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Submission to the AER

Regulatory Investment Test - Distribution

Issues Paper

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Total Environment Centre's National Electricity Market Advocacy

Established in 1972 by pioneers of the Australian environmental movement, Total Environment Centre (TEC) is a veteran of more than 100 successful campaigns. For nearly 40 years, we have been working to protect this country's natural and urban environment, flagging the issues, driving debate, supporting community activism and pushing for better environmental policy and practice.

TEC has been involved in National Electricity Market (NEM) advocacy for eight years, arguing above all for greater utilisation of demand side participation — energy conservation and efficiency, demand management and decentralised generation — to meet Australia's electricity needs. By reforming the NEM we are working to contribute to climate change mitigation and improve other environmental outcomes of Australia's energy sector, while also constraining retail prices and improving the economic efficiency of the NEM — all in the long term interest of consumers, pursuant to the National Electricity Objective (NEO).

Regulatory Investment Test – Distribution

TEC appreciates the opportunity to make a submission to the AER regarding the creation of a Regulatory Investment Test for Distribution (RIT-D). A key tenet of the AEMC's national framework for electricity distribution planning and expansion (Framework) is to improve demand management (DM) outcomes by

> *Creating incentives for, and a framework within which, distribution businesses can explore non-network options as alternatives to capital expenditure. This will also incentivise and assist non-network providers to efficiently plan and offer alternative, cost effective options to network augmentations.*

As a consistent advocate for increasing DM in the NEM, we focus on this aspect of the RIT-D in this submission. However, given that the ambit of the AER's power to develop the RIT-D is heavily circumscribed by the Rules, we can provide little recommendations for improving the prospects of DM within a defective RIT-D.

The RIT-D and DM

There has been increasing awareness over the past few years of the inherent conflict between DM opportunities and the revenue model for distribution network service providers (DNSPs). We remain highly sceptical whether NSPs can be encouraged to invest in an economically efficient level of DM whilst the regulatory framework overall is skewed in favour of increasing throughput.

Given that DNSPs have strong incentives for network solutions, DNSPs heavily favour augmentation options, and in 2002 IPART concluded:

> *To a large extent, one of the major obstacles continues to be a culture which favours traditional 'build' engineering solutions and which pays little more than lip service to alternative options.*

The RIT-D process takes place before investment decisions are made, in theory so that "it is applied in a way that ensures distribution companies assess all credible options before they choose the best option

available to meet their network's augmentation needs". The reality however, is that DNSPs are predisposed to undertaking infrastructure investment and the RIT-D is very likely to become a rubber-stamping exercise as it leaves the DNSPs as the gatekeepers of new investment.

TEC considers that the AER should have greater powers and resources to oversee these processes, being the arbiter instead of simply approving the result of processes conducted essentially by the proponents for their own benefit. Unfortunately, the AER is limited by the defective Rules under which it operates, which give the AER only a limited role in:

- developing and publishing the RIT-D and guidelines in accordance within the confines of the Rules;[1]
- determining whether additional classes of market benefits or financial costs should be applied to the RIT-D, which allows the regulatory some scope for improving DM outcomes;[2]
- administering the process and resolving disputes.[3]

This would suggest that the AER has very limited powers to genuinely oversee the RIT-D process, ensure that NSPs are considering non-network options, and encourage them to think beyond network solutions.

The failure of the RIT-T

Experience with the RIT-T further suggests that the RIT-D is unlikely to significantly curb network expenditure or increase DM activity. TNSPs have been required to undertake a RIT-D before committing to major new infrastructure spending since 2010. However, to our knowledge, no new transmission line or distribution network project proposal has ever been abandoned (as opposed to merely postponed) as a result of a RIT-T.

A number of factors could contribute to the abandonment of some network investment, such as initially inaccurate demand forecasts, actual demand being lower than projected, or an alternative (demand management or local generation) project being shown to be more economically efficient. Yet, if the results of the RIT-T are to be believed, none of these factors have come to pass.

This suggests that there is a major flaw in these processes. This is no surprise, since

a) proponents are expected to call for and review alternatives to their own infrastructure plans, and
b) the AER does not have the powers and/or the resources to properly review the merits of these proposals, instead essentially being reduced to the role of checking that the networks have "ticked the boxes" before concluding that, indeed, their project is the least-cost solution to an emerging network constraint.

[1] NER 5.17.1(a), NER 5.17.2(a)

[2] NER 5.17.1(c)(4)(viii), NER 5.17.1(c)(6)(iv)

[3] NER 5.17.5

An example: TransGrid

In 2009 TransGrid, the monopoly transmission line builder and operator in NSW, submitted its final notice to the AER for the proposed $227 million Dumaresq-Lismore 330 kV transmission line. Even at the time, its peak (46% over 10 years) and total demand forecasts appeared questionable. In spite of evidence of falling total demand in the interim, the company persisted with the same projections in its 2010 application for NSW planning approval.

