

3 September 2023

Ms Clare Savage
Chair
Australian Energy Regulator
7/2 Lonsdale Street
Melbourne VIC 3000

Electronic Submission – RITguidelines@aer.gov.au

AER Consultation Paper – Review of the cost benefit analysis guidelines and RIT application guidelines

Dear Ms Savage,

Energy Networks Australia (ENA) welcomes the opportunity to respond to the Australian Energy Regulator's (AER's) proposed draft amendments to its Cost Benefit Analysis (CBA) Guidelines and Regulatory Investment Test (RIT) for Transmission (RIT-T) and Distribution (RIT-D) Application Guidelines.

ENA is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide over 16 million electricity and gas connections to almost every home and business across Australia.

It is important that the operation of the Material Change in Circumstance (MCC) provisions and increased guidance on cost estimation are fit for purpose and result in outcomes that benefit consumers. Overall, ENA supports the AER's approach in the draft amendments of providing principles rather than prescription, whilst focusing on increasing transparency for consumers. As the AER recognises, the appropriate approach to both defining MCC reopening triggers and to cost estimation will vary depending on the specific nature of the RIT application, and it is important to maintain flexibility for the Network Service Provider (NSP) to adopt the most fitting approach. This will avoid unnecessary delays in the planning and evaluation process and increased costs for consumers in delivering the network infrastructure that is key to the energy transition.

In finalising the changes to the guidelines, ENA highlights the following points for the AER's consideration:

- » ENA supports the principles proposed by the AER to guide the identification of reopening triggers, and the non-prescriptive nature of this guidance.
- » ENA suggests refocusing some of the examples of reopening triggers, to set clearer expectations on what stakeholders could expect to see proposed as triggers in a RIT application.
- » ENA also suggests expanding the list of examples relating to actions that an NSP may take in response to an MCC event.
 - Re-applying the RIT in full (i.e., both the RIT analysis and the full RIT consultation process) is expected to only be required as a last resort. ENA

has provided some examples of more proportionate and timely actions that could be proposed in response to an MCC event.

- » ENA supports the introduction of a threshold for when the use of AACE cost classification must be considered by the NSP, but encourages the AER to clarify the precise definition and operation of this threshold:
 - Specifically, ENA considers the threshold should be where the estimated capital cost of the preferred option in the RIT exceeds \$100 million, in line with the threshold for the specification of reopening triggers, and that it is updated over time in line with the reopening trigger threshold;
 - ENA also considers that where the threshold is met, the NSP should retain the flexibility to consider applying the AACE classification system to each option in that RIT, rather than needing to apply the AACE classification across all options. Applying the AACE classification to all options will not always be proportionate or practical, particularly during the earlier stages of the RIT-T process and for options that initial analysis indicates are unlikely to be highly ranked.
 - The AER has also not addressed how the requirement to provide estimates to an AACE classification standard could be imposed on proponents of non-network options. Further, the AACE classification system does not extend to cost components such as land and biodiversity offset costs; and
 - ENA suggests that the threshold not apply to programs of works, but only single projects, so that it does not capture RIT-Ds applied to programs covering many small investments (which typically have a greater degree of cost certainty around individual cost components).
- » ENA supports the AER's guidance on sensitivity analysis being more broadly on those inputs/assumptions that may be material to the outcome of a particular RIT, instead of on one specific variable (e.g., costs).
- » ENA supports increased transparency around the assumptions and methodology adopted in deriving cost estimates. However, it is important that this provides meaningful information to consumers, is proportionate to the value of the proposed investment, and does not reveal commercially sensitive information or compromise outcomes in competitive tender markets.
 - ENA suggests that an appropriate level of cost disaggregation would be to the same level as the key asset and cost components identified in the NSP's regulatory proposals.
 - ENA also considers that references in the proposed guideline amendments to 'maximising' the accuracy and transparency of cost estimates would more appropriately be ensuring 'appropriate' accuracy and transparency, which can be expected to differ depending on the size of the RIT project.
 - ENA supports the AER's amended guidance being non-prescriptive on the inclusion of contingency allowances (as for many projects, cost estimates at the RIT stage do not generally include contingencies for specific risks)

- » ENA does not agree that ‘once the RIT is satisfied, there is little practical purpose to distinguishing early works from other activities’, and considers that such guidance would be helpful for early works contingent project applications. Further, ENA would be concerned if the AER were to disallow cost recovery for early works activities on the basis that those activities are already funded through regulatory allowances, whilst at the same time not allowing NSPs to seek cost pass through for a material increase in preparatory activities.

