

23 July 2013

Mr Chris Pattas  
General Manager - Network Operations and Development  
Australian Energy Regulator  
GPO Box 520  
Melbourne VIC 3001

Dear Chris

AER's Draft Regulatory Investment Test for Distribution (TIR-D)

The following submission by SA Power Networks is in response to the AER's Draft Regulatory Investment Test for Distribution and Application Guidelines published on 5<sup>th</sup> June 2013. We welcome the opportunity to respond on this draft of the document and hope that our response will be of assistance, particularly as SA Power Networks has had many years experience in applying similar tests to significant network projects.

The response is set out in two sections:

- Issues within the RIT-D document; and
- Issues within the RIT-D application guidelines.

Should the AER require any clarification of the views raised in this document, please contact Mr Grant Cox, Manager Regulatory Affairs at [grant.cox@sapowernetworks.com.au](mailto:grant.cox@sapowernetworks.com.au).

Yours sincerely

  
Sean Kelly  
General Manager Corporate Strategy

## Draft Regulatory Investment Test for Distribution

### Section 1.1

Paragraph 2. The term 'costs' has been redefined as 'direct costs' which has a different accounting meaning to 'costs'. For instance 'direct costs' exclude indirect costs of an option such as business overheads which are allowed under the regulations to be capitalised within our Regulatory Asset Base (RAB). Our preference is for the original term of 'Costs' to be retained.

Likewise in part (a) of the same paragraph the term 'costs' has been replaced with 'financial costs'. Again we believe that reduces the clarity of the original formulation which simply uses 'costs' as it raises the question of what constitutes 'Financial' costs.

Paragraph 3. If weighted average costs are used, (ie have an equal chance of being over or under) then applying the sensitivity analysis as suggested will by definition yield only the original value. Therefore, the intention of the clause to show the sensitivity of each option to changes in costs is defeated by the proposed method.

Paragraph 5. This seems to imply that for a need identified as a Reliability Corrective Action market benefits do not need to be quantified. This is not our interpretation of NER, which we believe makes it clear that market benefits always need to be identified where they are material to the outcome of the test. The difference between being 'material' (clause a) and 'alter the selection of the preferred option' (clause b) is never explained.

Paragraph 6. There would appear to be a contradiction between this clause and the guidelines document which does not require market benefits to always be compared to a 'Base Case'. If this paragraph refers to an identified need that is not a Reliability Corrective Action (paragraph 5) then this clause should make this clear.

Paragraph 8. This seems to suggest that the minimum standard applies to the market benefit rather than to the identified need. As there are no standards for the identified market benefits (for instance for electrical losses, or voluntary load curtailment) this clause does not appear to make sense.

Paragraph 10. "may" also implies 'may not'. It is more likely that the word 'should' should be used instead.

### Section 1.4

Paragraph 19. The sensitivity analysis excludes changes in costs. See note on paragraph 3 and in the major points.

Paragraph 21. The reference to 'avoidable costs' seems strange. If costs are avoidable, surely they should not appear in the state of the world scenario which results in them being avoided. Is this a typographical error with the intended term being 'unavoidable costs' or is this statement suggesting that those costs which have been avoided by a



particular solution should be included as a benefit to this option? If so, this isn't accomplished

## Review of RIT-D Application Guidelines

- Section 1.2      Ambiguity remains where the cost of addressing an identified need is due to a customer connection request where the cost of the augmentation component is partially funded by customer contributions and the remainder by the DNSP. In these cases, does the \$5 million threshold apply to the total cost of the augmentation or only the part funded by the DNSP? SA Power Networks believes that only the component funded by the DNSP should be subject to the threshold.
- Section 2.3      With respect to the example given, it would be useful to show the probability weighting across each reasonable scenarios for each option.
- Section 3.2      It would be helpful if an example detailing the calculation of the '*annual deferred augmentation charge*' were provided within the guideline document.
- Section 4          Within this section of the guidelines on page 22, the AER has proposed the definition of an interested party as
- *a network operator or other stakeholders such as aggregators or energy service companies in the NEM that:*
  - *Constrains the network operator's ability to fulfil functions mandated under the NER;*  
*or*
  - *Undermines the stakeholder's ability to perform its operations to the extent that it can no longer operate or perform a particular function. This may result from physical obstruction or a substantial reduction in profitability; or*
  - *an electricity consumer, in their role as a consumer of electricity that reduces the quality or reliability of their electricity supply below what is required under the NER or reduces the sum of consumer and producer surplus.*

SA Power Networks have the following concerns with this definition:

- The term '*substantial reduction in profitability*' is somewhat arbitrary and not readily quantifiable by DNSPs as we have no visibility of the profitability of any market participant.

