



25 February 2013

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Dear Chris

AER Issues Paper - Regulatory investment test for distribution (RIT-D)

The Victorian DNSPs (CitiPower and Powercor Australia, United Energy, SP AusNet and Jemena Electricity Networks) welcome this opportunity to respond to the AER's Issues Paper on the RIT-D¹.

The attached submission sets out our answers to each of the questions raised in the Issues Paper. We wish to emphasise the following key points:

- The Rules require that the level of analysis under the RIT-D must not be disproportionate to the scale and likely impact of the options being considered. To satisfy this Rule requirement, it is essential to simplify the operation and application of the RIT-D compared to the RIT-T, particularly in relation to the simplified assessment of market benefits that is warranted when there is no significant impact on power flows in the shared transmission network.
- The cost estimation methodology for the RIT-D should recognise that the scale and nature of distribution investments will not require the same level of analysis and detail as that for a major transmission investment. Each DNSP should have the flexibility to produce its own cost estimates consistent with its own business case approval and governance process without extensive guidance from the AER.
- As a general principle, the guidelines should illustrate simple methodologies for the quantification of market benefits, and suggest standard or deemed values where appropriate. The guidelines should also provide sufficient flexibility for a DNSP to use more complex methodologies where appropriate.
- It is not clear whether there are market benefits in the wholesale energy market as a result of demand side participation that should be included in a RIT-D analysis. The Victorian DNSPs would, in principle, accept their inclusion in the RIT-D providing that the benefits of doing so justified the additional analysis that would be required.

¹ AER, Issues Paper - Regulatory Investment Test for Distribution, January 2013.

- The Victorian DNSPs apply a probabilistic planning approach, and so there is a need for a base case to be included in the analysis. The RIT-D rules do not preclude a DNSP from including a base case in RIT-D evaluations, and we consider that the RIT-D guidelines should certainly not preclude this either.
- Under the STPIS model, DNSPs are incentivised to deliver efficient levels of network reliability, and future targets are set with reference to recent actual performance delivered in response to those incentives. The RIT-D does not give rise to any need to consider STPIS nor any need to interfere with the STPIS benchmarks. Different reliability outcomes can be evaluated by using an appropriate estimate of the Value of Customer Reliability (VCR), in accordance with the standard probabilistic planning approach.

The Victorian DNSPs appreciate the opportunity to make this submission and would welcome the opportunity to discuss any of the matters raised. We note that the Issues Paper is the first stage of the AER's consultation process, and we look forward to providing more detailed comments and suggestions once the AER has developed the draft RIT-D guidelines.

In the meantime if you have any questions, please contact Gabriel Wan (on 0402 060 761 or by email at gabriel.wan@jemena.com.au), who is acting as co-ordinator of the responses of the five Victorian DNSPs.

Yours sincerely,



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on behalf of the Victorian Electricity Distribution Businesses



Victorian Electricity Distributors' response to Questions in the AER's Issues Paper on the Regulatory Test for Distribution

Question 1: *Stakeholders should have regard to the regulatory test, RIT-T and RIT-T guidelines when considering their response to this Issues Paper. We are interested in what provisions of the RIT-T should be included in the RIT-D, modified or excluded altogether.*

The principles set out in clause 5.17.1 of the Rules require, amongst other things that the RIT-D must not require a level of analysis that is disproportionate to the scale and likely impact of each of the credible options being considered. In relation to the important principle of proportionality, we draw the AER's attention to COAG's guidance on best practice regulation, which states²:

"Proportionality involves ensuring that government action does not 'overreach', or extend beyond addressing a specific problem or achieving the identified objective. The scope or nature of government action should be commensurate with the magnitude of a problem, its impacts, or the level of risk without action. The principle of proportionality applies equally to the implementation of regulation, including the development of frameworks for ensuring compliance."