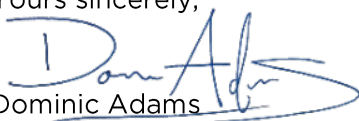
The above points are expanded on in the attachment.

Finally, ENA has consistently expressed reservations regarding the inclusion of binding obligations in RIT Application Guidelines. Given the likely binding nature of some of the AER’s amended guidance, it is important that the wording of the guidelines is sufficiently clear and precise. ENA has identified areas of the AER’s draft amendments where the wording could be improved and has provided a marked-up version of the AER’s draft amendments to the RIT-T Application Guidelines to illustrate these changes (noting that similar changes would also be appropriate for the other guidelines). We also suggest that the AER includes in the RIT-T and RIT-D Application Guidelines a list of the binding elements of the guidelines, similar to that currently included in Appendix A to the CBA Guidelines, to assist all parties in monitoring compliance.

ENA would be happy to meet with the AER if this would be beneficial in the next week or two. ENA and its members would also welcome the opportunity to review a near final set of draft guidelines prior to the final decision to ensure they are practical.

Should you have any queries on this response please feel free to contact Verity Watson, vwatson@energynetworks.com.au.

Yours sincerely,


Dominic Adams

General Manager - Networks

Attachment

RIT reopening triggers

ENA agrees with the AER that guidance in relation to the development of reopening triggers should not be prescriptive. A change in circumstances may be material to the outcome of one RIT application but not another, and the impacts of any given change in circumstances are likely to vary across options within a RIT application.

ENA supports the principles proposed by the AER to guide the development of reopening triggers, including that the triggers should identify circumstances that would have a real, rather than a potential, impact on the RIT outcome, and that they should be objective and capable of being verified. ENA also supports the triggers being identified where possible in light of the boundary values identified in the RIT application that could change the ranking of the preferred option (or result in it having negative net market benefits).

ENA has identified a small number of issues in relation to the proposed wording of the amended guidance. In particular, the draft amendments incorrectly refer to the \$100 million threshold for the RIT reopening trigger applying to the capital cost of a **credible option**, rather than the estimated capital cost of the **preferred option**.¹

ENA suggests this guidance is amended as follows:

“In addition to complying with the definition of a RIT reopening trigger, ~~for a credible~~ where the estimated capital cost of the preferred option ~~that~~ exceeds \$100 million (as varied in accordance with a cost threshold determination) and where AEMO is not the sole RIT-T proponent, a RIT-T proponent must propose one or more relevant RIT reopening triggers.”²

There are two further statements in the section of the draft amended guidelines relating to reopening triggers that ENA considers are currently unclear. ENA has provided alternative wording to improve clarity in an attached marked-up version of the AER’s draft amendments to the RIT-T Application Guidelines.

Examples – reopening triggers

ENA notes that all of the AER’s proposed examples relating to reopening triggers refer to changes from the Project Assessment Draft Report (PADR) (in the case of the RIT-T), or the Draft Project Assessment Report (DPAR) (in the case of the RIT-D).

Although the NSP will be consulting on the reopening triggers at the PADR/DPAR stage, the reopening triggers apply to the final RIT outcome. ENA therefore considers that the references in the examples should instead be to the Project Assessment

¹ The NER requirement is that the estimated capital cost of the proposed *preferred option* is greater than \$100 million. See NER clauses 5.16.4(k)(10), 5.16A.4(d)(9) and 5.17.4(j)(13).

