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## **EUAA RIT-T Submission**

The Energy Users Association of Australia (EUAA) is the peak body representing major Australian energy users. Our membership covers a broad cross-section of the Australian economy including significant retail, manufacturing and materials processing industries.

The annual energy bills paid by our members collectively amounts to many billions of dollars and constitutes a significant cost to their business. Even small movements in energy prices can make a big difference to the financial stability of our members and greatly affects their ability to create employment and shareholder returns.

We welcome the Council of Australian Governments (COAG) review of the RIT-T regulatory test and its' impact on the National Electricity Objective (NEO) - of the long-term interests of consumers.

What can now be observed is consumers are paying a high price for failures in past network determinations when approved investment, operating costs and Weighted Average Cost of Capital (WACC) were all well above what an efficient network would need to build and operate the system to meet the NEO.

The paper notes (p.5):

“The key questions which will be considered as part of the Review are whether the RIT-T is, in its design and application, working effectively to deliver optimal NEM investment outcomes in all circumstances”

This is a very high bar that will be difficult to achieve. However, there is certainly scope to make significant improvements in the current regime. This submission makes comments in two areas:

1. What changes should be made to the current test to improve its efficiency and effectiveness to achieve the NEO, and
2. Whether the RIT-T test is fit for purpose depends on the “purpose” which is very confused now given the inconsistent Commonwealth and State energy and climate policies.

Before making comments in these two areas, this submission provides some context for how the EUAA and consumers more broadly see the debate on network regulation and why it has failed to achieve the NEO.

## **Some context and history from consumers' perspective**

Energy users have watched with varying levels of interest and dismay at how the NEO has been interpreted over time, generally by parties that are not consumers, as NEM policy has evolved.

In network regulation the NEO was interpreted as allowing networks to earn a secure rate of return to ensure the networks meet their reliability standards. The assumption being this was what consumers wanted. However, consumers have never been given the opportunity to balance price and reliability trade-offs. This most fundamental of conversations regarding the value consumers receive from marginally improved reliability against the cost of achieving this should have been at the forefront of the engagement process. This resulted in efforts to ensure network efficiency from both an operator and consumer perspective being severely limited.

This approach gave networks a very strong incentive to increase their Regulated Asset Base (RAB) given the allowable rates of return were much higher than the risk allocation between asset owners and consumers would suggest. Networks were very successful in increasing their RAB, leveraging their information asymmetry and a merits review process to their favor.

The Australian Energy Regulator (AER), along with consumer advocacy groups has highlighted these issues during the recent Limited Merits Review consultations.

In an attempt to “protect” consumers from unnecessary increases in this RAB, regulators have developed immensely complex rules like RIT-T, refined over many years to ensure economic purity. As the Review paper notes (p.5):

“...a cost benefit framework to ensure protection of the long term interests of consumers.”

And then effectively handed over implementation of RIT-T to the networks.

Unfortunately for consumers, the AER's RIT-T role is simply assessing compliance with the rules, such as did the network apply the cost benefit criteria correctly or did it consider and evaluate non-network options that have been proposed in the consultation process? They have no merits review type role from which a much broader, more holistic view could be arrived at.

Some may contend there is a substantial amount of information available to the public, however this all comes from the network. Consumers do not have the resources or detailed knowledge to critically analyse this information nor are they in a position to commission independent analysis of every application or decision.

What consumers do understand is price separation between adjoining regions with a congested interconnector, and the potential value of interconnector expansion. They realise there are many factors that can contribute to price separation, and acknowledge that interconnector expansion should be seriously considered. They are then told the cost benefit framework designed in their interests has an economically pure benefits test – where any price effects were simply a welfare transfer between generators and consumers and not a benefit to be included in evaluating whether an interconnector could pass the regulatory test.

While this may be an economically pure approach, consumers struggle to see how being prevented from getting access to lower prices was protecting their long-term interests. The fact that consumers may have been willing to hand over part of that cost saving in paying for an interconnector was again, apparently, not in their long term interests and has never been part of a broader discussion between users and proponents.

It is easy to understand why consumers began to be skeptical of how those who were not consumers sought to represent their interests and justifiably have lost confidence in the evaluation process.

What consumers also understand is that network regulation over the last 10 years has left a legacy of large increases in network prices and may have created stranded assets that consumers will have to pay for well into the future. During this period, actual and forecast rising peak demand was driving substantial new network investment.

However there was no willingness to apply any economic or equity test to pricing that peak demand which may have created the basis for strong demand side response mechanisms. The result is that the fall in overall grid demand means all consumers are left paying the bill for stranded assets for a 20<sup>th</sup> century grid built on very inefficient and inequitable power pricing.

