

6 April 2018

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

Melbourne Vic 3001

via email: RIT@aer.gov.au

Dear Mr Adams

RE: AER ISSUES PAPER - REVIEW OF THE APPLICATION GUIDELINES FOR THE REGULATORY INVESTMENT TESTS (FEBRUARY 2018)

Endeavour Energy appreciates the opportunity to provide feedback to the AER's review of the Regulatory Investment Test (RIT) application guidelines. This review was recommended by the COAG Energy Council following their review of the RIT-T in February 2017. We agree that an update to the guidelines are required following the AEMC's July 2017 decision to expand the RIT to include network replacement, refurbishment and other expenditure arising from asset de-rating decisions (the 'repex' rule change).

Based on the AER's issues paper, Endeavour Energy has conducted over one third of all RIT-Ds since the obligations came into effect in January 2014. This demonstrates our commitment to engage with the non-network market to better understand the opportunities offered by emerging alternative supply methods and models which have been facilitated through recent technological advancements and regulatory reforms.

We note that the number of non-network options adopted through a RIT-D process has been low to date. We do not consider this is due to biases or procedural failings by NSPs in applying the RITs or shortcomings within the RIT framework. Rather, the low uptake is due to non-network options not being economically feasible or preferable to traditional network solutions. However, we remain confident that as the contestable non-network market develops and matures, non-network options will become more available, reliable and cost competitive and duly adopted as preferred investment options.

As such, substantial changes are not required to the RIT application guidelines. The current guidelines provide a good overall balance of direction and flexibility needed to promote the efficient investment principles which underpin the RIT. We consider amendments to the guideline should largely be limited to accommodating the expansion of the RIT framework to replacement projects.

For instance, replacement projects are fundamentally different to augmentation projects. Capacity constraints can often be met incrementally in augmentation projects whereas replacement projects generally require large, immediate solutions with consideration of existing supply arrangements with connected customers. Given these disparities, additional guidance on the treatment of replacement projects and methods to quantify market benefits, including worked examples, would be particularly useful.

Overall, it is important a revised guideline not be overly prescriptive or administratively burdensome. Direction provided through the guidelines gives confidence to all stakeholders that RIT proponents are fulfilling their obligations. However, excessive prescription may unintentionally curtail the prospects of non-network solutions. NSPs must be given the flexibility to frame their RITs and enhance the opportunities to work collaboratively with non-network service providers to develop innovative solutions including those which combine network and non-network elements.

We consider the long term interests of customers are best served by a guideline that ensures NSPs select the most efficient solution in a transparent and procedurally fair manner. This is supported by a guideline that is neutral between network and non-network solutions, promotes evidenced based decision making and provides NSPs with the discretion to utilise their established and proven asset management procedures and knowledge.

Attachment A contains our responses to the questions raised in the issues paper. We would welcome the opportunity to work collaboratively with the AER to improve the guidance provided in the RIT application guidelines and more broadly, promote efficient investment decisions.

If you have any queries or wish to discuss this matter further please contact Joe Romiti, Regulatory Analyst at Endeavour Energy on (02) 9853 6232 or via email at joseph.romiti@endeavourenergy.com.au.

Yours sincerely,



Ty Christopher
General Manager Asset Management
Endeavour Energy

Appendix A – Endeavour Energy’s responses to the AER’s questions.

Promoting competitive neutrality and efficient decisions

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

Whilst we note that this question is best answered by customers themselves, from a DNSP perspective, it is well embedded within the regulatory framework that regulated entities must make decisions that promote the long-term interests of customers. Consequently, our asset management processes have been developed to ensure our investments are prudent and efficient and balance our customers competing priorities of affordability, safety and reliability. By following these processes we believe we can best serve the long-term interests of our existing and future customers.

Requiring NSPs to fairly evaluate the feasibility of non-network options through a robust cost-benefit analysis, the RIT-D has become a valuable tool facilitating deployment of the most cost-effective solution to a network constraint - irrespective of whether the investment is a network or non-network solution. We consider the RITs ensure the preferred option is determined on merit and helps promote efficient investment decisions.

We believe a revised RIT guideline should maintain promoting efficient investment decisions as the key objective.

Application

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?

The NER exempts projects from a RIT-D process if the capital cost to the network businesses affected by the RIT-D project of the most expensive credible option to address the identified need is less than \$5 million.

With regard to external financial contributions, we agree that if such a contribution(s) resulted in lowering the costs paid by network customers to below the relevant threshold, the project should be exempt from a RIT assessment.

Consumer Engagement

Question 3: How do you think we should amend the RIT application guidelines to better facilitate consumer engagement throughout the RIT application process?

The RIT broadly aims to facilitate a wider consideration of feasible options to network constraints. To effectively do this, NSPs are required to engage directly with non-network service providers and communicate the technical details of the identified constraint. The RIT therefore appropriately triggers engagement between NSPs and the non-network market as the two most relevant parties whose input will ultimately determine the preferred option.