While the above quotation relates specifically to the appropriateness of Government action, it is equally applicable to the scope of regulation, such as the RIT-D. In this context, the following differences between transmission and distribution should be noted:

- DNSPs have smaller but more capital projects than TNSPs. Therefore, a larger volume of relatively low-value RIT-D assessments are likely to be undertaken each year by DNSPs, compared to the smaller number of relatively high-value RIT-T assessments undertaken by TNSPs.
- The drivers of projects on the distribution network are more localised and they may arise relatively quickly, so they often require prompt responses at short notice.

It follows from the above that in very broad terms, these considerations point to a need for the guidelines to facilitate the timely and efficient application of the RIT-D by the proponent applying methodologies and provisions that are proportionate to the scale of the options being assessed.

More specifically, it is noted that the RIT-T includes requirements for the proponent to consider:

- wholesale market competition benefits;
 - changes in fuel consumption costs arising through different patterns of dispatch; and
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- the impact on generator bidding behaviour.

The RIT-T also specifies a requirement for the proponent to undertake market dispatch modelling.

These matters are not components of the RIT-D under the Rules because distribution projects are highly unlikely to have a material influence on these classes of market benefits. Moreover, we note that Victorian distribution networks are not operated in parallel with the transmission networks, as may be the case in other states, but rather are operated off single terminal station connections and therefore do not have significant impacts on declared shared transmission network power flows. If the RIT-T guidelines are to be adapted to develop the RIT-D guidelines, then the AER should ensure that all transmission-specific requirements are excluded.

The RIT-T guidelines discuss the meanings of the terms “commercially and technically feasible”, and “economically feasible”. We note that the term “economically feasible” appears in relation to the RIT-T in clause 5.16.3(a)(2) of the Rules, however it is not used in the RIT-D provisions of the Rules. The question of the meaning of the term “economically feasible” therefore does not arise in relation to the RIT-D, and so there is no need for it to be addressed in the RIT-D guidelines. Page 10 of the RIT-T guidelines defines the term “commercially feasible” as follows:

“The AER considers that an option is commercially feasible under clause 5.6.5D(a)(2) of the Electricity Rules 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.”

We consider it would be appropriate for this definition to be adopted in the RIT-D guidelines.

The RIT-T guidelines do not provide guidance in relation to joint planning. We note that in Victoria, the DNSPs have responsibility for planning transmission-to-distribution connection facilities. Joint planning of these facilities involves the Victorian DNSPs and the local TNSP (AEMO). These parties have agreed - via a Memorandum of Understanding (MoU) - the arrangements for the conduct of joint planning, including arrangements for joint application of the RIT-T. The MoU sets out arrangements relating to leadership and administration of the joint RIT-T analysis.

We suggest that it would be helpful for the RIT-D guidelines to provide guidance to the effect that the initiating party should be the default lead party in preparing a joint RIT-D analysis if an agreement as to that matter between the relevant NSPs cannot be reached. This would provide a ‘safety net’ to ensure that the NSP who has identified the need - and has the incentive to address that need - can progress the necessary RIT-D analysis in the unlikely event that an agreement with the other NSPs involved in conducting a joint RIT-D cannot be reached in a timely manner.

Question 2: *We are interested in how the differences in electricity distribution and transmission may require us to adjust our approach to the way RIT-T and RIT-D should be considered.*

Our answer to question 1 highlighted some of the differences between the characteristics of transmission and distribution. As noted above, these differences have implications for the way in which the AER should approach its consideration of the RIT-D in light of the RIT-T arrangements already in place.

One further key difference between transmission and distribution relates to the obligation on Victorian DNSPs to offer to connect. Currently, under their distribution licences, Victorian DNSPs are required to provide offers to connect within 20 business days. This will change when NECF is implemented in Victoria. Large connection projects will come under the negotiated connection offer rules. Under clause 5A.F.4(a) of those rules a DNSP must use its best endeavours to make a negotiated connection offer to the connection applicant within 65 business days after the date of the application for connection. This rule will apply to Victorian DNSPs when NECF commences in Victoria. We note that NECF has commenced in some jurisdictions.