Now we have the challenge to build a 21<sup>st</sup> century grid to ensure system security and reliability with much more distributed renewable generation. The prospect of adding many new interconnectors to their revenue asset base is naturally very attractive to networks, which have enthusiastically supported the need to build an integrated national 21<sup>st</sup> century grid.<sup>1</sup> The assumption seems to be that the RIT-T will be no barrier to ensuring these interconnection assets will be built.

We believe this assumption should be challenged. The rapid technological change and changes in relative prices now mean non-network solutions could be a cheaper alternative both now and well into the future. If this is not a consideration, consumers are worried that the RIT-T test is not going to ensure the most efficient solution is chosen.

As we look to the development of the network for the 21<sup>st</sup> century we continue to be worried about the network RAB incentive and whether we are going to look back in 20 years and lament the stranded assets that were supposedly designed for the 21<sup>st</sup> century grid. As the Issues Paper notes (p.14):

“...interconnectors are expensive, long lived assets”.

Networks are worried about the prospect of ‘disruptive technologies’ leaving too few customers drawing an ever-decreasing volume of energy through their network so that in 20-30 years there will be insufficient revenue to pay for these 21<sup>st</sup> century grids that are straight line depreciated.

Networks are now promoting a move to accelerated depreciation and demand charges as if this is in consumers’ interests. While we should be prepared to consider such a move we would warn that this could simply be another way for networks to recover their “low risk” position where volume and price risk is disproportionately held by consumers. At the very least consumers must be involved in decisions regarding their best interests rather than have their agreement assumed.

In short, consumers do not have confidence in a network regulatory regime that creates incentives on networks to inefficiently increase their RAB, where information asymmetry creates enormous barriers to entry for consumers seeking to participate in the debate, and where, in the case of RIT-T, networks control the process. This process has undermined achieving the NEO. In the next section this submission makes some suggestions to improve the existing RIT-T test with these issues in mind.

Reform is not only about tinkering at the edges with exiting mechanisms. It is about seeing how all parts best fit to achieve the NEO given the overall policy context that Governments are seeking to achieve. Unfortunately, this policy context is missing.

Unfortunately we currently see a complicated and inconsistent mix of Federal and State energy and climate policies that make it difficult to describe what a “fit for purpose” RIT-T test should look like. The final section of this submission makes comments on this.

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<sup>1</sup> E.g. ENA and CSIRO work as part of the Electricity Network Transformation Roadmap  
<http://www.ena.asn.au/electricity-network-transformation-roadmap>

All this discussion emphasises the need to be careful not to make “policy on the run” in response to a particular situation. For example, it is contended that additional interconnector capacity could have helped South Australia in recent months. However, we would note the development of interconnectors into South Australia has a chequered history with various campaigns by past State Governments, generators and merchant interconnectors seeking to get a particular advantage that did not have the NEO as their prime focus.

A second Basslink could provide greater security to consumers in Tasmania and a marketing opportunity for Tasmanian generators to sell into the NEM. A second Basslink to achieve the former should be evaluated against other non-network alternatives applied to an improved RIT-T test. Consumers need to have the confidence that if they are taking on the costs of a long life regulated asset that the benefits are worth paying for over the asset life.

A second Basslink to achieve the latter is not something that should be subsidised by consumers. If Tasmanian renewable generators have a comparative advantage vs. other NEM generators (e.g. fast response hydro or better wind resource) then this comparative advantage should be judged on the basis of the delivered costs of Tasmanian power to Victoria.

These delivery costs should not be cross-subsidised by consumers.

In all cases we need to ensure any revised RIT-T process does actually have the NEO as its focus.

### **Some suggestions on how to improve the current RIT-T process**

Following are key reforms to the RIT-T test the EUAA considers are necessary to ensure it is more aligned with the NEO.

#### *Improved consumer engagement*

The recent initiatives around the AER’s Better Regulation Program, the Consumer Challenge Panel and the ECA have all been welcome, but there is still a long way to go. There is still a huge information asymmetry between the networks and other stakeholders, particularly consumers.

Consumers, even large ones, see a complex process – of which the RIT-T is but one part, which to a large extent is a black box. When they lift the RIT-T lid and find that lower prices to consumers are not a benefit, they start to lose confidence in the test. Yet another part of the network regulation regime that appears to work against consumers. Further, when disputes arise over determinations and the matters move to the Australian Competition Tribunal, the consumer side is vastly under resourced to fund a challenge, in comparison the network businesses and the resources they can bring to the table.

While the test provides for public consultation, it is not surprising that consumer involvement in RIT-T evaluations has been small and generally focussed on seeking to have the benefits of lower prices recognised as a material consideration of the assessment process.

