



Australian Energy Market Commission

## DRAFT RULE DETERMINATION

# National Electricity Amendment (Regulatory Investment Test for Transmission) Rule 2009

### Rule Proponent

Ministerial Council on Energy

2 April 2009

**JOHN TAMBLYN**

**Chairman**

For and on behalf of the Australian Energy Market Commission

**RULE  
CHANGE**

## **Inquiries**

The Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

**E:** [aemc@aemc.gov.au](mailto:aemc@aemc.gov.au)

**T:** (02) 8296 7800

**F:** (02) 8296 7899

## **Citation**

AEMC 2009, *Regulatory Investment Test for Transmission*, Draft Rule Determination, 2 April, 2009, Sydney

## **About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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## Abbreviations

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
Commission	see AEMC
CPI	Consumer Price Index
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
Rules	National Electricity Rules
SCO	Standing Committee of Officials
TNSP	Transmission Network Service Provider
TUoS	Transmission Use of Service

## Summary

The Australian Energy Market Commission (Commission) has received a Rule Change request from the Ministerial Council on Energy (MCE) seeking to implement a new regulatory investment test for transmission (Rule Change Proposal).

The Rule Change Proposal arises out of the Commission's National Transmission Planning Arrangements Review (NTP Review). One of the outcomes of that Review was a set of proposed Rules to implement a new regulatory investment test for transmission (RIT-T) which would displace the current Regulatory Test. In the Rule Change Proposal the MCE requests that the Commission make the proposed RIT-T Rules that were included in the Commission's final report of the NTP Review (NTP Final Report)

The Commission decided to fast track the Rule Change procedure in accordance with section 96A of the NEL, as the proposed Rule contained in the Rule change request was included in the Commission's NTP Final Report and was the subject of public consultation.

The main arguments proposed by the MCE in support of the proposed RIT-T Rules were:

- the amalgamation of the reliability and market benefits limbs of the Regulatory Test would optimise the decision making process in relation to transmission planning and also promote efficiency;
- increased consultation on the options that are available to address any given transmission issue and earlier consultation in the planning process taken together should decrease efficient options being overlooked; and
- application of more rigor and greater consistency to the analysis of costs and benefits before transmission investment is undertaken is likely to promote greater consistency, transparency and predictability to transmission planning decision making.

The Commission assessed the Rule Change Proposal and is of the view that the proposed RIT-T Rules, subject to some modification, do meet the statutory Rule making test. While adopting the substance of the proposed RIT-T Rules, the Draft Rule differs from the proposed RIT-T Rules in some respects. Some modifications have been made to improve the application of the proposed Rules but they do not affect the rationale and intent of the proposed RIT-T Rules which is still reflected in the Draft Rule.

The Commission invites submissions on this draft Rule determination by 15 May 2009.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule determination. Any request for a pre-determination hearing must be made in writing and must be received by the Commission no later than 10 April 2009.

Submissions and requests for a hearing should quote the project number “ERC0077” and may be sent electronically to [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au) or by mail to:

Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

# 1 MCE's Rule Change Proposal

## 1.1 Proposal

The Australian Energy Market Commission (Commission) has received a Rule Change request from the Ministerial Council on Energy (MCE) seeking to implement a new regulatory investment test for transmission (Rule Change Proposal)<sup>1</sup>.

The Rule Change Proposal arises out of the Commission's National Transmission Planning Arrangements Review (NTP Review). One of the outcomes of that Review was a set of proposed Rules to implement a new regulatory investment test for transmission (RIT-T) which would displace the current Regulatory Test. In the Rule Change Proposal the MCE requests that the Commission make the proposed RIT-T Rules that were included in the Commission's final report of the NTP Review (NTP Final Report).<sup>2</sup>

The MCE has requested that the Commission fast track the Rule Change Proposal in accordance with section 96A of the National Electricity Law (NEL), as the proposed RIT-T Rules were the subject of public consultation as part of the NTP Review, and were included in the NTP Final Report.<sup>3</sup>

The Rule Change Proposal also included another related Rule change request from the MCE requesting the Commission to make a Rule to implement a National Transmission Statement. This is being considered separately by the Commission.

## 1.2 Objective of the Rule Change Proposal

In the Rule Change Proposal the MCE stated that the RIT-T would provide a single framework to apply to all transmission investment and remove the current distinction between reliability driven projects and projects motivated by the delivery of market benefits.<sup>4</sup>

The purpose of the RIT-T would be to identify the transmission investment option which maximises the net economic benefits and, where applicable, meets the relevant jurisdictional Rule based reliability standards. The RIT-T framework would require consultation on the range of credible options for any given transmission issue, and

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<sup>1</sup> Ministerial Council on Energy, *MCE Response on AEMC Final Report on the National Transmission Planning Arrangements*, 5 November 2008 (Rule Change Proposal, Part 1) and Ministerial Council on Energy Standing Committee of Officials, *MCE Rule Change requests – National Transmission Statement and Regulatory Investment Test for Transmission*, 16 February 2009 (Rule Change Proposal, Part 2) (together the Rule Change Proposal).

<sup>2</sup> AEMC 2008, *National Transmission Planning Arrangements*, Final Report to MCE, 30 June 2008, Sydney (NTP Final Report).

<sup>3</sup> Rule Change Proposal, Part 1, p 1, 14.

<sup>4</sup> Rule Change Proposal, Part 2, pp 3 – 4.

consultation on a comparative analysis of costs and benefits using a standardised list of classes of costs and benefits.<sup>5</sup>

The MCE also referred to the need for Rules relating to transitional arrangements supporting the RIT-T:

- the current Regulatory Test would continue to apply to any project assessment analysis which commenced prior to the commencement of any Rules to implement the RIT-T; and
- the Australian Energy Regulator (AER) would be given 12 months to develop and publish the new test and related guidelines.<sup>6</sup>

### 1.3 Background

As part of the reform process initiated by Council of Australia Governments, and in response to the Energy Reform Implementation Group recommendations on achieving a fully national and efficient energy market, the MCE requested that the Commission conduct the NTP Review<sup>7</sup>. The NTP Review looked at the implementation of a strengthened national electricity transmission planning function.<sup>8</sup>

The MCE requested that the Commission develop a revised transmission network planning and consultation process to replace the current 'Regulatory Test' with an assessment process that amalgamates the reliability and market benefits criteria of the current Test and expands the definition of market benefits to include national benefits. The revised transmission planning and consultation process ultimately proposed by the Commission was termed the 'regulatory investment test for transmission or 'RIT-T' in the NTP Final Report.<sup>9</sup>

The Commission submitted the NTP Final Report to the MCE on 30 June 2008 (as specified in the Terms of Reference). On 22 July 2008 the Commission published the NTP Final Report following a request from the MCE that the Report be made publicly available.

Other recommendations from the NTP Final Report are being progressed via other means. In particular, the proposed national transmission planning function will be implemented through the MCE's Australian Energy Market Operator (AEMO) establishment process.<sup>10</sup>

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<sup>5</sup> Rule Change Proposal, Part 2, pp 3- 4.

<sup>6</sup> Rule Change Proposal, Part 2, pp 3- 4.

<sup>7</sup> For more information on the background to the NTP Review refer to the COAG Communique, 13 April 2007. In that Communique COAG responds to Energy Reform Implementation Group, *Energy Reform: The Way Forward for Australia*, January 2007.