² AER RIT-T Application Guidelines – draft amendments, section 4.5.1. The AER has proposed similarly worded amendments for the other guidelines.

Conclusions Report (PACR) (in the case of the RIT-T) or the Final Project Assessment Report (in the case of the RIT-D).

More generally, ENA considers that the examples could be improved to be more specific and to more clearly meet the principles set out by the AER. ENA understands that the examples are not prescriptive. However, they are likely to influence stakeholder expectations, including feedback on the draft triggers proposed at the PADR/DPAR stage, and so it is desirable for the examples to be as realistic as possible.

The examples relating to increases in the costs of the preferred option and decreases in the cost of alternative credible options are helpful. They could however be strengthened (and more clearly linked to the AER's proposed principles) by including a clearer link between the proposed cost metric (e.g., PV real cost increase of 10%) and the outcome of boundary testing in the relevant RIT analysis. For example, the first bullet point in Example 36 (for the amended RIT-T Application Guideline) could be amended to read:

Preferred option present value (PV) real cost increase of 10% or more (consistent with the boundary test analysis) compared to that applied in the relevant project assessment ~~draft~~ conclusion report.

Similarly, the percentage changes in the example relating to a demand shock could also be explicitly linked back to sensitivity analysis and/or boundary testing on different demand levels in that RIT application.

In relation to the other three examples proposed by the AER – a change in government policy, an 'Act of God' event and a technological change – in many cases these events would impact the RIT outcome through their impact on the costs of the preferred option (or an alternative option), and/or their impact on demand. As a consequence, these are circumstances which could give rise to the cost and/or demand triggers set out in the AER's earlier examples, rather than being circumstances which by themselves constitute a reopening trigger.

- » For example, the introduction of a specific government policy may increase the costs of the preferred option, but not by an amount which is sufficient to change the ranking of the preferred option. In this case it would not be appropriate for that government policy to be identified in itself as a reopening trigger.

ENA suggests that factors such as a specific government policy change or the emergence of a credible option that utilises a new technology may be better incorporated in the description of the factors that could lead to a cost change or demand shock as part of the examples of those trigger events, rather than being separately identified as examples of reopening triggers.

If the AER decides to keep these current examples, ENA suggests that:

- » The pre-ambule and the example itself may be better reversed for the change in government policy, 'Act of God' and technological change examples, as currently the examples presented are very general (and likely not appropriate as a

reopening trigger) whereas the preceding description in each case is more specific.

- » The example relating to technological change should avoid the use of words such as 'likely' and 'promising', which are not consistent with the example being focused on new technology which is a new 'credible option', and therefore which needs to be technically and commercially feasible.
 - ENA agrees with the AER that any new technology needs to represent a credible option, so that the reopening trigger is consistent with an event which would have a real (rather than a possible or potential) impact on the RIT outcome, and investment is not delayed by a requirement to consider new technologies which are not yet proven.
- » Including an example covering an 'Act of God' is unlikely to be helpful in practice because such events are often unforeseen and so are difficult to specify in advance in a meaningful way in a reopening trigger. Further, any Act of God which did have a material impact on costs and/or demand would either be picked up via those reopening triggers or could be considered as an MCC event even in the absence of a specific reopening trigger.

Examples – actions the NSP may take in response to an MCC

ENA notes that there is a continued emphasis in the AER's Explanatory Statement and in the proposed guideline amendments on 'reapplication of the RIT' in response to an MCC.³

The AEMC's final decision on the MCC Rule change made clear that reapplication of the RIT is expected to be a 'last resort',⁴ and that it is open to the NSP to propose other more appropriate courses of action that are less likely to delay investment. ENA suggests the examples provided on actions the NSP may take in response to a MCC could be expanded in the AER guidelines to better reflect this intent.

The RIT process encompasses both the NPV analysis to identify the preferred option, and the consultation process around both identifying potential options and the outcome of the NPV analysis.

Overall, application of the RIT is costly and time intensive. ENA believes it is in the interest of all parties if, where there is an MCC, the RIT is unwound to the minimum extent necessary to confirm that the appropriate investment option is being pursued. In many cases this is likely to only require updating the NPV analysis component of the RIT, and engaging with stakeholders on the findings, rather than unwinding the RIT process right back to the initial consultation report.