Given this, the EUAA sees great benefit in the AER and networks making increased efforts to improve consumer involvement in, and understanding of, the RIT-T test. This should be through an expanded stakeholder engagement process and review by the Consumer Challenge Panel for all RIT-T matters – with the model being that which networks undertake for the revenue reset process. It is important to regain consumer confidence in the RIT-T process, particularly with its extension to distribution.

#### *Strengthen its technology neutral approach*

This could involve more explicit directions on how to consider new and emerging technologies – the tests must evolve and move with these changes in technologies.

### *Greater powers and resources to the AER*

The AER should be given greater powers and resources to critically evaluate the cases prepared by networks and publish an independent review of the network proposal. Greater relevance and reliance on Benchmarking should also be considered.

Network regulation provides a strong incentive for networks to increase their RAB and hence reject non-network solutions. While the RIT-T test is designed to force networks to consider non-network solutions, there is no independent evaluation of whether they have and, if so, whether the analysis is a robust and transparent comparison. This is a role for the AER.

It is recognised that the AER is not a network-planning organisation in a technical sense, but it cannot make informed decisions on economic regulation without a core technical competence. This review ability should be supported by expert advice from AEMO. The EUAA supports the proposal made by the Productivity Commission which recommended AEMO prepare a

“...parallel independent analysis” to that prepared by the network and that this analysis “...should have presumptive force in the AER’s deliberations”<sup>2</sup>. As a result of this review, the

AER should have the power to reject a network proposal.

### *Support its extension to replacement capital*

In a low grid demand growth world, replacement capital is increasingly important. The EUAA supports the AER’s current rule change application to extend the RIT-T test (and RIT-D test) to replacement capital.

### **Is the RIT-T “Fit for Purpose”?**

The existing test was designed for a very different NEM than the one now evolving. The Issues Paper highlights the rapid changes currently underway from centralised to a decentralised generation environment. The role of Interconnection’ is changing from the bulk movement of power from centralised generation to consumers to having a greater role in spreading renewable generation across a broader area, increased energy security and providing ancillary services.

But to answer the question on “fit for purpose” we need to know what is the purpose? Is it the current policy context in Australia of?

- A Federal Government policy of 26-28% reduction below 2005 levels by 2030 which could be less than is required to meet Australia’s share of achieving a 2 degree world
- Individual State Governments pursuing different State based renewable and efficiency targets without any overall co-ordination
- No time of day pricing on either networks or energy components of delivered electricity prices
- No price on carbon
- Restrictions on the ability to develop demand response following a recent AEMC rule change<sup>3</sup>
- Straight line depreciation of network assets
- Consumers bearing stranded asset risk

Or is it something different? Clarity over all of these elements is crucial. For example time of day pricing could have a dramatic impact on network vs. non-network solutions. As would

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<sup>2</sup> Productivity Commission “Electricity Network Regulatory Frameworks” April 2013 Recommendation 17.1

<sup>3</sup> AEMC Draft determination on the Demand Response Mechanism and Ancillary Services Unbundling rule change 1<sup>st</sup> September 2016 <http://www.aemc.gov.au/News-Center/What-s-New/Announcements/Draft-determination-on-the-Demand-Response-Mechani>

demand response. As may a move to a 5-minute settlement period to the extent that it changes generator-bidding patterns.

A 50% renewables target in South Australia at the same time as a 40% renewables target in Victoria and a 50% target in Queensland, without any overall NEM co-ordination, is likely to require significant interconnector investment that is very unlikely to be approved under the current RIT-T test.

The EUAA believe the correct approach is not to modify the RIT-T test to enable these interconnectors to be approved in the RAB. It is to get the energy and climate policy framework aligned between the Commonwealth and States. Only then can we clearly see what regulatory structure best suits and supports this implementation.

The EUAA would offer the following points for longer consideration in the report to COAG:

- The Issues paper puts the NEO front and centre of its review. Have an explicit statement in the report to COAG around what application of the NEO actually means for RIT-T test. This would include justification of the benefits test as consistent with the NEO.
- Recognise that there is a lot of uncertainty – not just in Government policy but also in the pace of technological change. Discuss how changes in the RIT-T test adapt to this changing “purpose”. This means the best solution today might not be the best solution for the life of that asset. Discuss ways of addressing the stranded asset risk. What are alternative risk allocations between network owners and consumers, and who should bear this risk? Can we have a “no regrets” decision framework?
- Be explicit that the transition to a lower emissions electricity system is likely to cost a lot – and how should those costs, and risks, be shared?

Once again, thank you for the opportunity to make this submission. The EUAA remain open to further consultation and to discussing the detailed technical and cost benefit analysis when it is complete.

Regards



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