<sup>8</sup> The NTP Review was carried out under Section 41 of the National Electricity Law.

<sup>9</sup> Refer to chapter 4 of the NTP Final Report.

<sup>10</sup> Rule Change Proposal, Part 1, p 16.



## **1.4 Fast track Rule change process**

On 26 February 2009 the Commission published a notice under section 95 of the NEL advising of its intention to commence the Rule change process in respect of the Rule Change Proposal.

The Commission has decided to fast-track the Rule Change Proposal under section 96A of the NEL and, accordingly, there has been no first round consultation on the Rule Change Proposal. The basis for making this decision is set out below:

- the MCE has made a request for the making of a Rule on the basis of such a recommendation contained in a MCE directed review; ie, the proposed RIT-T Rule was included in the NTP Final Report;
- the Rule change request reflects or is consistent with the relevant recommendation contained in the MCE directed review; ie, the Rule Change Proposal is consistent with the Commission's recommendations contained in the NTP Report; and
- there was adequate consultation with the public by the AEMC on the content of the relevant recommendation. The issue of the RIT-T was consulted on as part of the NTP Review. The consultation is outlined below.<sup>11</sup>

The Commission consulted extensively with market participants and other stakeholders to inform the preparation of the RIT-T recommendations as part of the NTP Review. This was a key requirement specified in the MCE Terms of Reference. The process included:

- Scoping Paper published on 3 August 2007;
- Issues Paper published on 9 November 2007;
- Discussion Paper published on 28 March 2008;
- Public Forum held in Melbourne on 2 April 2008; and
- Draft Report published on 2 May 2008.

The Commission also held a number of briefing sessions and bilateral meetings with stakeholders. In developing its RIT-T recommendations, the Commission also sought advice from Frontier Economics.

## **1.5 Consultation on draft Rule determination**

The Commission invites submissions on this draft Rule determination by 15 May 2009.

In accordance with section 101 of the NEL, any interested person or body may request that the Commission hold a hearing in relation to the draft Rule

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<sup>11</sup> Refer to sections 96A(1)(b) and 96A(2)(b) of the NEL.

determination. Any request for a pre-determination hearing must be made in writing and must be received by the Commission no later than 10 April 2009.

Submissions and requests for a hearing should quote project the number "ERC0077" and may be sent electronically to [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au) or by mail to:

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PO Box A2449  
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## 2 Draft Rule Determination

### 2.1 Commission's draft Rule determination

In accordance with section 99 of the NEL, the Commission has determined to make and publish this draft Rule determination. The Commission has decided to make, with amendments, the draft Rule proposed by the MCE (referred to as the proposed RIT-T Rules).<sup>12</sup>

A draft of the Rule to be made (Draft Rule) is **attached** to, and published with, this draft Rule determination.

### 2.2 Commission's considerations

This draft Rule determination sets out the Commission's reasons for making the Draft Rule. In making this draft Rule determination, the Commission has taken into account:

- the Commission's powers under the NEL to make the Rule;
- the Rule Change Proposal (including the MCE's response to the NTP Final Report) and the proposed RIT-T Rules;
- the NTP Final Report;
- the revenue and pricing principles;<sup>13</sup> and
- the Commission's analysis on the ways in which the proposed Rule will, or is likely to contribute to the National Electricity Objective (NEO) so that the statutory Rule making test is satisfied.

For the reasons set out in the following chapters, the Commission has concluded that the Draft Rule satisfies the Rule making test. The Commission is satisfied that the Draft Rule will or is likely to contribute to the achievement of the NEO, taking into account the revenue and pricing principles. The Draft Rule will promote the efficient investment in electricity services for the long term interests of consumers of electricity as follows:

- the amalgamation of the reliability and market benefits limbs of the Regulatory Test should optimise the decision making process in relation to transmission planning by promoting dynamic and allocative efficiency. By including the

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<sup>12</sup> Section 99(3) of the NEL provides that the draft Rule to be made need not be the same as the draft of the proposed Rule relating to the section 95 notice.

<sup>13</sup> Under section 88B of the NEL the Commission is required to take into account the revenue and pricing principles set out in section 7A in certain cases. The revenue and pricing principles must be taken into account with respect to matters or things specified in items 15-24 and 25 – 26J of Schedule 1 to the NEL.

assessment of market benefits, the transmission process should promote more efficient investment over time;

- greater prescription of market benefits and costs and how they should be assessed should improve the consistency and transparency across transmission investment assessment and should, over time, promote more efficient decision making;
- requiring a project specification consultation should improve the transparency and application of the transmission assessment process which should ultimately promote more efficient outcomes over time;
- a substantial increase in the amount of consultation undertaken in relation to transmission assessment should unearth a greater number of efficient investment options and therefore lead to more efficient outcomes overtime; and
- exemptions from the project assessment draft report stage promotes the efficient use of resources where appropriate, thus reduces the regulatory burden faced by TNSPs and as a result promotes good regulatory practice.

The Draft Rule is also consistent with the revenue and pricing principles because, through greater consultation and more prescription of the costs and benefits to be assessed, the transmission planning process should identify more efficient investment. This should address the risk of the potential for under and over investment by the TNSP and the potential for under or over utilisation of the transmission network.

### **2.3 Differences between the proposed Rule and the Draft Rule**

While adopting the substance of the proposed RIT-T Rules, the Draft Rule differs from the proposed RIT-T Rules in some respects. Some modifications have been made to improve the application of the proposed Rules but they do not affect the rationale and intent of the proposed RIT-T Rules which is still reflected in the Draft Rule. Some examples of the changes that have been made are:

- amendments have been made to certain definitions, moving the substance of the definition into the body of the Rules, rather than including the substance in chapter 10 of the Rules;
- the transitional arrangements have been amended to ensure that the current procedures remain operational until the RIT-T commences;
- clarification that the Regulatory Test will still apply to transmission investment which supports the distribution network;
- the definition of 'transmission investment' has not been included in the Draft Rule; and
- the definition of 'preferred option' has been amended to clarify that investments that tend to meet relevant jurisdictional Rule based reliability requirements may have negative net economic benefits.

Other changes have been made which are of a consequential, minor drafting nature.

## **2.4 Commission's power to make the Rule**

The Commission is satisfied that the Draft Rule falls within the subject matters that the Commission may make Rules as set out in section 34 of the NEL and in Schedule 1 of the NEL. The Draft Rule is within:

- the matters set out in section 34 (1)(a)(iii), as it relates to the activities of persons participating in the NEM or involved in the operation of the national electricity system;
- the matters set out in items 12, 14A and 14B of Schedule 1 to the NEL, as it relates to the operation of transmission systems which is subject to National Electricity Rules; and
- the matters set out in items 15 - 24 of Schedule 1 to the NEL as it also relates to transmission system revenue and pricing.

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### **3 Commission's assessment approach**

This chapter sets out the Commission's approach for assessing the Rule Change Proposal. The Commission's detailed assessment and reasons for its draft Rule determination are set out in chapters 4 and 5.

#### **3.1 Methodology**

In assessing any Rule change request against the NEL criteria the first step is to consider the counterfactual arrangements against which the Rule change is being compared. In the present case the counterfactuals are the current arrangements; being the current Regulatory Test.