The DNSPs' obligation to offer to connect raises questions as to the rationale for applying the RIT-D to augmentations associated with a connection offer.

We consider that there are strong reasons for concluding that such augmentations should be excluded from the RIT-D. This is because the NECF provisions relating to connection offers provide information and rights to retail customers to ensure that the connection charges offered by DNSPs are fair and reasonable. Specifically, the Rules require that the connection applicant be provided with information including details of any augmentation that is necessary to give effect to the connection. The Rules also provide the retail customer with the right to dispute the connection offer. In addition, the AER is required to publish connection charge guidelines, the purpose of which is to ensure that connection charges:

- (1) are reasonable, taking into account the efficient costs of providing the connection services arising from the new connection or connection alteration and the revenue a prudent operator in the circumstances of the relevant Distribution Network Service Provider would require to provide those connection services; and
- (2) provide, without undue administrative cost, a user-pays signal to reflect the efficient cost of providing the connection services; and
- (3) limit cross-subsidisation of connection costs between different classes (or subclasses) of retail customer; and
- (4) if the connection services are contestable – are competitively neutral.

In view of the purposes of the AER's connection charge guidelines, and the provisions in Chapter 5A of the Rules that ensure connection charges are fair and reasonable, it is highly questionable whether the application of the RIT-D to these augmentations would add anything further. On the contrary, it is more likely to duplicate or confuse the connection offer process set out in Chapter 5A, which, incidentally, makes no mention of the RIT-D.

We note however, that in its determination on the Distribution Network Planning and Expansion Framework Rule, the AEMC stated³:

“Where expenditure on an upgrade to the shared network is required to support a new customer connection, and this expenditure will be made by a DNSP and recovered from all users of the network, the upgrade should be within the scope of the RIT-D. To the extent that there are specific issues in relation to the connection timing requirements under Chapter 5A of the NER, resolving these issues is outside the scope of this rule change.”

³ AEMC, Rule Determination - National Electricity Amendment (Distribution Network Planning and Expansion Framework) Rule 2012, pages 142-143.

For the reasons set out above we consider the current position to be less than optimal, and we suggest that the AER should therefore adopt a pragmatic approach in dealing with this issue in the RIT-D guidelines. Specifically, we suggest that the guidelines will need to provide for streamlined processes to ensure that:

- the DNSPs' ability to meet the deadlines to provide a negotiated connection offer is not compromised; and
- customer-initiated work (the cost of which may be largely funded through customer capital contributions) is not delayed because of the time required to complete the RIT-D and associated processes.

We will carefully monitor the impacts of applying the RIT-D to customer-initiated augmentations on our ability to deliver customer connection services in a timely and efficient manner. If necessary, we will seek a Rule change to address any issues arising under the new arrangements.

One similarity between transmission and distribution - which is unique to Victoria - is that Victorian DNSPs apply a probabilistic planning approach which is similar to that applied by AEMO in its capacity as the planner of the declared shared transmission network in Victoria. Accordingly, under the probabilistic approach, the Victorian DNSPs would ordinarily include losses and expected unserved energy in evaluating options to address distribution network constraints. We expect to continue to do this under the RIT-D. We suggest that the guidelines should describe how the value of losses and the value of customer reliability (VCR) should be derived for a RIT-D, and that such guidance should be consistent with AEMO's probabilistic planning approach.

Question 3: *We are interested in how stakeholders believe this will change the analysis for RIT-D proponents.*

Section 4.1 of the AER's Issues Paper describes the removal of the base case as one of the significant differences between the RIT-D and the RIT-T. The Issues Paper states:

"The RIT-D removes the requirement under the RIT-T for each credible option to be compared against a base case where no option is implemented. RIT-D proponents would otherwise have been required to develop a 'do nothing' option for each credible option.

This amendment reflects the fact that distribution network service providers are obligated to meet statutory reliability requirements. A 'do nothing' option is not feasible where the identified need is reliability corrective action or to meet a deterministic standard. Consequently, removing the requirement to assess all credible options against a base case will remove a level of unnecessary analysis for reliability driven projects. For these projects, it is arguable that the relative ranking of the options is more important than the absolute values of the net economic benefits for each option."