³ See for example the AER Explanatory Statement p.5, p.9 and p.14.

⁴ See AEMC, National Electricity Amendment (Material Change in Network Infrastructure Project Costs), Rule Determination, October 2022, p.iii, p. 5)

ENA has provided three examples below, to supplement those in the AER's draft guideline amendments.

ENA also notes that the example provided in the CBA Guidelines does not include reference to:

- » 'if the change in circumstance is complex (particularly where more than one key input or assumption is affected), reapplying the RIT-T'

Whereas this reference is included in the example in the amended RIT-T Application Guidelines, with an equivalent provision in the amended RIT-D guidelines.

Example 1: The proponent continues with the original preferred option, despite the MCC leading to another option becoming more highly ranked

A reopening trigger event occurs, leading to the following sequence of actions:

1. The proponent updates the RIT NPV analysis and finds that the second-ranked credible option would now be the preferred option, although only by a slim margin.
2. Substantial costs have already been sunk on the originally preferred option. Taking this into consideration, the proponent concludes that the original option should continue to be pursued.
3. The proponent presents the results of the updated NPV assessment and its decision to proceed with the original option to its customer reference group.
4. The proponent informs the AER (in line with the NER):
 - that an MCC has occurred;
 - the feedback received from its customer reference group; and
 - that it intends to continue with investment in the previously preferred option.

Example 2: Updated NPV analysis shows the second ranked option is now

preferred by a substantial margin, and the proponent decides to proceed with this option instead

A reopening trigger event occurs, leading to the following sequence of actions:

1. The proponent updates the RIT NPV analysis and finds that the previously second-ranked credible option is now the preferred option, by a substantial margin.
2. The proponent publishes the updated NPV analysis and its decision to now proceed with an alternative option, and seeks feedback from consumers. Since the second option has already been consulted on as part of the RIT process, and is now preferred by a substantial margin, a second detailed consultation process is not considered required.
3. The proponent informs the AER (in line with the guidelines) that:
 - o that an MCC has occurred;
 - o that it has updated the NPV analysis and sought feedback from consumers, who support pursuing the alternative option; and
 - o that it intends to re-issue the PACR/FPAR and pursue the previously second-ranked option.

Example 3: A new credible option is introduced as a result of the MCC – the proponent decides to re-issue the PADR/DPAR to allow for further stakeholder input

A reopening trigger event occurs, leading to the following sequence of actions:

1. The proponent identifies a new credible option as a consequence of the MCC event (e.g., use of a new technology).
2. The proponent updates the RIT NPV analysis and finds the new credible option to be top-ranked.
3. The proponent briefs its customer reference group and concludes it would be appropriate to re-issue the PADR/DPAR to allow for further consumer consultation, given the change in the nature of the preferred option.
4. The proponent informs the AER (in line with the guidelines):
 - o that an MCC has occurred;
 - o that it proposes to re-issue the PADR/DPAR; and
 - o the feedback it has received from its consumer representative group on this course of action.
5. Following AER approval of this course of action, the proponent reissues the PADR/DPAR with updated analysis and undertakes consultation in line with the usual PADR/DPAR process.

Cost estimation: use of the AACE cost estimation classification system

The AER's draft guideline amendments state that where the estimated costs of a credible option exceed \$100 million, a RIT proponent must:

- » in a RIT application, outline the process it has put in place, or intends to apply, to maximise the accuracy of all estimated costs;
- » consider use of the AACE cost estimate classification system; and
- » if a RIT proponent does not apply the AACE classification system, provide reasons to explain why.

Application to RIT-Ts

Consistent with our earlier submission, ENA is generally supportive of the adoption of a standard cost estimate classification system for RIT-T applications for projects over \$100 million, to provide greater transparency to consumers on the nature of the cost estimates. ENA therefore supports the intent of the AER's draft guidance for RIT-Ts, and the inclusion of a materiality threshold on when this guidance is binding.

