty for all stakeholders compared to the current RIT process where the dispute process represents the only formal stage for consumers to engage with the AER on a RIT. We support further consideration of this as part of the work underway by the Energy Security Board (ESB) responding to the Energy Council request of 10 August.

f) Large investments in Information Technology

CCP20 notes that all utilities propose significant investments in information technology, with many single projects costing well over the RIT threshold. In many cases, these forms of ICT are seen as integrated with the risk management processes inherent in considering repex proposals or even demand management in addressing network augmentation needs.

Whilst acknowledging that ICT investment is not currently being considered as part of the RIT frameworks, we suggest that the AER may wish to consider the future integration of ICT into the RIT framework, in particular:

i) The establishment of base-case investment and performance

ii) Identification of the need for investment

iii) Formal process of considering alternatives to upgrade or replacement, similar to 'non-network alternatives'

iv) Acceptance of an engagement process for major expenditure

v) Seeking external services that may be an alternative to the planned investment