The Victorian DNSPs do not contest these observations, given the explicit assumption that DNSPs are obligated to meet statutory reliability requirements, and therefore a 'do nothing' option is not feasible where the identified need is 'reliability corrective action' or to meet a deterministic standard.

However, the approach to jurisdictional distribution planning standards in Victoria differs from those applied in other jurisdictions. Specifically, the Victorian jurisdiction does not set deterministic reliability standards, and the Victorian DNSPs do not identify distribution augmentation work on the basis that it would be classified as 'reliability corrective action' unless

it is an unforeseen augmentation. We do recognise, however, that investment may be required (to support jurisdictional regulatory requirements, for instance) well ahead of the time defined by the cost/benefit analysis against the base case. This should be recognised in the guidelines as a valid reason for augmentation.

As noted in the answer to question 2, under a probabilistic planning approach there is a need for a 'do nothing' option to be included in the analyses. The inclusion of a 'do nothing' option or 'base case' in our market benefit assessments enables us to determine the economically optimum (that is, net market benefit maximising) timing of the preferred option. In some situations, the 'do nothing' option may be the preferred option when applying probabilistic planning.

We note that the RIT-D rules do not preclude a DNSP from including a base case in RIT-D evaluations, and we consider that the RIT-D guidelines should certainly not preclude this either.

Question 4: *We are seeking stakeholder views on how any of the factors which should deliver market benefits listed in clause 5.17.1(c)(4) should be clarified.*

In relation to the various factors listed in clause 5.17.1(c)(4), we note the following:

- **Voluntary load curtailment:** The guidelines should recognise that expression of interest or tender processes can be used to elicit offers from energy consumers to curtail consumption. The prices offered in such circumstances should be taken to represent the cost of this resource to the DNSP, and would reflect the value of the resource for the purpose of the RIT-D.
- **Involuntary load shedding:** As noted in our answer to question 3, the application of a probabilistic approach (necessarily) entails the valuation of expected unserved energy for all the options being considered, including the base case. Victorian DNSPs therefore use the VCR estimates published by AEMO (in its capacity as the planner of the declared shared transmission network in Victoria) to value expected unserved energy⁴. We envisage continuing to do this after the RIT-D comes into effect. We note, however, that VCR estimation is subject to considerable uncertainty⁵, so we support the application of sensitivity testing of this key variable.
- **Other parties' costs from differences in the timing of new plant, capital costs, as well as operating and maintenance costs:** We have no specific suggestions in relation to this item at this time, other than to note that it would be helpful for the guidelines to:
 - describe the likely identities of the "other parties";
 - list the types of costs that would typically fall into this category; and

⁴ It is noted that following the AEMC's June 2012 report to the MCE on the Effectiveness of NEM Security and Reliability Arrangements in light of Extreme Weather Events, AEMO has been tasked to conduct a national VCR survey. It is expected that an issues paper will be released by AEMO in the next month or two.

⁵ See TransGrid's submission of 12 July 2012 to the AEMC's Review of Distribution Reliability Outcomes and Standards - NSW Workstream for an analysis of the uncertainty of VCR estimates. The submission is available from: <http://www.aemc.gov.au/Media/docs/TransGrid---120713-0e717868-e84e-4662-816e-a187e8d3d47c-0.PDF>

- where possible, to provide standard or deemed rates in relation to particular items.
- **Timing of expenditure:** In relation to expenditure timing and the comparison of options, we note that appropriate allowances should be made to account for residual asset values (or unexpired asset service potential) at the conclusion of the analysis period. This is particularly important when options of unequal lives are being compared, or the analysis period is much shorter than the expected asset life. One possible solution is to compare the annualised total capital and operating costs of different options.
- **Load transfer capacity and the capacity of Embedded Generators to take up load:** The guidelines should clarify that load transfer capacity excludes load shifting (to a different period of time). In addition we note that 'load transfer capacity' is a local defined term, which refers to shifting loads from one asset to another in the event of a contingency to avoid load shedding. While this capability reduces the risk of unserved energy on the constrained asset, it does increase the risk of unserved energy on the surrounding assets to which the load is being transferred. Hence if load transfer capacity is included, the RIT-D analysis must include the risk of unserved energy on both the constrained asset and the surrounding assets.
- **Electrical energy losses:** Please refer to our answer to question 8 below.