Given the present context, this task involves reviewing the NTP Final Report for its recommendations and rationale supporting the proposed RIT-T Rules. Accordingly, to assess the Rule Change Proposal the Commission's approach has been to:

- describe the proposed RIT-T Rules which are the subject of the Rule Change Proposal;
- confirm the key recommendations and supporting reasoning for the proposed RIT-T Rules (from the NTP Final Report);
- review and analyse the proposed RIT-T Rules for their consistency with the key RIT-T recommendations;
- review and analyse the proposed RIT-T Rules for their clarity and consistency with the Rules more generally, particularly given the commencement of Rules since the completion of the NTP Final Report, and other developments, such as the AEMO establishment process; and
- assess the proposed RIT-T Rules, together with any amendments, against the NEO, taking into account the revenue and pricing principles.

#### **3.2 Rule making test and the National Electricity Objective**

The Rule making test states that the Commission may only make a Rule if it is satisfied that the Rule will, or is likely to, contribute to the achievement of the NEO<sup>14</sup>. The overarching objective of the NEL is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

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<sup>14</sup> See section 88(1) of the NEL.

- price, quality, safety, reliability and security of supply of electricity; and
- the reliability, safety and security of the national electricity system.<sup>15</sup>

The NEO is founded on the concepts of economic efficiency (including productive, allocative and dynamic dimensions of efficiency), good regulatory practice (which refers to the means by which regulatory arrangements are designed and operated) as well as reliability, safety and security priorities.

In its Rule Change Proposal the MCE gave the following reasons as to why, in its view, the proposed RIT-T Rules meet the NEO:

- the proposed RIT-T Rules seek to identify options that maximise the present value of net economic benefits (or minimise the present value of net economic costs) subject to meeting relevant jurisdictional Rule based reliability standards (where they apply). The amalgamation of reliability and market benefits would optimise the decision making process in relation to transmission planning and also promote efficiency.
- the proposed RIT-T Rules would provide a prescriptive framework for the inclusion of national market benefits by providing a list of classes of market benefits and costs that a TNSP must consider in undertaking the project assessment stage. This framework would encourage TNSPs to broaden the scope of possible market benefits, rather than potentially focusing only on the impact of augmentations within a particular jurisdiction or region.
- the proposed RIT-T Rules would facilitate earlier consultation in the planning process thereby enabling other potential viable non-network options to be identified and assessed appropriately.<sup>16</sup>

Accordingly, for the MCE, the aspects of the NEO that are of relevance in the context of this Rule Change Proposal are certainty, predictability and transparency, leading to optimal and efficient decision-making.

### **3.3 Revenue and pricing principles**

In addition to the Rule making test set out in section 88 of the NEL under section 88B of the NEL, the Commission must take into account the revenue and pricing principles in making a Rule for or with respect to any matter of thing specified in items 15 to 24 and 25 to 26H of Schedule 1 to the NEL. The subject matter of the Rule Proposal requires the Commission to take into account the revenue and pricing principles.

The revenue and pricing principles relate to providing a reasonable opportunity to service providers to recover efficient costs, effective incentives to promote efficiency

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<sup>15</sup> See section 7 of the NEL.

<sup>16</sup> Rule Change Proposal, Part 2, p 4.



and to ensuring that prices should allow for a return commensurate with the regulatory and commercial risks involved in providing the service.

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## 4 Context for proposed RIT-T Rules

The MCE has requested that the proposed RIT-T Rules be progressed based on the recommendations advanced by the Commission. Prior to considering the proposed RIT-T Rules in detail, the key recommendations and reasoning supporting the proposed RIT-T Rules are summarised below<sup>17</sup>.

For the purposes of considering the proposed RIT-Rules, the Commission remains of the view that the RIT-T recommendations contained in the NTP Final Report are current, relevant and present a sound basis from which to assess the proposed RIT-T Rules. The proposed RIT-T Rules are assessed in chapter 5.

### 4.1 Description of proposed RIT-T Rules

The proposed RIT-T Rules provide for a single framework to apply to all transmission investment. They would remove the current distinction between reliability-driven projects and projects motivated by the delivery of market benefits.

The NTP Final Report summarises the RIT-T recommendations as follows:

- The RIT-T should be undertaken by a transmission network service provider (TNSP) when a transmission network planning issue exists and the most expensive economically credible option is estimated to cost more than \$5 million; the planning issue is not urgent or unforeseen; and the planning issue is not solely the provision of connection services nor negotiated transmission services or replacement;
- The purpose of the RIT-T should be to identify the preferred option, being the one which maximises the present value of net economic benefits (or minimises the present value of net economic costs) subject to meeting relevant jurisdictional Rule based reliability standards (where they apply);
- The RIT-T would involve:
  - a quantified assessment of costs and benefits across a range of credible options;
  - a 12-week consultation on the range of credible options to assess and the classes of costs and benefits (from a standardised list) that are materially relevant;
  - publication of a draft report on the assessment of costs and benefits for consultation for 6 weeks;
  - an ability to raise disputes, which would then be assessed by the AER; and

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<sup>17</sup> For more detail on the RIT-T refer to the NTP Final Report, chapter 4.

- the application of the same process irrespective of whether a transmission issue is motivated by reliability or by the potential to deliver market benefits, or both; and
- Projects assessments for planning issues relating to distribution networks would continue to be assessed under the current regulatory test.<sup>18</sup>

Refer to Appendix A for a flow chart which sets out the RIT-T process.

## **4.2 Reasoning for RIT-T**

The reasoning supporting the key RIT-T recommendations is set out below<sup>19</sup>.

### **4.2.1 Amalgamation of the reliability and market benefits limbs of the Regulatory Test**

As part of the NTP Review the MCE directed the Commission to establish a new project assessment and consultation process which amalgamated the reliability and market benefits limbs of the current Regulatory Test, in order to allow proposed transmission projects to be assessed against both local reliability standards as well as their ability to maximise benefits to the national market.

Under the proposed RIT-T, all prospective investments above a suitable cost threshold would be assessed under a cost-benefit framework. The purpose would be to identify options which maximise the present value of net economic benefits (or minimise the present value of net economic costs) subject to meeting relevant jurisdictional Rule based reliability standards (where they apply).

TNSPs would be required to investigate whether an enhancement to a reliability project, or a different project that met the same reliability standard, would provide additional market benefits that justified a higher cost, and select such a project if one is found. Where no options have market benefits, and hence the project is solely driven by the need to meet reliability standards, the RIT-T would effectively be a 'least cost' test analogous to the test applied under the 'reliability limb' of the current Regulatory Test.

### **4.2.2 Greater prescription of market benefits and costs**

The NTP Review also considered whether the current definition of market benefits is sufficiently comprehensive to capture all national benefits rather than those focused within a region of a TNSP.

It was concluded that the current definition of market benefits sufficiently allows for all national benefits to be assessed but the Rules could provide greater prescription on the framework of the RIT-T by mandating a list of classes of market benefits and

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<sup>18</sup> NTP Final Report, p 41.

<sup>19</sup> Taken from chapter 4, NTP Final Report.

costs that a TNSP must consider in undertaking the project assessment stage. Under the current Regulatory Test TNSPs could focus only on the impact of augmentations within a particular jurisdiction. By amalgamating reliability and market benefits, TNSPs would be required to broaden the scope of possible market benefits when examining project options.

It was proposed that the Rules mandate a list of market benefits and costs that a TNSP must consider in undertaking the project assessment stage of the RIT-T, thereby addressing the perception that, under the current test, there is a potential to 'cherry-pick' the classes of benefits to be quantified. To improve further the transparency of project assessments, TNSPs would be required to provide information on classes of market benefits occurring outside the TNSP's region.