Consult with interested parties etc.

SA Power Networks understands that "consult" in terms of the NER Rule 5.17.4 requirement means that we must make publicly available on our web-site all notices



and reports specified in the Rule. In addition we need to maintain a register of interested parties and a demand side engagement register. Those registers will comprise persons who have registered via our Website or have contacted us and provided all the required information to populate the registers.

To facilitate consultation with stakeholders, interested parties and customers SA Power Networks maintains a web-page which advising those persons/bodies how they can register. The web page provides details of who should register and why. In addition, it details what future communications will be provided to persons registered.

Section 5 The footnote referring to 5.15.3(a) of the NER refers to the determination of cost threshold reviews under the RIT-T. Clause 5.15.3(c) of the NER relates to the RIT-D. In addition, Section 5 of the guidelines relates to the application of discount rates. The NER clauses being referred to relate to review of the cost threshold, not discount rates.

Section 7.3 The wording of the third paragraph relating to the reasons for not publishing a non-network options report should be re-drafted.

Section 10 A definition of '*Material*' would be welcome.

It would be useful for the AER to state whether or not there needs to be a proponent for a reduction in third party costs to be considered. For instance, if an augmentation increases network capacity at a particular substation, it will also reduce the future augmentation charges levied on new applicants. This effectively reduces the cost of connection to those applicants and therefore represents a change in costs for that, as yet unidentified, party. Should this change be included in the analysis and if so, how?

Section 12.1 We request the AER to clarify that the requirement to seek permission to include additional classes of costs in an evaluation does not have to be sought for each evaluation (ie once permission to include a class of costs or benefits has been granted, the future inclusion of these costs is deemed to be approved). In addition, if such permission is granted to any DNSP, does this imply that it is granted to all DNSP's?

Section 15.2 The AER's treatment of cost sensitivity (section 15.2) as separate to the sensitivity of other factors may be relevant to application of the Regulatory Investment Test – Transmission (RIT-T), however when applied to the Regulatory Investment Test – Distribution (RIT-D), it creates a number of significant issues due to differences in the trade off of cost versus risk between the RIT-T and RIT-D. While the RIT-T deals with a relatively small number of very high value projects, the RIT-D deals with a large number of relatively low value projects.

When identifying credible options, a DNSP will typically assess a large number of potential solutions using a high level design and then select a small number of potentially credible solutions requiring further investigation. For each credible



option chosen, a concept design will be produced and costed using standard costs based on historical costs for similar projects. At this stage of a project, it is often not possible or practical to estimate any specific sensitivity related to these costs (eg exchange rates, labour prices, base metal prices, land costs etc.) or for that matter any variations specific to the option (eg the presence of rock or extensive soil contamination). Estimating these sort of risk factors requires detailed studies that cannot be reasonably expected to be performed for all options under consideration due to the disproportionate cost and time impact of doing so (when compared to the value of the project). For example, spending \$500k to explore a variety of options and the associated risk with each on a \$100 million project is reasonable, doing so on \$5 million project is not.

Furthermore, the use by DNSPs of weighted average values for standard costs (ie the same risk of over estimation as under estimation) implies that any generic variation resulting in any single value will return the same number that was started with - the average weighted cost. This defeats the purpose of the analysis proposed which is to assess the sensitivity of the outcome to variations in costs.

In addition, the requirement to assess the specific factor sensitivity of third party solutions as given in the example ignores the following:

- the DNSP will have no information on how third party proposals would respond to such changes changes (eg variations in exchange rates); and
- any preferred solution utilising a third party solution is likely to be secured by the DNSP for a fixed price and therefore the risk of variations would not be carried by participants in the NEM but by the third party through changes in their profit margin.

SA Power Networks believes that a better approach to reflect cost sensitivity is to approach this in a similar manner to all of the other factors and simply apply a uniform percentage variation to all costs considered under each option. If this variation shows a sensitivity of the preferred solution (ie that with the highest market benefit) to cost, then the DNSP should be required to undertake more detailed studies to reduce the risk (in terms of uncertainty) to the point where costs can be estimated with sufficient accuracy for their variation to be no longer of material impact.

Section A.5 Where a constraint on an embedded generator is removed, how is the potential increase in generation from that generator to be valued or is it to be ignored?

Section A.7 The AER needs to state how the price per MWh is to be derived – for instance short term market price, long term average cost of generation etc.

