



6 April 2018

Mr Peter Adams
General Manager, Wholesale Markets
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Electronic submission: RIT@aer.gov.au

Dear Peter

Re: REVIEW OF THE APPLICATION GUIDELINES FOR THE REGULATORY INVESTMENT TESTS FOR TRANSMISSION AND DISTRIBUTION ISSUES PAPER

CitiPower, Powercor and United Energy welcome the opportunity to respond to the Australian Energy Regulator's (AER) issues paper on the review of the application guidelines for the regulatory investment tests for transmission (RIT-T) and distribution (RIT-D).

We support the application of RITs in the identification of least-cost solutions, including non-network alternatives. We have undertaken 19 RITs and regulatory tests for our three networks to date, affording us considerable experience in the development of RITs, cost-benefit analysis, the identification of credible options as well as engagement with consumers and non-network services providers.

In general, the guidelines on the application of RITs should be limited to allow proponents flexibility in defining and describing projects and carrying out the cost-benefit analysis. While there are similarities between the needs on each network, networks businesses experience localised and jurisdictional complexities which limit the extent to which the guidelines can prescribe solutions. As such, networks are best placed to interpret the National Electricity Rules (Rules) when conducting RITs.

In summary, we support the guidelines being updated to clarify:

- the base case in replacement expenditure RITs as a credible 'business as usual' option
- financial contributions from all third parties, regardless of whether they are internal or external to the National Electricity Market (NEM), should be treated equally.

However, we do not consider guidance should assist stakeholders in the following aspects of RIT development:

- consumer and stakeholder engagement
- description of the identified need
- calculation of option value and scenario modelling
- application of RITs to replacement expenditure.

We provide reasoning for these conclusions and further considerations for the review below.

1 RIT process issues

1.1 Consumer and stakeholder engagement

Engagement with consumers and stakeholders in the electricity distribution sector has grown significantly over the last few years as innovative approaches develop. Examples of innovative engagement include the 'draft

regulatory proposal' and the 'New Reg Model'. Our consumer and stakeholders engagement with regard to large projects includes formal and informal engagement activities, ranging from community and public forums on RITs and the Distribution Annual Planning Report (**DAPR**), to meetings and workshops with local councils and major customers on works in their area.

We also engage with non-network solution providers through our demand side engagement register and through informal meetings and data requests. From our experience, non-network service providers prefer to have a direct one-on-one conversation with the network regarding their proposed solutions, and as a result we often provide them directly with the data necessary for their modelling. We have established formalised working relationships with non-network solution providers through Memorandums of Understanding (**MoU**) to explore and facilitate the development of non-network solutions.

Additionally, in Victoria we prepare RIT-Ts in conjunctions with the Australian Energy Market Operator (**AEMO**) and AusNet Services Transmission Group, which involves considerable engagement and collaboration between the RIT proponents and other stakeholders.

Given we are already engaging extensively, and will continue to do so, it is not necessary for the AER to provide prescriptive guidance on consumer engagement. The AER provides guidance on consumer engagement in its 'Consumer engagement guideline for network service providers' which can be referenced in the RIT guideline. Ultimately, the consumers and non-network service providers are best placed to tell us how to improve engagement with them in the future.

2 RIT application issues

In general, guidance on the RIT application should be limited. We should have flexibility to identify the need on our networks and define and describe credible solutions. Prescriptive guidelines can limit innovation and create boundaries on possible solutions. We are all exposed to localised and jurisdictional complexities that limit the extent to which any guidelines can prescribe solutions relevant to all proponents.

We expand on the different issues raised about the RIT application below.

2.1 The identified need

We do not require additional guidance on the description of the identified need. The Rules provide a balance of direction and flexibility for us to identify and describe the needs of our network. The descriptions of the identified needs in RIT-Ds we have conducted to date inherently take into account the local and jurisdictional specifications of our network. As each RIT will include differing circumstances, the RIT guideline should not seek to reduce our flexibility to tailor for these circumstances.

2.2 Option value analysis and scenario modelling

We do not require any guidance on option value analysis and scenario modelling.