ENA also supports the AER's approach of not mandating the level of accuracy that an NSP is required to apply within the AACE classification system. The AER has stated that it expects proponents to specify the level of accuracy of costs and explain why a cost estimate falls within the specified class.⁵ ENA notes that this guidance is not currently reflected in the draft amendments to the guidelines and suggests it could be added to ensure clarity on this point.

Given that this may be a binding element of the guidelines, it is important that the amended guidelines be clear in specifying both the cost threshold above which the guidance applies, and the consequence of meeting this threshold.

ENA therefore encourages the AER to clarify in its final guidelines:

- » that references to 'costs' above \$100 million is intended to be 'capital costs' above \$100 million (in line with the application of the \$100 million threshold for reopening triggers);
- » how the threshold will be updated over time:
 - ENA suggests the guidelines could explicitly link the threshold to the threshold applying in the Rules for RIT reopening triggers,⁶ to ensure it is

⁵ AER Explanatory Statement, p. 17.

⁶ As specified in NER clauses 5.16.4(k)(10), 5.16A.4(d)(9) and 5.17.4(j)(13).

updated over time in line with the AER's review of that cost threshold (which is a requirement under the Rules);

- » whether the threshold applies to the cost of the **preferred option** (which would be in line with the application of the \$100 million threshold for reopening triggers), or to **any credible option** evaluated in the RIT;⁷ and
- » whether, if the threshold is met, the NSP needs to apply the AACE classification system to the cost estimates for **all options** included in that RIT, including any that fall below \$100 million.

ENA highlighted in its earlier submission that mandating the use of the AACE classification system for all options in a RIT-T will not always be practical and is likely to increase the costs and timeframes for undertaking RIT-T assessments:

- » It is not clear how a requirement to provide estimates to an AACE classification standard could be imposed on third party non-network option (NNO) proponents. The AER has provided no response to this point in its Explanatory Statement.
- » Further, AACE classification does not extend to cost components such as land and biodiversity offset costs, which may be material for some projects.
- » In addition, there may be some options in a RIT-T which initial analysis shows are not expected to be top-ranked, and so the costs and extended timeframe associated with obtaining AACE class estimates are not likely to provide any benefits.

Further, it may be appropriate for the AACE classification adopted to vary across the course of a RIT assessment.

ENA therefore suggests that the AER retain flexibility in its guidance and that the consequence of meeting the threshold for considering AACE classification is not that a TNSP then needs to adopt the same AACE classification for all options included in that RIT-T. Rather, it would be appropriate for the NSP to retain the flexibility to consider the application of the AACE classification system separately for each of the options in a RIT for which the threshold is met, and to provide reasons where it decides not to apply the AACE classification (or to apply a different AACE classification) for any particular option. ENA has suggested the following wording in the attached mark-up to address this point:⁸

The AACE classification adopted may appropriately vary both across credible options within the same RIT-T, and at different stages of the RIT-T process, provided that in

⁷ Currently the AER Explanatory Statement and the draft guideline amendments contain conflicting statements on this point. For example, the AER Explanatory Statement refers to the threshold in the context of both 'projects over \$100 million' (p. 17) and 'the estimated cost of the preferred option is over \$100 million' (p. 25).

⁸ AER mark-up of RIT-T Application Guidelines section 3.5A.1. The same guidance should also be reflected in the other guidelines.

each case the cost estimates provide an appropriate basis for ranking the credible options under the RIT-T.

ENA also has concerns with the AER's proposed wording in the amended guidance of the obligation for the RIT proponent to:

'In a RIT-T application, outline the process it has put in place, or intends to put in place, to maximise the accuracy of all estimated costs.'⁹ (emphasis added)

The use of the word 'maximise' in this context is problematic, as it would always be possible to do more to improve the accuracy of the cost estimates, but with a consequential impact on timing and costs. Further, the proposed wording of this obligation could be interpreted as running counter to the AER's intent that the RIT proponent is able to determine the level of accuracy of the cost estimates appropriate and achievable at the RIT stage.