Providing greater prescription in the Rules as to which classes of benefit and cost should be considered would promote consistency in the application of the RIT-T, and remove any perception that results are influenced by the selective inclusion or exclusion of classes of costs or benefits. This process would promote more efficient decision making.

#### **4.2.3 Additional market benefit category of option value**

The NTP Final Report recommended an additional category of market benefits for option value be added to the RIT-T process, to cover any benefits that a proposed project may have for future investments and costs. An example of this in practice would be a non network investment potentially deferring network investment, and thus enabling the deferred network investment to benefit from improved information and therefore be more appropriately specified. The NTP Final Report reasoned that the inclusion of such benefits could facilitate a more strategic assessment of projects.

#### **4.2.4 Scope of projects**

The NTP Final Report recommended the following scope of projects:

- the cost threshold for projects subject to the RIT-T should increase from \$1 million to \$5 million;
- that the threshold should be applied to the most expensive option which is both technically and economically feasible;
- that urgent and unforeseen investments should be exempt from undertaking the RIT-T;
- network reconfigurations which augment the network or affect service levels and cost more than \$5 million should be also subject to the RIT-T; and
- projects which combine augmentation and replacement expenditure should also be included if the augmentation component is more than \$5 million.

A cost threshold of \$5 million for projects subject to the RIT-T would reflect an appropriate balance between the regulatory burden placed on TNSPs and would ensure that transmission investments proceed in a timely manner. Small scale projects would be likely to have less profit potential, therefore it is less likely TNSPs will favour uneconomic behaviour. Further, under the proposed RIT-T there would likely be an increase in the proportion of projects that require benefits to be quantified as part of the project assessment process, and applying such analysis to small scale projects would place an undue regulatory burden on TNSPs.

It was also considered sensible to apply the threshold to the most expensive option which is technically and economically feasible, instead of the preferred solution. TNSPs should be encouraged to undertake project specification consultations earlier in the planning process and linking the threshold to the TNSPs preferred solution may unnecessarily delay the project assessment process.

#### **4.2.5 Project specification consultation**

All projects subject to a RIT-T assessment would be required to go through a project specification consultation stage before any assessment of costs and benefits. The purpose of this stage would be to consult on the range of materially relevant costs and benefits and the range of credible options. Market participants, including the national transmission planner, would have the ability to comment on the possible market benefits and also possible options for consideration. The timeframe for consultation should be twelve weeks, at a minimum.

Under the current Rules, the procedural differences determined by a TNSP's decision as to whether an investment is reliability or market benefits driven cannot be rolled forward in the context of a single 'limb'. A standard consultation process would need to apply to all projects subject to the RIT-T to achieve the requirement of the two limbs of the existing Regulatory Test being integrated into a single limb.

It was considered that the consultation stage would help ensure that all potential options are identified and considered and would enable all market participants to inform the TNSPs on the extent of possible market benefits associated with the proposed investment. This would ensure that the key inputs into the project assessment would be subject to consultation, helping to improve the application of the assessment and promote transparency.

Prior consultation would improve the identification of alternatives and market benefits. The NTP Final Report highlighted that the risk that efficient options (and possible non-network options) are overlooked would be reduced when substantially increasing the amount of consultation undertaken on the options that are available to address any given transmission issue.<sup>20</sup>

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<sup>20</sup> Final Report – National Transmission Planning Arrangements, Summary xi.

Further, earlier consultation would enable market participants to identify possible national market benefits associated with the projects which would ensure that broader market benefits are recognised under the project assessment process.<sup>21</sup>

#### **4.2.6 Selection of market benefits and costs to be quantified**

TNSPs would be required to quantify those classes of market benefits associated with each credible option which, in their objective judgement, have a material relevance.

It was concluded that it would be preferable to give TNSPs some guided discretion to decide which classes of benefits would require quantification on a case by case basis. Mandating the quantification of all costs could impose an unnecessary or impractical burden on TNSPs without adding any value to the decision making process. The RIT-T would include a quantification of all classes of market benefits which are deemed to be material. TNSPs would need to demonstrate why a particular class of benefit did not need to be analysed in the particular circumstances. In making its decision, the TNSP should have regard to the views of market participants raised during the project consultation process.

#### **4.2.7 Selection of credible options for assessment**

The NTP Final Report reasoned that the most appropriate approach for selection of credible options for assessment would be for a TNSP, under an objective framework (including consultation) to determine which alternatives are credible and should be assessed under the RIT-T. The framework should specify the definition of a credible option and require the TNSP to apply this definition in an objective and balanced manner.

With respect to the framework for the selection of credible options, the current arrangements for identifying credible alternatives for discretionary market benefits investment were deemed sensible and appropriate. They would allow TNSPs to dismiss unrealistic or insubstantial alternatives, while also ensuring that realistic and well-defined alternatives are given due consideration. Therefore it was proposed that such arrangements are extended to cover all projects.

#### **4.2.8 Project assessment**

Following a review of the submissions received during the project specification consultation stage, the TNSP would decide upon the credible options and material benefits to be assessed. The TNSP would carry out the cost-benefit analysis as required by the RIT-T which would be developed by the AER.

The next stage would be for the TNSP to consult on the findings of the project assessment and the option which maximises net economic benefit through the publication of a project assessment draft report. The TNSP would also be required to

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<sup>21</sup> Final Report – National Transmission Planning Arrangements, Summary xi.

provide reasoning for its decisions in respect to the selection of credible options and material market benefits.

To ensure timely investments it would be appropriate to link the publication of the project assessment draft report to the date of the project specification consultation report. It was proposed that if the TNSP elects to proceed with the investment then the project assessment draft report must be published within 12 months of the end of the consultation on the project specification.

#### **4.2.9 Exemption from project assessment draft report stage**

The proposed RIT-T should make appropriate and efficient use of the planning resources available to the TNSPs. In particular, projects justified solely on reliability grounds should be delivered in an efficient and timely manner. It was concluded that certain limited projects should be exempt from the requirement of having to release and consult on a project assessment draft report. Such projects would go straight to the issue of a project assessment conclusions report.

A TNSP would be exempt from having to release a project assessment draft report if:

1. The estimated capital cost of the proposed preferred option is less than \$35 million;
2. the TNSP has stated its proposed preferred option, it reasons why it is the proposed preferred option, and that it intends to apply this exemption clause in the project specification consultation report;
3. the TNSP considers, that the proposed preferred option and any other credible option will not have a material market benefit, and has stated this in its project specification consultation report; and
4. no submissions were received on the project specification consultation report which identifies additional credible options that could deliver a material market benefit.

#### **4.2.10 Review of cost thresholds applied in the RIT-T**

The proposed new RIT-T would use a cost value as a threshold in two instances:

- a cost value of \$5 million in determining the scope of projects subject to the RIT-T ; or
- a cost value of \$35 million in determining, among other factors, whether a project can be exempted from the project assessment draft report stage.

These cost values would be reviewed by the AER every three years, in light of varying input costs overtime. Three yearly reviews were considered suitable due to historical input costs not varying significantly on an annual basis.