In 2010, following complaints from a group of affected farmers in the Tenterfield area, the AER conducted an investigation into the regulatory test followed by TransGrid, and found a series of shortcomings.[4] There was, for instance, no serious effort made to investigate alternatives to a new transmission line such as local generation and demand management. Nevertheless, the project remains on TransGrid's books, despite the company announcing a 1-10 year deferral in its 2012 Transmission Planning Report – a vague and open-ended delay that does no favours for affected landholders, whose incomes and quality of life remain in the balance.

In 2011 this project was also the subject of a scathing report commissioned by the same group of landholders by the Institute for Sustainable Futures at UTS.[5] It found, inter alia, that peak summer demand on the NSW North Coast had not increased over the past five years; that the proposed transmission line would be the most expensive way to meet increased peak demand in any case; and that there was no serious consideration of non---network alternatives to meet any increase in peak demand. DNSP culture and DM

Beyond RITs

A more holistic approach is needed in all distribution network regulation to ensure that non-network alternatives are given due consideration in network planning process, and the RIT-D can simply not provide this in isolation. Ultimately, we feel that the 'long term interests of consumers' entails the prioritisation of effective non-network alternatives over network augmentation.

We feel that network investment should be subject to public tender in which proponents of non-network alternative, such as DM aggregators and local solar power providers, can compete on an equal footing.

The RIT-D

Limited scope of the RIT-D

Aside from the fact that the RIT-D is a token effort to make DNSPs accountable for their infrastructure spending, the AEMC, in creating the framework for the RIT-D, has considerably limited its scope by making a number of exemptions to the test:

[4] See http://www.aer.gov.au/node/2395
[5] Rutovitz,J et al. 2011.TransGrid proposal for a new Dumaresq to Lismore transmission line: commentary on project need. Institute for Sustainable Futures, UTS.

- The exemption for replacement assets should have been removed as non-network solutions can provide an alternative to replacement, just as they can for augmentation projects. They would therefore have benefited from the RIT-D process.
- Exempting "urgent and unforeseen" investments from the RIT-D – we remain unconvinced that this exemption can be suitably defined, and believe that it is at risk of exploitation.
- The RIT-D will not apply where the estimated capital cost of the most expensive credible option is under $5 million. Combined, even small investments will comprise a significant imposition on consumers - allowing such investments to occur without the rigour of the RIT-D is against the interests of consumers as many non-network alternatives to smaller augmentation decisions will be overlooked.

Unfortunately, as these exemptions are now enshrined in the National Electricity Rules, the AER has no option but to attempt to build an effective RIT-D out of a defective framework. In the absence of more complete reform in this area, the AER should do its best to ensure that the RIT-D, at the very least, requires DNSP's to give genuine consider to non-network options and conduct robust assessments of such projects, and that the true value of DM is fully accounted for.

Quantification and recognition of benefits

We believe that a wide range of costs and benefits should be considered, to make the cost benefit assessment as holistic as possible. We therefore applaud the AER for recognising that DM can provide multiple benefits to the market, and for proposing the inclusion of these benefits in an additional, broader class of market benefit under the RIT-D test.

We will not attempt to provide a complete list, but we believe that the following should be included as benefits within this new class:

- Improved reliability, above the mandated minimum level.
- Improved extensibility – e.g. alleviation of fault level problems.
- Foregone distribution losses.
- Environmental benefits.

Each of these benefits need to be quantified, assigned a financial value and treated accordingly.

Defining 'interested party' and 'impacts'

We feel that the impact of changing the definition of impacts to focus solely on the NEM potentially provides clarity, but at the expense of more considered and holistic decision-making. As the AER states, this will "ensure that the focus of the RIT-D is kept in the context of the NEM specifically, as opposed to other impacts like those relating to environmental or planning issues". This is the kind of myopic thinking that unfortunately plagues NEM processes more generally, shutting out anything non-central to the pursuit of the lowest short-run marginal cost, and leaving it to be dealt with by other regulatory frameworks, rather

than taking a holistic view that would recognise, for instance, that good environmental outcomes can also be good for consumers — especially in relation to energy efficiency.

Given the large-scale nature of the investments undertaken by DNSPs, and the wide-reaching impacts that these investments can have, it is our opinion that consultation should be as broad and comprehensive as possible, and that consultation should not be narrowed by restrictive definitions in the RIT-D.

Yours sincerely,

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