

AER regulatory investment test public forum: Discussion summary

Matter name:	Review of the application guidelines for the regulatory investment tests
Date:	Wednesday 14 March 2018
Time:	09:00 am to 1:30 pm (AEDT)
Location:	Holiday Inn Sydney Airport
Chair:	Jim Cox, Board Member, AER

Note: This document provides an overview of the main points discussed during the AER public forum on improving guidance for better application of the regulatory investment tests (RITs). The content reflects information provided on butcher's paper notes, group presentations and the AER's observations from the group discussions. Its use is purely informative.

The Australian Energy Regulator (AER) held a public forum during the submission period on its issues paper for the RIT application guideline review. The AER gave a short presentation, which is available on the project page. This was followed by break-out group discussions, which have been summarised in this note and were based around four discussion topics.

Topic 1: What guidance should the RIT application guidelines provide on applying RITs to replacement expenditure (repex) projects?

There was some discussion around what the 'do nothing' option entails for repex projects, but there was general acceptance that this did not entail 'running to failure'. Rather, the 'do nothing' option would look more like business as usual, and this should be clarified in the RIT application guidelines. While it was recognised that the base case is just a comparison tool, stakeholders still considered that this should reflect a credible option, and what constitutes business as usual should be clarified in the RIT application guidelines. There was some questioning as to whether there might be a need to amend the RITs themselves to properly reflect what business as usual in the base case entails.

It was noted that the AER and the ENA, through their 'Asset Management Committee' are working together to provide guidance on the 'risk-cost framework'. This will include some guidance on the definition and direct costs associated with the base case. Guidance on the methodology should be provided by the AER around mid-2018. This will also include worked examples for a range of asset types. There was discussion over the requirements when dealing with secondary systems, including SCADA and protection and control systems.

The group noted that the RIT application guidelines will include the changes arising from expanding RITs to include repex projects. Network businesses were encouraged to provide the AER with examples for both projects and programs.

There was a preference towards the AER providing guidance on different types of repex programs, such as replacing poles and IT projects. There was discussion around guidance on how to estimate safety costs, including the ENA's work in this area.

There was full agreement among the discussion group that the combination of repex and augmentation expenditure (augex) cost would be the appropriate project cost for applying the RIT cost threshold.

There was some discussion after the break-out session on how the RIT needs to have a clear purpose in satisfying an identified need. One network business noted that it is currently working on the definition of 'identified need' internally, by trying to better express it in terms that affect customers rather than in technical engineering terms.

Topic 2: What guidance should the RIT–T application guidelines provide on how to work effectively with the Integrated System Plan (ISP)?

The group held the view that the ISP does not replace the RIT–T, but it will play a role in streamlining RIT–T applications and addressing uncertainty, which could limit reopeners that have the potential to drag the RIT–T process out. The ISP could also help deal with policy uncertainty by formalising a base set of assumptions. For instance, by providing a basis for particular inputs and assumptions, it can help foster a consistent view of uncertainty. This, in turn, could prevent the occurrence of elongated RIT–T processes. It was noted, however, that for this to be successful, there needs to be confidence in AEMO's ISP process, including its rigour and consultation.

The RIT–T application guidelines could help in the following ways:

- Formalising the link between assumptions in the ISP and the RIT–T.
- Linking the ISP and RIT–T with regards to the base case. For instance, a coordinated optimised approach that the ISP offers can lead to a common set of investments across scenarios, that might then diverge when particular investment decisions are made.
- Including a worked example of a RIT–T assessment when AEMO has identified a priority renewable energy zone (REZ).

Topic 3: What guidance should the application guidelines provide on how to deal with uncertainty, including through calculating option value, forecasting, performing scenario analysis, and accounting for high impact low probability events?