#### **4.2.11 Dispute resolution**

Under the Rules currently the dispute resolution framework is based on the separate limbs. Only issues relating to new large transmission augmentations ( greater than \$10 million) can be disputed. Also, the dispute resolution process and grounds for dispute differ depending on whether the proposed investment is considered to be a reliability investment or a discretionary market investment. In place of this the RIT-T framework contemplates a single consistent framework for dispute resolution. It is needed to support the amalgamation of the market benefit and reliability limbs of the current regulatory test.

It was recommended that the Rules contain more specification and detail on the basis for resolving disputes. The basis for assessing disputes should be whether the TNSP has complied with the Rules and the AER's RIT-T, and not on whether the best options has been selected, as this creates uncertainty for participants disputing the assessment and the affected TNSPs which might in turn deter legitimate disputes being raised. Further, greater prescription in the Rules would allow the AER to reject disputes immediately if the grounds for dispute are invalid, misconceived or lacking in substance. This safeguard is needed to protect against parties raising baseless or vexatious disputes in order to delay projects. The AER would be required to provide its reasons for any determination.

It is proposed that for all transmission projects that are subject to the RIT-T, interested parties can raise disputes in relation to the application of the RIT-T assessment, including the choice of credible options, the choice of classes of benefit to quantify, the accuracy of the analysis, and the results of the RIT-T.

### **4.3 Outcomes of NTP Final Report regarding RIT-T and their continued relevance**

Prior to finalising the RIT-T recommendations (and the other recommendations contained in the NTP Final Report) the Commission undertook an extensive and robust review process as part of the NTP Review. The Commission consulted extensively with market participants and other stakeholders at various stages and engaged expert advice as required to inform its decision making. Its process was consistent with the MCE terms of reference.

The RIT-T recommendations (and supporting reasoning) are consistent with the assessment criteria adopted by the Commission for the NTP Review, including promoting efficiency, proportionality and good regulatory design.

In this regard the RIT-T recommendations and rationale present a sound and robust basis from which to consider the proposed RIT-T Rules which are the subject of this Rule Change Proposal.

A number of developments have occurred and are ongoing since the completion of the NTP Final Report; in particular, the Commission's Climate Change review. At the time of writing, these developments would not require any amendments to the proposed RIT-T Rules or question the validity or relevance of the RIT-T recommendations as a basis for considering the proposed RIT-T Rules.

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## 5 Assessment of proposed RIT-T Rules

This chapter assesses the issues arising out of the MCE's Rule change request. The MCE has endorsed the proposed RIT-T Rules included in the NTP Final Report. In this chapter the Commission reviews the proposed RIT-T Rules for their consistency with:

- the recommendations from the NTP Final Report (as set out in chapter 4 above); and
- the Rules more generally, particularly given the commencement of Rules since the completion of the NTP Final Report and other developments, such as the implementation of the AEMO package.

Following this, the Commission assesses the proposed RIT-T Rules, together with the amendments identified by the Commission, against the Rule making test.

### 5.1 Consistency of proposed RIT-T Rules with the NTP Final Report

The proposed RIT-T Rules are consistent with the recommendations and rationale contained in the NTP Final Report. They are reflective of the benefits referred to in the NTP Report including:

- removing the current distinction in process between mandatory reliability and discretionary economic investments;
- ensuring that all market benefits associated with any prospective investment are properly considered when deciding between different options; and
- at the same time, not risking the ability of TNSPs to solely deliver reliability based projects within appropriate timeframes, and ensuring that accountability for investment decisions remains with TNSPs.

The proposed RIT-T Rules would involve the following amendments to the Rules:

- inserting new clauses 5.6.5B, 5.6.5C, 5.6.5D, 5.6.5E and 5.6.6AA;
- replacing existing clauses 5.6.6 and 5.6.6A with new clauses;
- amending a number of provisions in chapter 6A; and
- inserting new savings and transitional provisions in chapter 11.

The proposed RIT-T Rules are explained in detail below.

#### 5.1.1 Requirement to develop and publish Regulatory Investment Test for Transmission

- Clause 5.6.5B sets out the requirements for the regulatory investment test for transmission (RIT-T) to be prepared by the AER. It articulates the main purpose

of the RIT-T, being to identify the transmission investment option which maximises the present value of net economic benefits to all who produce, consume and transport electricity in the market. The RIT-T allows for investments which are required to meet relevant jurisdictional Rule based reliability requirements to have negative net economic benefits.

- The essential features of the RIT-T are described in detail in clause 5.6.5B(c). Importantly the RIT-T must:
  - be based on a cost-benefit analysis of the future were each credible option to be implemented compared to the situation of no options taking place;
  - not require a disproportionate level of analysis to the scale and impact of the likely options being considered;
  - be able to be applied in a predictable, transparent and consistent manner;
  - require TNSPs to consider a number of classes of market benefits (which could be negative or positive) that could be delivered including:
    - ... changes in fuel consumption arising through different generation dispatch;
    - ... changes in voluntary load curtailment;
    - ... changes in involuntary load shedding using a reasonable forecast of the value of electricity to consumers;
    - ... changes in transmission losses and ancillary service costs;
    - ... changes in other parties costs;
    - ... option value; and
    - ... competition benefits.
  - include a quantification of the classes of market benefits that are determined to be material in the TNSP's reasonable opinion unless the TNSP can demonstrate in the project assessment draft report that a particular class of market benefit will not affect the outcome of the assessment of each option; or the cost of undertaking the quantification analysis would be disproportionate to the benefit; and
  - require TNSPs to quantify the following classes of costs in relation to the credible option:
    - ... incurred in constructing or providing the credible option;
    - ... operating and maintenance;
    - ... compliance; and

- ... any other class determined to be appropriate for inclusion in the RIT-T by the AER.

### **5.1.2 Requirement to make RIT-T guidelines**

- Clause 5.6.5B(d) requires that, at the same time as developing and publishing the RIT-T, the AER must also develop and publish guidelines for the operation and application of the RIT-T.
- Under clauses 5.6.5B(e) - (f) the guidelines must provide guidance on the operation of the RIT-T, the process to be followed in applying the RIT-T and how disputes raised would be addressed and resolved. They must also provide worked examples on more technical details such as what constitutes a credible option, acceptable methodologies for valuing costs and what constitutes an externality under the RIT-T.
- Clause 5.6.5B(g) requires the AER to develop and publish the first RIT-T and guidelines by 12 months after the proposed RIT-T Rules commence. See amendments to chapter 11 below for related provisions.

### **5.1.3 Transmission assets subject to the RIT-T**

- Clause 5.6.5C(a) sets out the transmission investments to which the RIT-T must be applied. A TNSP must apply the RIT-T to a proposed transmission investment except where:
  - the investment is required to address an urgent and unforeseen network issue that would otherwise put at risk the reliability of the transmission network;
  - the estimated capital costs for the most expensive of the range of possible credible options is less than \$5 million;
  - the investment relates to maintenance or replacement and not intended to augment the transmission network;
  - the investment is a reconfiguration investment which the TNSP reasonably estimates to have a capital cost of less than \$5 million;
  - the maintenance or replacement expenditure also results in an augmentation to the network but the estimated capital cost for that augmentation component is less than \$5 million;
  - the transmission investment will be a dual function asset;
  - the investment is designed to ensure that a distribution network meets the minimum power system security and reliability standards;
  - the investment will be a connection asset; or

- the cost of the investment to be recovered through charges in relation to negotiated transmission services.
- Clause 5.6.5C(b) provides guidance on investments required to address urgent and unforeseen network issues that would otherwise put at risk the reliability of the transmission network. An investment will meet this test if:
  - the investment must be operational within three to six months of identification of the need;
  - the event causing the need was not reasonably foreseeable and beyond the reasonable control of the TNSP;
  - failure to address the need would be likely to affect the reliability and secure operating state of the transmission network; and
  - it is not a contingent project.