Question 5: *We are also interested in whether we should look at any additional distribution level market benefits, other than those specified under clause 5.17.1(c)(4). In particular, we are interested in whether broader types of demand side participation are likely to result in distribution level market benefits. In addressing this, we recommend that stakeholders have regard to the AEMC's Power of Choice Review.*

The Issues Paper notes that broader types of market benefits may result from demand-side activities, and these are likely to relate to savings in wholesale markets from reductions in electricity demand. The Issues Paper foreshadows the possibility of the AER including an additional, broader class of market benefit to ensure that all the market benefits from improved demand management are accounted for.

It is not clear whether there are market benefits in the wholesale energy market as a result of demand side participation that should be included in a RIT-D analysis. The Victorian DNSPs would, in principle, accept their inclusion in the RIT-D providing that the likely magnitude of the benefits of doing so justified the additional analysis that would be required. If broader types of market benefits are to be included in the RIT-D, it would be necessary for appropriate guidance to be provided on how this should be done. The guidance should take into account the DNSPs' capability and available resources to evaluate such benefits.

In addition, it is good regulatory practice to ensure that the regulatory framework provides incentives for DNSPs to pursue demand side options where it is economically efficient to do so. We note that this matter is addressed in the AEMC's November 2012 Power of Choice Review Final Report, which recommends:

“reforming the application of the current demand management and embedded generation connection incentive scheme in the NER to provide an appropriate return for DSP projects which

deliver a net cost saving to consumers. This includes creating separate provisions for an innovation allowance⁶.

We recognise that these matters are beyond the scope of the RIT-D guidelines. We suggest, however, that the RIT-D guidelines should not pre-empt decisions currently being considered by policy makers regarding the design of incentives for DNSPs to pursue demand side solutions.

Question 6: *Specifically, noting the recently released Power of Choice report, does the RIT-D consideration of market benefits need to be amended to support demand side participation?*

We consider that questions regarding the level of support for demand side participation go to commercial incentives, rather than the definition of market benefits in the RIT-D. As noted in our answer to question 5, the Victorian DNSPs welcome the prospect of strengthened incentives for DNSP utilisation of demand side resources. This matter is addressed in the Power of Choice Final Report, which is now with the Standing Council on Energy and Resources, together with a proposed implementation plan to make the necessary changes to the NER and other aspects of the market, for their consideration.

Question 7: *The RIT-D process is designed to capture significant new projects and programs. It is feasible that the scale of these new projects and programs could be large enough to have a material impact on overall network reliability. In these cases, it is most likely that the reliability impact will be a positive one and this would then result in the DNSP receiving an incentive payment under the Service Target Performance Incentive Scheme (STPIS). It is also technically feasible that the STPIS outcomes could be negatively impacted by a RIT-D project or program. In both of these cases, it would be reasonable to assess the STPIS impact and potentially adjust the STPIS targets to account for the forecast reliability change. How should the consideration of market benefits under the RIT-D recognise the impact the proposed works would have on the STPIS?*

Under the chapter 6 Rules, expenditure forecasts must include the costs required to meet the capital expenditure and operating expenditure objectives⁷, which provide for:

- maintenance of the quality, reliability and security of supply of standard control services; and
- maintenance of the reliability, safety and security of the distribution system through the supply of standard control services.

Under the STPIS regime (which applies rewards and penalties that reflect the VCR⁸ for changes in reliability performance) any reliability improvement expenditure is essentially “self-funding”. The regime provides the DNSP with incentives to pursue opportunities that deliver efficient changes in the level of reliability⁹.

