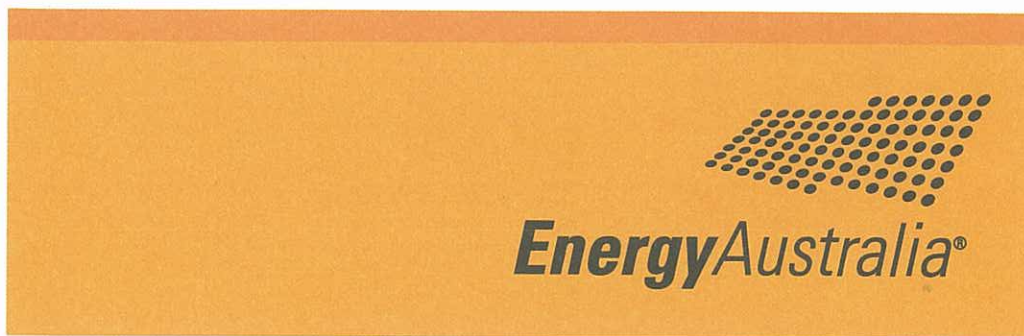


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14 May 2010

Mr Tom Leuner
General Manager - Markets
Australian Energy Regulator
GPO Box 520
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By email: AERInquiry@aer.gov.au

Dear Mr Leuner

Draft regulatory investment test for transmission and regulatory investment for transmission application guidelines

EnergyAustralia appreciates the opportunity to comment on the Australian Energy Regulator's (AER's) draft regulatory investment test for transmission (RIT-T) and regulatory investment for transmission application guidelines (Application Guidelines). EnergyAustralia has an interest in the development of the RIT-T and the Application Guidelines because it may influence the future regulatory tests applied to proposed distribution investments.

Presently, the RIT-T does not apply to EnergyAustralia's dual function assets, connection assets or work required to address limitations in a distribution system. This situation may change in light of the AEMC's proposed Draft National Electricity Amendment (Annual Planning and Regulatory Investment Test for Distribution) Rule 2009 that was submitted to the Ministerial Council on Energy (MCE) in September 2009.

In its Final Report, the AEMC recommended that each distribution network service provider (DNSP) would be required to undertake joint planning with any transmission network service provider (TNSP) that operates a transmission network connected to the DNSP's distribution network. Where the joint planning process results in the identification of a need for augmentation or a non-network alternative, then the RIT-T would apply to the options identified. If this proposal is accepted by the MCE and implemented through a subsequent rule change, then a proposed investment on a distribution network that was identified under a joint planning process could be subject to the RIT-T.

EnergyAustralia made submissions to the AEMC indicating that the distribution test (RIT-D) should apply to transmission investments required to meet distribution objectives and the transmission test

should be preserved for projects requiring joint planning where there is some likelihood that the augmentation will influence main transmission network and interconnector flows and thus have a material market effect. The AEMC did not accept EnergyAustralia's submission on this issue. Therefore the scope of the RIT-T may potentially apply to proposed distribution investments identified under joint planning arrangements.

We consider that the AER's proposed RIT-T and Application Guidelines may be an indication of the direction that the AER may take on the RIT-D. In particular, the AEMC has proposed that the AER could have a single set of Application Guidelines for the both the RIT-T and RIT-D.

One concern we have is the lack of clarity about the meaning of the term "economically feasible". Under clause 5.6.5C(a)(2) of the Rules, a TNSP must apply the RIT-T to a proposed transmission investment except in circumstances where the estimated capital cost of the most expensive option to address the relevant identified need which is technically and economically feasible is less than \$5 million (as varied in accordance with a cost threshold determination). We note that the AEMC has proposed a similar clause to apply to proposed distribution investments in the draft Rules.¹

Whilst this is not strictly a matter covered by the RIT-T itself, we consider that it would be helpful for the AER as the regulator to provide guidance on how to approach "economically feasible" in this context. This would ensure clarity in setting the threshold for proposed investments subject to the RIT-T (and potentially the RIT-D). The need for a workable definition of "economically feasible" is particularly relevant with respect to developing proposals aimed at meeting jurisdictional reliability requirements.

As a practical example, when considering a reliability driven need, the most expensive economically feasible option for the identified need could be a \$10 million project even though the same need could be addressed by a \$500,000 project or a range of projects below \$5 million. Even though the \$10 million project is not viable, the existence of such an option would appear to take the project above the RIT-T threshold. This would result in the TNSP having to consider it as an option and apply the RIT-T to all options.

We suggest that, to prevent this unintended outcome, there needs to be some reasonable parameters around the application of "economically feasible" in this context. EnergyAustralia would propose that an option is economically feasible if its cost is within, say 50%, of other potential options offering similar benefits.

The term "economically feasible" is used to screen whether a proposed transmission investment will be subject to the RIT-T. This has a different purpose to the use of the term "commercially feasible" in clause 5.6.5D(a)(2) which is used to identify credible options. As set out in the draft Application Guidelines an option is commercially feasible "if a reasonable and objective operator, acting rationally in accordance with the requirements of the RIT-T, would be prepared to develop or provide the option in isolation of any substitute options". (AER, draft Application Guidelines, p.9). Such guidance for the term "commercially feasible" is important and we consider that similar guidance for the term "economically feasible" would also be useful.

Another general concern we have is that the draft RIT-T process is overly complex for reliability driven projects. The draft RIT-T includes the consideration of market benefits for all proposed investments with the onus on the TNSP to demonstrate that benefits are not material or the cost of assessment is

¹ See proposed draft clause 5.6.5CB(a)(2) Investments subject to the regulatory investment test for distribution in AEMC, Distribution Annual Planning and Reporting Requirements and the Regulatory Investment Test for Distribution Draft Rule Change Request (including draft Rules) September 2009, pages 22- 23.

disproportionate to the exercise. We consider that the proposed approach is a very complex process for projects that are undertaken to maintain reliability rather than for market driven reasons. We suggest that the AER consider ways of ensuring the level of analysis undertaken is proportionate to the nature and value of the investment as required by clause 5.6.5B(c)(2) of the Rules. For low value reliability investments where there will be generally little scope to realise market benefits there needs to be AER guidance on when some classes of market benefits can be omitted from the application of the RIT-T because they are not material.

Without guidance from the AER then the justification of screening out of market benefits as immaterial may be open to interpretation with the resultant risk of disputes. If the AER does not provide such guidance then attempting to identify and quantify market benefits will be a costly exercise, especially given the low \$5 million threshold that applies to proposed transmission investments.

EnergyAustralia also has concerns about the requirement to set out a base case for reliability projects. In our view, there is little to be gained from calculating the impact of the base case if it is non-compliant with jurisdictional requirements. However, the exercise to calculate of the potential value of lost load for a 15 year period, due to capacity being exceeded requires a significant effort but for little purpose, given that the state of the world without meeting the jurisdictional requirements is not feasible for a TNSP.

We trust that these comments will be considered useful by the AER in light of the potential impact of the RIT-T on the future regulatory tests applied to proposed distribution investments. If you have any queries about these comments please contact Ms Jane Smith on 02 9269 4171.

Yours sincerely



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