Information on a investment determined to address an urgent and unforeseen network issue must be included to in the TNSP’s Annual Planning Report.

- For those investments to which the RIT-T does not apply, the TNSP must ensure that the investment is planned and developed at least cost over the life of the investment (clause 5.6.5C(d)).
- Importantly, under clause 5.6.5C(e), a TNSP must not treat different parts of an integrated solution separately as individual investments for the purposes of application of the RIT-T.

#### **5.1.4 Identification of a credible option**

- After the project specification consultation stage, the RIT-T requires identification of the possible credible options for the project assessment. In this regard, clause 5.6.5D(a) provides that a TNSP must consider all genuine and practical possible investment options that could reasonably be classified as credible options taking into account without bias: energy source, technology, ownership, extent of enabling intra-regional/inter-regional trading of electricity; whether network or non-network options, whether intended to be regulated; whether there is a viable proponent or any other factor the TNSP reasonably considers should be taken into account.

#### **5.1.5 Review of cost thresholds**

- Under clause 5.6.5E(a), every three years the AER must undertake a cost threshold review to take account of in the input costs used to calculate the estimated capital costs referred to in clauses 5.6.2A, 5.6.5C and 5.6.5, for the purposes of determining whether the relevant amounts need to be changed.
- Clauses 5.6.5E(b)-(e) set out the process to be adopted by the AER when undertaking the cost threshold review.

### **5.1.6 RIT-T Procedures – project specification**

- The RIT-T Rules contemplate two sequential stages. The first is a project specification stage. Following this is a project assessment stage. Clause 5.6.6(a)-(g) relates to the first stage.
- Under clauses 5.6.6(a)-(b) a TNSP who proposes to make an investment of the type referred to in clause 5.6.5C must undertake a consultation in accordance with this clause.
- A TNSP must prepare a project specification consultation report including:
  - a description of the identified need;
  - technical characteristics of the identified need that a non-network option would be required to deliver such as size of load reduction;
  - detailed description of all possible credible options that address the identified need, including alternative transmission options, demand side management and market network services; and
  - for each possible option, detailed information such as technical characteristics, classes of market benefits considered to be material (Clause 5.6.6(c)).
- A TNSP must make available to all interested persons the report and related information. It must make the report available within 3 business days of a request from an interested person and provide a summary of it to NEMMCO (which NEMMCO must include on its website) (Clauses 5.6.6 (d)-(f)).
- A TNSP must seek submissions on the options and issues included in the report. The consultation period must be not less than 12 weeks (Clause 5.6.6(g)).

### **5.1.7 RIT-T Procedures - project assessment**

- Clause 5.6.6(j) commences the second stage of the RIT-T. If the TNSP elects to proceed with the transmission investment, within 12 months of the end of the consultation period the TNSP must prepare and make available to all interested persons a project assessment draft report. The report must take into account submissions received and include a number of details such as:

- a description of each credible option assessed;
  - a summary of submissions to the consultation report;
  - a quantification of the costs and material classes of market benefit for each credible option;
  - a description of the methodologies used in quantifying market benefits and costs;
  - the identification and value of any class of market benefit estimated to arise outside the TNSP’s region; and
  - the identification of the proposed preferred option and, in respect of it, details on the technical characteristics, estimated construction timetable and commissioning date, indicative costs, and a statement and analysis that the preferred option satisfies the RIT-T.
- For a reliability augmentation the identity of the proponent is required to be included in the project assessment draft report (Clause 5.6.6(k)).
  - The TNSP must provide a summary of the report to NEMMCO (who must include it on its website) and provide a copy of the report to any person within 3 business days of a request (Clauses 5.6.6(m) – (n)).
  - The TNSP must seek submissions from interested persons and the submission period must not be less than 30 business days (Clause 5.6.6(o)-(p)).
  - The TNSP must use its best endeavours to meet with interested parties who request a meeting where the TNSP considers it necessary or desirable to do so or more than two interested parties request a meeting (Clause 5.6.6(q)).

### **5.1.8 Project Assessment Conclusions Report**

- As soon as practicable after the end of the consultation period for the project assessment draft report the TNSP must prepare and make available to all interested parties a further report, a project assessment conclusions report. This report must set out:
  - the matters required for the project assessment draft report; and
  - a summary of submissions and the TNSP’s response to those submissions (clause 5.6.6(r)).
- The TNSP must provide a summary of the project assessment conclusions report to NEMMCO (who must include it on its website) and a copy of it to any interested person within three business days of a request (Clause 5.6.6(s)-(u)).



### **5.1.9 Exemptions from the project assessment draft report for transmission investments that do not provide material market benefits**

- Not all transmission investments must go through the project assessment draft report stage of the RIT-T. Clause 5.6.6(x) provides that a TNSP is not required to comply with clauses 5.6.6(j) to (r) if:
  - the estimated capital cost of the preferred option is less than \$35 million;
  - the TNSP has identified in its project specification consultation report its preferred option, reasons for that option and that its transmission investment has the benefit of this exemption;
  - the TNSP considers that the preferred option and any other credible option does not have a material market benefit for any of the classes of market benefit specified in clause 5.6.5B(c)(4) and has stated this in the project specification consultation report; and
  - the TNSP forms the view that submissions on the project specification consultation report did not identify additional credible options that could deliver a market benefit.

### **5.1.10 Disputes in relation the application of the RIT-T**

- Clause 5.6.6A(a) permits registered participants, the AEMC, the market operator and other interested persons may, by notice to the AER, dispute conclusions made by the TNSP in a project assessment conclusions report. The dispute can be made in relation to:
  - the application of the RIT-T;
  - the basis on which the TNSP has classified the proposed transmission investment as being a reliability augmentation; or
  - the basis on which the TNSP has classified the proposed transmission investment as having a material inter-network impact.
- The dispute cannot be about issues that are treated as externalities by the RIT-T or relate to an individual's property rights (Clause 5.6.6A(b)).
- The notice of the dispute must be given to the AER within 30 days of the publication of the project assessment conclusions report. A copy must be given to the TNSP (Clause 5.6.6A(c)).
- Within 40 days of receipt of the dispute notice the AER must either:
  - reject the dispute notice if the AER considers the grounds invalid, misconceived or lacking in substance; or

- make and publish a determination directing the TNSP to amend the project assessment conclusions report or stating that no amendment is required ( Clause 5.6.6A(d)).
- In making its determination the AER:
  - must only take into account information that the TNSP could reasonably be expected to have considered or undertaken at the time of performing the RIT-T;
  - must publish its reasons for making a determination;
  - may request further information from the disputing party or TNSP (the disputing party or TNSP must provide the information requested by the AER);
  - may disregard any matter raised by the disputing party or the TNSP that is misconceived or lacking in substance (Clause 5.6.6A(e)).
- The AER may only make a determination directing the TNSP to amend a project assessment conclusions report if it determines that:
  - the TNSP has not correctly applied the RIT-T;
  - the TNSP has incorrectly classified an investment as being a reliability augmentation or incorrectly assessed whether the investment would have a material inter-network impact; or
  - there was a manifest error in the calculations performed by the TNSP in applying the RIT-T (Clause 5.6.6A(f)).