The performance benchmarks or targets within the STPIS are based on an average of actual recent performance. It is reasonable to expect that any sustained change in reliability

⁶ Recommendation 18 of the AEMC’s November 2012 Power of Choice Review Final Report.

⁷ Clauses 6.5.6(a) and 6.5.7(a), respectively.

⁸ Albeit on a customer number basis.

⁹ Where the VCR is taken to be a reasonable proxy for the marginal value of reliability to consumers.

performance would arise as a result of the DNSP's response to incentives to deliver an efficient level of reliability. Under the STPIS, any such changes in reliability performance will be reflected in future targets. In this way, the STPIS automatically adjusts performance targets through time, to reflect the actual performance of DNSPs who face strong incentives to deliver an efficient level of reliability. Under this model, there is no need to interfere with the STPIS benchmarks.

In addition, the RIT-D would recognise reliability benefits in a manner that is wholly consistent with the design of the STPIS, as both the RIT-D and the STPIS value reliability at the VCR. However, if the STPIS were not designed in this manner, this would not be a satisfactory reason to amend the RIT-D, as the RIT-D is intended to identify the economically optimal project option.

Question 8: *A portion of electricity is naturally lost in its transmission and distribution. RIT-D proponents pass through these costs on the network, although proponents are obligated to comply with certain efficiency standards. How should the economic cost of electricity loss be treated within the market benefits assessment?*

The Victorian DNSPs agree that losses should be included in the RIT-D analysis. Where a non-network option results in loss reduction (and hence a corresponding increase in usable capacity), the value of the increase in usable capacity should be included as a benefit.

We note that in most cases, inclusion of losses in a RIT-D is unlikely to affect the decision signal. This suggests that the guidelines should not make the valuation of losses an unduly complex or onerous task. It would be helpful if the guidelines were to provide clear guidance on how losses should be evaluated, and particularly on the quantification of the value of losses.

Question 9: *We are seeking stakeholder views on who should be considered an interested party under this definition.*

We note that clause 5.17.5(a) identifies the parties that can raise a dispute with the AER, and these include interested parties. Importantly, disputes can only be raised in relation to whether:

- the RIT-D proponent has applied the RIT-D in accordance with the Rules; or
- there was a manifest error in the calculations performed by the RIT-D proponent in applying the RIT-D.

A dispute may not be raised on matters that:

- are treated as externalities by the RIT-D; or
- relate to an individual's personal detriment or property rights.

Clause 5.15.1 provides that:

“Interested party means a person including an end user or its representative who, in the AER's opinion, has the potential to suffer a material and adverse National Electricity Market impact from the investment identified as the preferred option in the project assessment conclusions report or the final project assessment report (as the case may be).”

We observe that the onus is on the party raising a dispute to demonstrate that they satisfy the provisions set out in clause 5.15.1.

We suggest that rather than seeking to provide guidance on who can raise disputes, the guidance should address questions such as:

- How the AER would determine whether a party raising a dispute has, in fact, the potential to suffer a material and adverse National Electricity Market impact?
- What is the threshold for determining material and adverse NEM impacts?
- What constitutes a 'manifest error'?

The purpose of providing any such guidance should be to reduce unnecessary disputes that may delay the implementation of the preferred option.

Question 10: *We are interested in what guidance stakeholders would find useful in interpreting the definition of interested parties.*

Please see the response to question 9 above.

Question 11: *We are of the view that the change in terminology from material and adverse 'market impacts' to 'NEM impacts' improves clarity. We are seeking stakeholders' views on this.*

We welcome the change in terminology. We concur with the AER that this would help ensure that the focus of the RIT-D is kept in the context of the NEM specifically, as opposed to other impacts such as those relating to environmental or planning issues. It would be helpful if the guidelines were to set out this reasoning, to assist interested parties to understand the scope of the RIT-D, and the grounds on which disputes may be raised.

