7 September 2018

Mr Peter Adams
General Manager, Wholesale Markets
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Electronic submission: RIT@aer.gov.au

Dear Peter

Re: DRAFT APPLICATION GUIDELINES FOR THE REGULATORY INVESTMENT TESTS FOR TRANSMISSION AND DISTRIBUTION

CitiPower, Powercor and United Energy welcome the opportunity to respond to the Australian Energy Regulator's (**AER**) draft application guidelines for the regulatory investment tests for transmission (**RIT-T**) and distribution (**RIT-D**).

We support AER's intent to maintain the same level of prescription in the amended RIT guideline, ensuring the RIT process allows flexibility for innovation and improvement in industry best practices over time. We also support the inclusion of worked examples and clarification on the articulation of the identified need.

Our response proposes changes to the draft guidelines that would improve the simplicity and credibility of the RITs, leading to long-term benefits for consumers.

1.1 Base case for replacement projects

The draft guideline states the base case should reflect a 'business as usual' approach where the distributor keeps the asset in poor condition and does not implement any credible option to meet the identified need. However, even in Victoria where probabilistic planning and risk monetisation approach is used in network management, this does not reflect a business as usual approach.

As per our submission on 6 April 2018, we consider the base case for replacement RITs should be a credible business as usual option where the asset(s) is kept in service for as long as viable. This ensures considered options are compared to a credible business as usual case rather than hypothetical, when selecting a solution with the highest net benefit.

For example, where practical, a credible business as usual option may include changes in operating practice, additional monitoring and maintenance in accordance with business practices, in order to manage the level of risk from continuing to operate deteriorating asset(s). At some point the asset may have to be replaced or retired to ensure efficient industry practice. Therefore the credible business as usual base case may also include the retirement or replacement of the asset. The trigger point for replacement of the assets prior to the base case will then be when the costs of replacement outweighs the base case options costs (including unserved energy and other risks).

1.2 Treatment of external funds

We support the draft guidance to treat financial contributions from all third parties, regardless of whether they are internal or external to the National Electricity Market (**NEM**), as an offset to the capital cost of the option *when considering if a RIT threshold is reached*. Ultimately, what matters is the actual cost customers are required to fund.

However, we do not support the draft guidance to treat funds from participants inside and outside the NEM differently *when conducting a cost-benefit analysis*. This would effectively deem an option with funding from outside of the NEM as lower cost compared to exactly the same option with funding from inside the NEM. While the RIT is based on a market-wide cost-benefit analysis, reducing *only* the cost of the option with a financial contribution from outside the NEM would significantly favour that option but is likely to be an inaccurate evaluation of the long-term benefit to the NEM.

Given the complexity of calculation of long-term benefits to NEM, we propose all funds are treated equally in the RIT cost-benefit analysis and the cost-benefit analysis is conducted on the actual cost to consumers (project cost less external funding). This would maintain the simplicity of the cost-benefit analysis and reduce the potential for the selection of inefficient options in the short-term.

1.3 Discount rate

We support the draft guidance that RIT proponents should use the same discount rate for different credible options to address a given identified need. This is current industry best practice and ensures any risks associated with the different credible options are captured in the scenario and option analysis. However, the most appropriate discount rate for projects in electricity distribution is the regulated cost of capital. Using a rate higher than the regulated cost of capital would inflate the cost of the options to consumers while the actual cost would be measured at the regulated rate.

1.4 Consistency in treatment of risk

In our submission on 6 June 2018, we outlined that, in our experience, there can be significant variations in non-network proponent’s understanding of the cost of mitigating the risk associated with addressing the identified need and that of RIT proponents. This variation in understanding of risks on the network has been the largest cause of disagreements and RIT delays in our experience to date.

While this issue was not addressed in the draft guideline, we reiterate the importance of encouraging non-network service providers to engage with networks early, to understand the risk profile of addressing a specific identified need before developing proposed solutions.

Should you have any queries about our submission please do not hesitate to contact Sonja Lekovic on (03) 9683 4784 or slekovic@powercor.com.au.

Yours sincerely,

Brent Cleeve
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