The framework allows several opportunities for non-network service providers to query, consult and collaborate with NSP’s throughout the decision making process. This is appropriate as the success of RIT assessments hinge on establishing and maintaining strong engagement between NSPs and the non-network market.

Whilst we welcome opportunities to involve customers in our investment decisions (as we have demonstrated most recently in developing our regulatory proposal to the AER for 2019-24), we consider there may be limited benefit in prescribing engagement between NSPs and consumers within the RIT guidelines. NSPs should be allowed the flexibility to undertake consultation in accordance with their standard planning processes and tailor engagement specific to the RIT project.

We are concerned that prescriptive consumer engagement requirements may add to the regulatory burden of conducting the RIT and in certain circumstances, deny fair consideration of non-network options. For instance, if asked for their preference between a like-for-like asset replacement and investment in an unfamiliar form of non-network solution, some customers may exhibit a bias towards the certainty and familiarity offered by the network option with limited regard to the relative costs. This is particularly true when from an individual customer perspective, the difference between the two options will make negligible difference to their individual electricity bill. Involving customers in a forum that requires a relative detailed understanding of the technical and economic issues which underpin RIT assessment could pressure NSP towards adopting inefficient network investments – contrary to the objective of the RIT.

We do however foresee benefits in providing guidance which facilitates engagement between the non-network market and consumers. As small scale DER becomes more prevalent, aggregation of services will likely provide a genuinely feasible non-network option in the future. Collaboration between consumers and aggregators will enhance the opportunities of some non-network solutions. NSPs are generally one-step removed from end-use customers who mainly deal with retailers or alternative service providers offering a product.

Screening for N-N options

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? Are there specific ways we should complement this guidance with greater oversight over distribution business' non-network engagement activities?

We believe the prescriptive requirements outlined in the NER (and reinforced in the RIT-D guideline) relating to non-network options reports and screening requirements are clear, unambiguous and reflective of the type of information valued by non-network providers in order to effectively evaluate their prospective solutions against the identified need. We consider these obligations are sufficient to enable NSPs to publish meaningful documents for consultation. Our post assessment reviews have revealed non-network providers are generally complementary on the level of engagement undertaken with Endeavour Energy and the level and detail of information made available.

As stated earlier, the RIT provides several opportunities for non-network service providers to query, consult and collaborate with NSP's, both formally and informally, throughout the assessment process. Stakeholders are permitted to raise a RIT-D dispute at the conclusion of the assessment, further incentivising NSPs to engage in genuine and regular consultation. We regularly work with non-network providers and offer additional guidance and information upon request to enhance their ability to submit feasible proposals.

Given the robustness of the current framework, we are not convinced that closer oversight of the process by the AER will lead to greater uptake of non-network alternatives.

Improved outcomes are best facilitated through a flexible engagement approach that should not be prescribed in the guideline.

Consistency between RITs

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?

Not applicable to Endeavour Energy.

Cancellation of RIT assessment

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

We agree that there is currently limited guidance for proponents on what information must be published when cancelling a RIT and support increasing the transparency of such decisions consistent with other aspects of the RIT.

Given that cancellations will not generally adversely impact customers, we would reasonably expect that additional reporting requirements should not be administratively burdensome or costly on the part of the RIT proponent.

We consider non-network providers and other non-NSP stakeholders are best placed to suggest possible improvements.

Identified need

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

We agree that there has been some variability in how NSPs have chosen to define the identified need underpinning their RIT assessments and definitions have not strictly adhered to the guidance provided in the RIT guideline. This observation however should not be taken as evidence that non-network options have been denied fair opportunity for consideration as a preferred option.

We believe it is important that some discretion be afforded to the NSP to frame the identified need in a manner that is meaningful to non-network providers and enhances the opportunity to elicit genuinely feasible non-network options.

For instance, we recently sought to engage the non-network market to investigate the technical viability of non-network solutions to limit the level of replacement investment required at Marayong zone substation. The wording used to describe the identified need was carefully selected to provide the market a challenging but practically achievable objective. Given this was our first application of the RIT towards a replacement project, we considered presenting the objective in these terms would improve the likelihood of non-network providers identifying opportunities to complement network investment to redress the significant capacity shortfall.

We consider requiring RIT proponents to express the identified need as the achievement of an objective that is consistent with identifying a preferred option, whilst technically compliant with the requirements of the NER, risks descriptions becoming relatively homogenous, uninformative and of limited value to prospective non-network service providers.

The current guidelines suggest RIT proponents may find it useful to explain the likely outcomes if no credible option were adopted. We would support retaining this advice in the updated guidelines as it provides added context to the identified need.

Option value and scenario analysis

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? Are there particular scenarios where a worked example would be helpful in providing this guidance?

We consider that option value can be accounted for through applying scenario/sensitivity analysis and agree with the AER that there is scope to provide more clarity around calculating option value in the RIT guideline. We expect that the flexibility offered by non-network options and staged network investment of augmentation projects in particular may potentially lead to large benefits that will need to be accurately captured.