Question 12: *We are interested in stakeholder views regarding what other financial costs are likely to be relevant.*

In relation to the costs listed in clause 5.17.1(c)(6), we suggest that payments to providers of demand side (network support) services should be included. We note that it is currently our practice to adopt an offered price for network support as representing the economic cost of that resource for the purpose of investment evaluation, and we envisage continuing to do this under the RIT-D.

Question 13: *The RIT-T specifies that transmission network service providers could determine additional classes of costs if we agreed that they were relevant. We are seeking stakeholders' views on whether it should make a similar specification for RIT-D proponents under the RIT-D.*

The Victorian DNSPs would support the inclusion of such arrangements in the RIT-D.

Question 14: *The RIT-T specifies that if the costs were materially uncertain, the cost should reflect the probability weighted present value of the direct costs of the credible option under a range of different cost assumptions. We are seeking stakeholders' views on whether we should make a similar specification under the RIT-D.*

The Victorian DNSPs consider that the guidelines should not mandate requirements to express uncertain costs in probability-weighted terms. Typically, it is not possible to ascribe probabilities to items such as cost estimates in a RIT-D assessment. Where this is the case, then arbitrarily assigning probabilities creates a false sense of precision and opens up the risk that the analysis may produce spurious results.

We consider it would be better practice for the guidelines to require scenario analysis, and sensitivity testing of individual variables to examine the robustness of the decision signal to a range of plausible changes in key variables. We also consider that the guidelines should not prescribe ranges for the purpose of sensitivity testing. We consider that the determination of the limits within which a key variable will be tested is a matter for the DNSP, as the DNSP will have the best information available in the particular circumstances to make that judgement. It would be good practice for the DNSP to explain the reason(s) for the choice of sensitivity testing limits employed and / or scenarios studied.

Risks such as the need to include underground cable instead of overhead conductor need to be included and evaluated properly such that a new test is not required if these more expensive options prove necessary.

Question 15: *We seek stakeholder views on whether the RIT-D should specify the same methodology for determining the discount rate as the RIT-T and current regulatory test.*

We consider that the methodology for determining the discount rate currently set out in the RIT-T would be appropriate for the RIT-D.

We note that the regulatory WACC remains a contentious issue. Moreover, recent volatility in capital markets has led to significant changes in the risk free rate (and hence the regulatory WACC) since the onset of the GFC. Given these considerations, it would seem counter-productive to seek to “hard wire” a discount rate or a methodology for determining the discount rate in the RIT-D guidelines at this time. Again, we consider it would be better practice for the guidelines to require scenario analysis, and sensitivity testing of individual variables to examine the robustness of the decision.

Question 16: *We seek stakeholder views on the methodology that the RIT-D should specify for estimating costs. We are interested in whether stakeholders think the methodology should be adopted from those specified under the RIT-T and regulatory test.*

The cost estimation methodology for the RIT-D should recognise that the scale and nature of distribution investments will not require the same level of analysis and detail as that for a major transmission investment. Each DNSP should have the flexibility to produce its own cost estimates consistent with its business case approvals and governance process without extensive guidance from the AER.

Page 16 of the Issues Paper states:

“The RIT-T requires different classes of costs to be quantified. For instance, costs incurred in providing, operating and maintaining the credible option. Where there is a material degree of uncertainty in the costs, the RIT-T requires the cost to be the probability weighted present value of the direct costs of the credible option under a range of different cost assumptions.”

As noted in our response to question 14, we consider it would be inappropriate to adopt these RIT-T provisions for inclusion in the RIT-D.

Question 17: *We seek stakeholder views on what guidance and examples for distribution would be useful to include in the RIT-D guidelines.*

We suggest worked examples relating to the following project types should be included:

- New distribution feeder;
- New sub-transmission feeder/line, including a replacement and augmentation component for both radial and meshed sub-transmission lines;
- Additional transformer at a Zone Substation;
- New Zone Substation (augmentation);
- New Dual Function Asset;
- Incidental augmentation associated with an asset replacement project (eg. standardisation of ratings or voltage levels by not replacing old equipment at end of life with like-for-like, but replacing to the current standard. This work often results in an augmentation);
- Augmentation of a Zone Substation due to a customer initiated project (i.e. customer connection); and
- Augmentation of a line due to a customer initiated project.