#### **5.1.11 Determination that new large transmission asset satisfied RIT-T**

Under clause 5.6.6AA(a), where an investment is not a reliability augmentation and the conclusion in a project assessment conclusions report is not in dispute the TNSP may request that the AER make a determination as to whether the investment satisfies the RIT-T.

Within 120 business days of receipt of the request the AER must make and publish a determination including reasons. The AER must use the findings and recommendations contained in the project assessment conclusions report, may request further information from the TNSP and may have regard to other matters that the AER considers relevant (Clause 5.6.6AA(b)).

#### **5.1.12 Amendments to Chapter 6A**

The proposed RIT-T Rules include a number of amendments to chapter 6A, essentially to require the AER to have regard to any relevant RIT-T project assessment conclusions reports when assessing a TNSP's proposed operational and capital expenditure. Such reports would contain substantial information on the

economic justification of the project which would assist the AER in its determination. The information contained in the reports would be an additional factor, among the other specified factors, that the AER would consider in approving a TNSP's revenue proposal.<sup>22</sup> It was considered by the Commission in the NTP Final Report that these amendments would further drive more efficient outcomes. The clauses affected are 6A.6.6(e), 6A.6.7(e) and 6A.6.7(b)(4).

### **5.1.13 Amendments to Chapter 11**

The proposed RIT-T Rules also included new provisions for insertion into chapter 11. They are required to account for the fact that if the proposed RIT-T Rules were made the AER would need twelve months to prepare the new RIT-T and related guidelines. In the mean time, the existing Regulatory Test would need to apply for transmission investments for the ensuing 13 months. The provisions in chapter 11 were designed to serve this purpose.

### **5.1.14 Other minor amendments**

Other amendments related to changing the reference from Regulatory Test to RIT-T. They are in Schedule 6A.2. The proposed RIT-T Rules also included consequential amendments to clauses 8.2.1, 9.3.2 and 9.28.3. A number of definitions have been deleted.

## **5.2 Application of the proposed RIT-T Rules and proposed modifications**

The Commission is proposing to largely adopt the MCE's proposed RIT-T Rules, as described above, subject to some modifications arising out of its own analysis and review. These modifications are considered to improve the application of the Rule and better promote the NEO. The manner and reasoning for the significant proposed amendments are set out below. The Commission is also proposing to make a number of consequential and minor drafting changes to improve the clarity and application of the Draft Rule.

### **5.2.1 Improve clarification and application of the RIT-T**

The Commission has identified a number of amendments that it considers would improve, and clarify the application of, the proposed RIT-T Rules. These amendments do not affect the principles behind the proposed RIT-T Rules as set out in chapter 4.

Most of these amendments related to how terms are defined and applied. A number of the definitions in the proposed RIT-T Rules have been moved to the main clauses of the Draft Rule as on balance, they appear to be better located in the main body of the Rules (e.g., credible option, preferred option).

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<sup>22</sup> NTP Final Report, p 75-76

Other proposed modifications include:

- a definition is no longer attached to the term ‘transmission investment’, rather it is merely referred to generally in the Rule without definition;
- the phrase ‘where the relevant credible option is an reliability augmentation, minimises the net economic costs’ has been included in the preferred option definition. This is to clarify that investments required to meet relevant jurisdictional Rule based reliability requirements may have negative net economic benefits;
- clause 5.6.5B(c)(4)(iv) has been amended to clarify that this refers to changes to capital and operational expenditure of other parties (e.g., generators, loads) and not to the TNSPs costs, which are captured in clause 5.6.6 B (c) (8);
- a requirement has been included in clause 5.6.5 B (c) (4) (ix) (A) that any other classes of benefits to be included in the assessment as determined by the TNSP must have been agreed to by the AER;
- a reference to TNSPs has been included in clause 5.6.5B(c)(9) for completeness;
- clause 5.6.5 B (c) (10) has been expanded to recognise that sensitivity analysis is required in the project assessment. This supports the direction to the AER requiring the scope of the RIT-T guidelines;
- some of the requirements regarding the content of the RIT-T guidelines, set in clause 5.6.5 B (d) have been amended to improve and clarify the scope of the guidelines;
- the application of the term of ‘credible option’ has been clarified to remove any duplication of varying concepts relating to the identification of credible options (see clause 5.6.5D (a));
- the definition of ‘identified need’ has been moved to clause 5.6.5C(a) and expanded to provide more guidance as to what issues can be an identified need; and
- the definition of reconfiguration investment has been amended to refer to investments which re-route one or more paths of the network other than on a temporary basis. Temporary re-routing of network paths is sometimes undertaken during augmentation of the network and such situations are not intended to be captured in this term.

## 5.2.2 Transitional Arrangements

As explained in section 5.1.13, the proposed RIT-T Rules would commence 12 months after they are made. Therefore transitional arrangements are needed to ensure that the current provisions continue to apply in the meantime. However the Commission notes that the proposed transitional provisions in clause 11.2 of the

proposed RIT-T Rules would only grandfather the *Regulatory Test* itself and the process for establishing the test, and not the consultation procedures followed by the TNSPs, nor the reporting procedures on new small transmission network assets.

Therefore existing clause 5.6.6 (which covers the existing consultation procedure for large network assets), clause 5.6.6A (process for new small transmission network assets) and clause 5.6.2A (5) (reporting requirements on new small transmission network assets) also need to be grandfathered.

### **5.2.3 Clarifying that the regulatory test will still apply to transmission investment which supports the distribution network**

The NTP Final Report makes clear that transmission investments which primarily address an issue on a distribution network would not be subject to the new RIT-T and the new RIT-T process, but will instead continue to be subject to the existing Regulatory Test and the existing consultation processes.<sup>23</sup>

This intent is confirmed in the proposed drafting of clauses 5.6.2(e) and 5.6.2(e1) of the proposed RIT-T Rules. However, the continuation of the Regulatory Test regime for some transmission investments is not fully reflected in the drafting of the proposed RIT-T Rules. In particular, clauses 5.6.2 and 5.6.5A need to be further amended to ensure that they capture not only applications of the Regulatory Test by distribution network service providers (DNSPs), but also applications by TNSPs (under joint planning processes), for transmission investment that supports the distribution network.

A related issue is whether the proposed RIT-T Rules provide sufficient clarity on the treatment of projects that result from the joint planning process. It is recognised that in practice, some potential projects may address both transmission and distribution network issues. For example, a projected limitation of the capacity of a major transmission/distribution connection point may be able to be addressed either by augmentation of the connection point by the TNSP or by augmentation to the distribution network by the DNSP to move load to alternative connection points.

The introduction of a separate test for transmission would result in two separate project assessment and consultation processes. Under the proposed RIT-T Rules, a TNSP would be required to conduct the RIT-T where the proposed project addresses a problem on the transmission network (subject to the exemptions set out in clause 5.6.5C), which achieves the policy intention of the MCE when it agreed to having a new test for transmission investment.

Therefore where a joint planning situation includes the possibility of transmission investment, the TNSP would be required to apply the RIT-T to identify the preferred option. It would be expected that TNSPs would work closely with DNSPs when conducting the joint planning process to identify the most economic option in such situations.

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<sup>23</sup> NTP Final Report, p.42-43.