It was noted that uncertainty is currently accounted for by probability-weighting scenarios so that the cost–benefit analysis is based on a probabilistic assessment of outcomes. The use of the contingent projects regime also helps deal with uncertainty. The group:

- Wondered if we could agree on a standard set of replacement/failure rates, noting that these may be unique to legacy equipment.
- Noted that there tends to be different durations for non-network and network options, which makes it difficult to compare them on a like-for-like basis in a RIT.
- Recognised that one way to account for uncertainty is through discount rates, although there are other ways, including through project cash flows within a probabilistic scenario analysis.
- Suggested it would be useful for the RIT application guidelines to include examples on how to calculate option value for both network and non-network options. This example should incorporate a decision tree analysis. It would also be useful for the

worked example to reflect project staging in a way that can help manage uncertainty, including through project cash flows within a probabilistic scenario analysis

After the break-out session:

- There was some discussion on how the RIT application guidelines could assist stakeholders in understanding the application of this topic with regards to replacement projects at the edge of the grid. It is possible that many 'fringe of grid' projects would not pass a cost–benefit analysis. As such, there might be some thought as to how these customers might be taken off the grid whilst maintaining their service standards.
- It was raised that weighting scenarios by probabilities is in the RIT application guidelines and the RITs, but it is not in the National Electricity Rules themselves. On this basis, the question was raised as to whether we could amend this if we wanted to give greater weight to high impact, low probability events than their expected value, reflecting a degree of risk aversion on behalf of consumers.
- A question was raised about risks that do not necessarily result in costs to the National Electricity Market. For instance, there are costs associated with having to block off traffic to repair the network, but it is not clear how the RITs would account for these costs.

Topic 4: What guidance should the application guidelines provide on how to engage with consumers and non-network options when applying RITs?

The RITs have to be seen as part of a suite of options as there are many moving parts that work together to drive outcomes for consumers.

At the grassroots level, discussions should focus on how the project impacts the customers, especially with respect to price. Discussions should also be catered to the stakeholder/customer at hand. We are seeing an emergence of different participants, and a need to target those who are likely to respond. There is also increasing value in partnering with the customers and other stakeholders (such as non-network providers, retailers, property developers), as this allows for non-network options and consultation to be done more effectively. This is particularly the case since network businesses are a 'step back' from the customers, and are not always in the best position to do this effectively.

There is a need to build the concept of risk into the conversation on costs and benefits by articulating trade-offs and guiding stakeholders on where risk fits into things. The counterfactual is not always clear to stakeholders, and this can be particularly tricky in the case of repx. For instance, how will the community understand the risk of delaying a repx project for as long as possible?

A major challenge is that the RITs apply a cost–benefit analysis framework and it is not always clear if or how stakeholder feedback can fit into this framework. For instance, sometimes customers value things that do not necessarily have a market value in the scope of the RITs, which sometimes requires expectations management. In this context, some guidance on when customers can influence decisions might be useful.

There can also be a tension when the stakeholders that benefit are decoupled from those that pay, since the costs of network investments are smeared across customers. Due to this, the stakeholder groups with the incentive to engage may not always have the incentive to seek a least-cost solution. The point was also raised that, in certain circumstances, there may be benefits of customers only paying up to the point that a project is efficient under the RIT, with co-payments coming from state governments to the extent they have identified social benefits that fall outside the RIT framework.

It is better to cross-reference the stakeholder engagement guidelines rather than to incorporate more new guidance into the RIT application guidelines. The group generally felt that the AER's stakeholder engagement guidelines are good, and take a realistic approach. It is often more helpful to provide high-level principles rather than detailed guidelines.

When engaging, it might be more valuable to invest more at the Annual Planning Report (APR) stage where stakeholders can get a sense of program implementation. This allows stakeholders to see the 'big picture' and moves things away from a locational conversation to a broader conversation. It is good to have information sharing through various avenues. The benefits of having the distribution APR template was cited as having a lot of value, along with network mapping tools. For a lot of stakeholders, this is a good way to see what is in it for them.

After the break-out session, it was raised that there will be instances at the 'fringe of grid' where the network business will be genuinely trying to avoid the network solution. They will be publishing reports under the RITs with the aim to elicit responses more so than they have in the past.