In its final decision on the demand management incentive scheme (**DMIS**), the AER supported stakeholders using any reasonable approach to approximate option value where the cost of doing a costlier analysis is unviable.¹ As part of the DMIS consultation the AER also published an Oakley Greenwood study which included a workable example of option value analysis. We believe the RIT guideline should reflect the approach taken in the final DMIS decision.

¹ AER, *Explanatory statement: Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

With regard to scenario modelling, there can be significant variation in each project's cost-benefit analysis which limits the merit of any guidance on such analysis. We undertake cost-benefit analysis and scenario modelling as a matter of course in managing our network and are best placed to extend that analysis to the RITs.

2.3 Replacement expenditure RITs

A key principle supporting the application of the RIT process is to facilitate the consideration of non-network solutions as an alternative to network investment. This recognises that non-network solutions can efficiently defer network expenditure, and lead to lower cost outcomes for customers.

Non-network alternatives, however, are unlikely to provide credible or practical solutions for geographically dispersed, high-volume, low-cost replacement works (e.g. pole replacements). For these works, a risk assessment is conducted immediately after the inspection, and if deemed necessary, the asset is typically replaced within 90 days. Each network has asset types that fall within this category.

Further, the nature of these works is not supported by the RIT-D process. For example, these works are not bound by time constraints (i.e. they are driven by rolling inspection cycles), so identifying the applicable time period for a RIT-D would be an arbitrary process.

The Rules already provide appropriate flexibility to not undertake a RIT-D in the above circumstances. Namely, the Rules only refer to RIT-D 'projects', as distinct from ongoing works. We understand the AER supports this view and we do not consider further guidance is required.

It should also be recognised that irrespective of our RIT-D obligations, we remain incentivised to identify and implement efficient non-network alternatives under the regulatory framework.

2.4 Treatment of external funds

Financial contributions from all third parties, regardless of whether they are internal or external to the NEM, should be treated as an offset to the capital cost of the option (i.e. in effect, treated as though the funding is external to the NEM).

Ultimately, what matters is the actual cost customers are required to fund. The existing distinction for contributions from within the NEM simply adds unnecessary complexity to the RIT without reducing the actual cost to consumers.

2.5 Base case

We support the AER clarifying that the base case for replacement RITs should be a credible 'business as usual' option. This ensures that any alternative options are compared to a credible, rather than hypothetical, solution.

In the context of asset replacement decisions, a credible business as usual option may include keeping the existing asset(s) in service. This may require additional monitoring and maintenance, or additional work to manage any increased safety or other relevant risks from extending the life of the asset(s). This recognises that probability and consequences of failure may increase rapidly over time.

The trigger point for the timing of the base case scenario would be when the monetised service costs, including unserved energy and other risks, exceeds the replacement project costs. Once the optimal timing and replacement cost of the base case is developed, the net present value (**NPV**) of other options can be assessed.

There may also be circumstances where the credible business as usual option is to replace the asset prior to failure (e.g. where replacement on failure is not a practical option). It remains important, therefore, that any clarification provided by the AER retains the existing flexibility for distributors to define the base case.

2.6 Consistency in treatment of risk

We do not require guidance on the treatment of risk in the RIT application. However, our experience shows there can be significant variations in non-network proponent's understanding of the cost of mitigating the risk associated with addressing the identified need and that of RIT proponents. We encourage non-network service providers to engage with networks early to understand the risk profile of addressing the identified need and consider those risks in their proposed solution.

3 Long term view

The length of the RIT process is one of our largest concerns. Some RITs can take up to two years, during which time the relevance of the identified need and the non-network options can change, including potential changes to the political and regulatory environment under which the RIT is conducted.

Given the lengthy process, the long-term relevance of the RIT is being challenged by the speed of technological change. Platforms for instantaneous engagement and dispatch of demand response and other non-network solutions are being developed. When implemented, these platforms will make various non-network options readily available to networks to manage small and large constraints, most likely at a lower cost when compared to contractual requirements of the RIT. The platforms are also likely to more swiftly develop a market for non-network solutions compared to the RIT process.

While the timing and the purpose of RITs are outside the scope of this review, we encourage the AER to broadly consider the long term relevance and limitations of RITs, particularly with regard to technological improvements over time.

Should you have any queries about our submission please do not hesitate to contact Sonja Lekovic on (03) 9683 4784 or slekovic@powercor.com.au.

Yours sincerely,



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