#### **5.2.4 Achieve consistency with the implementation of AEMO**

It is anticipated that the AEMO will become operational on 1 July 2009. The proposed RIT-T Rules need to be amended to reflect this, mainly in relation to the AEMO taking over the responsibilities currently performed by the Inter-Regional Planning Committee.

#### **5.2.5 Achieve consistency with other Rule amendments**

In October 2008 the Commission made a Rule relating to the regulatory test thresholds and information disclosure on network replacement.<sup>24</sup> There is some overlap between the effect of this Rule and the proposed Rule. For example, this Rule introduced information requirements relating to replacement expenditure. Therefore clause 5.6.2 of the proposed Rule has been removed since the effect of this clause has already been achieved.

### **5.3 Commission's assessment**

The Commission has analysed and assessed the issues arising out of the Rule Change Proposal. Outlined below is the Commission's assessment of the Draft Rule (being the proposed RIT-T Rules amended in the manner suggested in section 5.2 above) and its explanation for why the Draft Rule meets the NEO.

#### **5.3.1 Amalgamation of the reliability and market benefits limbs of the Regulatory Test**

The Commission considers the RIT-T design in the Draft Rule, which amalgamates both reliability and market benefits, adequately addresses the issue raised by ERIG and reflected in the MCE terms of reference for the NTP Review around the limitations of the market benefits limb of the Regulatory Test.<sup>25</sup> The RIT-T ensures that all prospective investments are assessed both on their ability to meet the reliability standards and their ability to deliver market benefits. A common test means that all projects are assessed in the same manner irrespective of the primary cause of the investment.

#### **5.3.2 Assessment and consultation process**

The RIT-T project assessment set out in the Draft Rule involves TNSPs:

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<sup>24</sup> Regulatory Test Thresholds and Information Disclosure on Network Replacements – October 2008.

<sup>25</sup> In its report ERIG highlighted that over 90 per cent of projects submitted to the Regulatory Test have been submitted as reliability augmentations. ERIG indicated that many of these projects would have had both market and reliability benefits. However, due to the least cost assessment nature of the reliability limb, alternative options which have broader market benefits would **not** be deemed to have passed the Test if they are not least cost, regardless of any benefits that may accrue to the national market.

- issuing a project specification consultation report to all Registered Participants, NEMMCO and other interested parties and seeking submissions on the credible options presented, over a consultation period no less than 12 weeks;
- preparing a project assessment draft report which outlines the process of identifying the preferred option, taking into account submissions;
- seeking submissions on the project draft report, over a consultation period no less than 30 days; and
- as soon as practicable after the consultation period, issuing a project assessment conclusions report, taking into account submissions.

This can be compared to the current project assessment approach which involves TNSPs:

- sending a Request for Information for projects which have an estimated cost of more than \$10m and are not reliability augmentations;
- seeking submissions, over a consultation period no less than 8 weeks; and
- issuing an application note outlining reasons for proposed asset, which is published for 30 days.

Interested parties can make a submission to the application note and may request a meeting. TNSPs must then produce a Final Report, containing same detail as application notice and summarises submissions received.

The major difference between the current consultation process and the process proposed in the Draft Rule is the timing of providing information to market participants on the identified need and potential options to serve that need. The requirement for TNSPs to prepare a project specification report (which details the identified need and potential options) before any assessment of costs and benefits substantially brings forward this information for market participant consideration compared to the current approach.

This is likely to promote greater consultation from relevant stakeholders, which should help ensure that more potential options are identified, considered and quantified in terms of possible market benefits associated with the proposed investment options. This process should reduce the risk that efficient options are overlooked and ensure that broader market benefits are recognised under the project assessment process, and thus improve the application of the assessment and promote transparency. The Commission believes this framework provides a superior platform for non-network options to be considered, as well as quantifying the market benefits associated with credible options put forward.

### **5.3.3 Greater prescription of market benefits and costs**

Compared to the current Regulatory Test the Draft Rule provides greater prescription on classes of benefits and costs needed to be considered whilst

undertaking an investment assessment process. This is supported by the direction given to the AER regarding the content of the RIT-T guidelines.

The Commission considers this greater prescription in the Draft Rule will improve the consistency and transparency across transmission investment assessment, and should over time promote more efficient decision making. In addition, the requirement in the draft Rules to provide information on any classes of market benefits which occur outside the TNSP's region will promote a more strategic national focus for transmission investment which should lead to more efficient outcomes over time.

Furthermore, the specification of an additional market benefits category for option value in the draft Rules should facilitate a more strategic assessment of projects. This is likely to both optimise decision making and improve the efficiency of the transmission investment assessment.

#### **5.3.4 Scope of projects**

Under the Draft Rule, projects where the most expensive option is less than \$5 million are exempted from the project assessment process. The Draft Rule also clarifies the treatment of joint augmentation/replacement projects and reconfiguration investments, and provides an exemption for urgent and unforeseen investments.

This recognises the appropriate balance between ensuring that the appropriate range of projects are subject to a robust economic assessment and the timing and resources required to conduct the planning process.

#### **5.3.5 Selection of market benefits and costs to be quantified**

The Draft Rule allows the TNSP in each application of the RIT-T to identify and consult on which classes of benefits and costs that are likely to be materially relevant to the decision being made, thus allowing the TNSPs to apply judgment, supported by reasoning and analysis, to justify the specification of the RIT-T in any given case, with stakeholders given the opportunity to comment. This process should ensure that a proper assessment is undertaken on market benefits and costs whilst at the same time where possible it seeks to reduce, where possible, the regulatory burden faced by TNSPs, as such reflecting good regulatory practice.

#### **5.3.6 Exemption from project assessment draft report stage**

The Draft Rule permits a possible exemption from the project assessment draft report stage. This exemption should help prevent straightforward investment from being unnecessarily delayed where appropriate, thus reducing the regulatory burden faced by TNSPs and, as a result, promote good regulatory practice. The Draft Rule provides sufficient clarification and obligations to prevent this exemption from being inappropriately used. Furthermore such projects remain subject to the possibility of a dispute being raised.



### 5.3.7 Rule making test

The Commission is satisfied that the Draft Rule will or is likely to contribute to the achievement of the NEO, taking into account the revenue and pricing principles. The Draft Rule will promote the efficient investment in electricity services for the long term interests of consumers of electricity through:

- the amalgamation of the reliability and market benefits limbs of the Regulatory Test should optimise the decision making process in relation to transmission planning by promoting dynamic and allocative efficiency. By including the assessment of market benefits, the transmission process should promote more efficient investment over time;
- greater prescription of market benefits and costs and how they should be assessed should improve the consistency and transparency across transmission investment assessment and should, over time, promote more efficient decision making;
- requiring a project specification consultation should improve the transparency and application of the transmission assessment process which will ultimately promote more efficient outcomes over time;
- a substantial increase in the amount of consultation undertaken in relation to transmission assessment should unearth a greater number of efficient investment options and therefore lead to more efficient outcomes overtime; and
- exemptions from the project assessment draft report stage promotes the efficient use of resources where appropriate, thus reduces the regulatory burden faced by TNSP's and as a result promotes good regulatory practice.

The Draft Rule is also consistent with the revenue and pricing principles because, through greater consultation and more prescription of the costs and benefits to be assessed, the transmission planning process should identify more efficient investment. This will address the risk of the potential for under and over investment by the TNSP and the potential for under or over utilisation of the transmission network.

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## A Appendix