Specifically, we would welcome additional guidance of how to best quantify option value, possibly through detailed worked examples. We suggest the AER refer to scenarios encountered in their review of previous RITs, both for augmentation and replacement, to develop realistic scenarios reflective of the type commonly encountered by NSPs.

Replacement expenditure

Question 9: Would any guidance in addition to the areas listed in section 5.3 of this issues paper assist in the application of the RITs to repex projects? Is there particular guidance stakeholders would like to help understand how the RITs will apply to asset replacement programs?

The expansion of the RIT to include asset replacement is a key driver of the need to update the current RIT guidelines. We believe there is scope to provide additional guidance by including asset replacement scenarios in the guidelines to help guide the decision making process.

Furthermore, we note the AER have stated they intend to provide guidance on asset retirement decisions in the RIT guidelines. We understand the AEMC did not include a network retirement reporting guideline in their final repex rule change decision as initially proposed by the AER. At the time of consultation, it was argued that NSPs were best placed to consider when assets would most appropriately be retired.

On the basis that NSPs have the best understanding of the condition and capability of network assets and are held accountable for prudence of their investment decisions, we agree that the timing of asset retirements should be determined by NSPs. However we welcome the opportunity to work with the industry on establishing a commonly agreed set of principles which promote efficient asset retirement decisions. Such guidance would need to be a suitably high level to accommodate various approaches to asset management practices and allow departures to be made on a technically sound or otherwise justifiable basis.

Accounting for external funds when applying RITs

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 come from outside the market to a party within the market should increase the final net benefit?

We agree with the AER views and cannot foresee a scenario where we would hold a conflicting view.

Treatment of high impact, low probability events

Question 11: Do you agree that the scenario analysis currently prescribed in the RIT application guidelines can sufficiently capture the effects of high impact, low probability events and system security requirements? Do the RIT–T application guidelines require expanding to assist proponents in accounting for these events? Is there specific guidance you would like on this topic, or particular scenarios where a worked example would be helpful—and how (if at all) should this differ between the RIT–D and RIT–T application guidelines?

Not applicable to Endeavour Energy.

Environmental policy and the National Energy Guarantee

Question 12: What additional guidance would stakeholders find useful in regarding the treatment of environmental policies in the RIT-T application guidelines?

Not applicable to Endeavour Energy.

Discount rate and treatment of risks

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?

It has been our standard approach to apply the same discount rate for assessing different credible options during RIT assessments. We consider different levels of risks are reflected in the costs of each respective credible option and captured in scenario/sensitivity analysis.

We support the AER’s proposal to maintain a constant rate across all credible options and require proponents to justify discount rate variation. We would expect the revised guidelines to preserve the ability of RIT proponents to vary the discount rate in conducting scenario analysis.

Value of customer reliability

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

We agree with the AER that VCR values are becoming an increasingly important input into decision making. The VCR reflects the value customers place on maintaining their electricity supply, or conversely the price they will pay to avoid supply interruption. However, the distribution network is increasingly being used to facilitate a number of new and emerging services, including energy exchange and trading, which have the potential to provide customers significant benefits.

We believe VCR values do not entirely capture these benefits and there is a risk of inefficient decisions being made on the basis of understated VCR values. The VCR should reflect a whole-of-market concept, whereby the full value customers place on being connected to the interconnected grid is adequately captured. As industry transformation accelerates, the divergence between value stated through the VCR and the true value placed on grid connections will increase. The services provided by NSPs are key enablers of future energy trends and we ask the AER to consider how to better incorporate these in VCR values.

Furthermore, from a VCR perspective, we believe greenfield augex projects addressing energy at risk to customers waiting to connect are different to brownfield augex and replacement projects driven by the risk of connected customers losing supply.

We consider the value that customers place on continuity of supply is different to the value customers waiting to connect will place on having access to supply. However the RIT guidelines currently provide no guidance on procedures to follow in greenfield development situations. In the absence of guidance, we have adopted the same VCR value regardless of the underlying driver of the RIT project.

We would welcome guidance on appropriately monetising the economic risks associated with deriving unconnected customers of supply.

Selection of base case

Question 15: Should we revise the RIT–D application guidelines to clarify that a 'business-as-usual' base case should be used for repex projects? Is there any other guidance the RIT application guidelines should provide on selecting an appropriate base case?

The current guidelines indicate the base case is the state of the world in which an NSP fails to put in place a credible option (reliability corrective action needs exempted).

With regard to a replacement RIT, we believe the base case can reasonably be interpreted to be the 'do nothing' option or 'business-as-usual' option.

Understanding that the 'do nothing' option could imply failure to perform routine operational work required in order to keep asset(s) functional and in service, we believe clarification of 'business-as-usual' as the base case is warranted.

Other RIT issues — Integrated System Plan

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?

Not applicable to Endeavour Energy.