We also suggest that consideration should be given to including examples that cover every service described in the Standard Control Services category.

We would be pleased to assist the AER in developing these examples.

Question 18: *The RIT-T guidelines provide guidance and worked examples on these topics. Having regard to the RIT-T guidelines, we are interested in whether the RIT-T guidelines provide useful information which should be adopted in the RIT-D guidelines.*

The RIT-T guidelines provide many useful worked examples that are applicable to the analysis of potential credible options on the transmission network and cover the complexities involving the evaluation of broader electricity market benefits such as competition benefits, generator fuel costs, and benefits to other regions. However, many of the worked examples do not apply to the evaluation of projects on the distribution network.

As noted in our answer to question 1 the RIT-D encompasses fewer classes of market benefits and does not consider the broader RIT-T specified market benefits and the analysis of “states of the world” that include the wholesale market. We would find it more beneficial for the guidance to provide the range of worked examples suggested in our answer to question 17.

Question 19: *Additionally, we are interested in whether stakeholders consider the guidelines should provide guidance and worked examples on any additional areas that have not been specified under clauses 5.17.2(c) or 5.17.2(b)(2) of the NER.*

As a minimum, we consider that guidance and worked examples for the RIT-D process and the valuation of market benefits and option costs under clauses 5.17.2(b)(2) and 5.17.2(c) should be included.

Question 20: *We seek views on what guidance we should give on when a regulatory test assessment will be considered to have commenced for the purposes of 11.50.5(c).*

The Issues Paper explains that under the transition arrangements in clause 11.50.5 of the Rules the AER must provide guidance on when a regulatory test assessment will be considered to have commenced. The Issues Paper notes that:

- some electricity distribution projects are likely to be initiated around the commencement of the RIT-D; and therefore
- the AER will be required to set a cut-off so that there is no confusion in terms of whether the old regulatory test or the RIT-D should be applied.

Clause 11.50.5(c) requires each DNSP that has commenced assessing a project under the regulatory test to submit a list of such projects to the AER by 31 December 2013. We concur with the AER that this list will assist it in determining which projects in progress will be exempt from having the RIT-D applied. We suggest that if option analysis under the Regulatory Test has commenced in relation to a project as at 31 December 2013, then that project should be regarded as being subject to the Regulatory Test, and therefore the RIT-D would not apply to that project.

Question 21: *We seek stakeholders' views on whether there are any particular areas where further guidance on the RIT-T assessment process would be useful.*

At this stage, we do not consider there are any particular areas in which further guidance would be useful, with the exception of the inclusion in the guidelines of a succinct summary of the timelines and process for the RIT-D, possibly in the form of a flow chart.

Question 22: *We seek stakeholder views on what methodologies the RIT-D application guidelines should adopt for valuing market benefits.*

In light of the characteristics of distribution capital programs (specifically, a relatively higher number of low-value projects), and having regard to the principle of proportionality, there is a need for simplified methods of quantification to be applied wherever possible. Standard values - such as updated unit rates used in the DNSPs' latest regulatory proposal, for instance - could be applied. Where standard or deemed values are inappropriate or impracticable, simplified methods should be developed in accordance with the principle of proportionality noted in our response to question 1. The guidelines should, however, not constrain DNSPs from applying more complex methods where the benefits of doing so are likely to exceed the costs.

Question 23: *We seek stakeholder views on what dispute resolution guidance would be of assistance. The RIT-T guidelines provide guidance on dispute resolution. Having regard to the RIT-T guidelines, we are interested in whether this content should be adopted into the RIT-D guidelines.*

The Victorian DNSPs consider that the guidance relating to dispute resolution provided in the RIT-T guidelines could be adapted for inclusion in the RIT-D guidelines.