ENA suggests at a minimum that the obligation above be reworded along the following lines:

'In a RIT-T application, outline the process it has put in place, or intends to put in place, to ~~maximise~~ ensure the appropriate accuracy of all estimated costs.'

Similarly, the proposed reference to 'maximise' in the later part of that section of the guidelines (relating to projects below \$100 million) should also be amended:

"We also encourage all RIT-T proponents, where the estimated costs of a credible option is less than \$100 million, to consider outlining the process it intends to apply to ~~maximise~~ ensure the appropriate accuracy of all cost estimates."

However, ENA suggests that both of these elements of the guidance would be better removed, as they are already covered by the obligations in the following section of the guidelines¹⁰ on the transparency of the cost estimates (where reasons have to be given on why methodologies and processes have been adopted).

Application to RIT-Ds

ENA's earlier submission highlighted that it does not support mandating the adoption of a consistent cost estimate classification system for RIT-D applications, as this would impose additional costs and increase planning timeframes without any material offsetting benefits for consumers.

⁹ AER mark-up of RIT-T Application Guidelines section 3.5A.1. The AER has proposed similarly worded guidance for the other guidelines.

¹⁰ i.e., section 3.5A.2 of the RIT-Application Guidelines. The AER has proposed similarly worded guidance for the other guidelines.

ENA welcomes the AER's proposal to introduce a \$100 million threshold¹¹ for when a DNSP needs to consider adopting the AACE classification system for cost estimates. The majority of distribution projects fall below this threshold, and so will not be affected by this obligation.

There may however be programs of work for which DNSPs apply the RIT-D and which are above the \$100 million threshold. ENA understands from discussion at the AER public forum that the intent of the guidance is to provide greater transparency around the cost estimates used for large projects, rather than multiple smaller projects that make up a program. ENA therefore encourages the AER to consider amending the proposed threshold to explicitly exclude RITs where the credible options represent a program of works rather than an individual project.

ENA also notes that no DNSP currently adopts the AACE cost estimate classification system, and that adopting this system would incur substantial implementation costs. ENA recognises that the draft guidance provides flexibility for a DNSP to explain why it has not adopted the AACE cost estimate (in the case of major projects when the guidance applies). However, ENA still considers it would be preferable to remove this guidance from the RIT-D guidelines altogether.

Sensitivity analysis

The draft amended guidelines require RIT proponents to undertake sensitivity analysis where the cost of a credible option is over \$100 million, by varying one or more inputs and/or assumptions.

ENA supports the AER's revised focus for the guidance on sensitivity analysis from being on a specific variable (in particular 'costs'), to being more broadly on those inputs/assumptions that may be material to the outcome of a particular RIT. ENA agrees that the appropriate sensitivity tests will vary across RITs.

ENA supports the AER's inclusion of a materiality threshold for this requirement, whilst noting that sensitivity analysis is routinely undertaken for RIT-T and RIT-D assessments.

As in the case of the threshold for considering AACE classification, the cost threshold needs to be clearly specified in the guidelines, including:

- » that the reference to 'costs' above \$100 million is intended to be 'capital costs' above \$100 million;
- » how the threshold will be updated over time; and

¹¹ There is a need to clarify this threshold in the case of RIT-D projects, consistent with the discussion in the prior section for RIT-T projects.

- » whether the threshold applies to the cost of the **preferred option** (which would be in line with the application of the \$100 million threshold for reopening triggers), or to **any credible option** evaluated in the RIT.

Improved cost estimation transparency

The AER proposes to include a binding requirement in the guidelines for the RIT proponent to specify, for each credible option:

- » all key inputs and assumptions used to derive cost estimates;
- » a breakdown of the main components of the cost estimates;
- » the methodologies and processes applied in deriving the cost estimates;
- » the reasons in support of the key inputs and assumptions adopted and the methodologies and processes applied; and
- » where the NSP has included a contingency allowance, the level of that allowance and rationale for inclusion.

This obligation is proposed to apply to all RIT-Ts and RIT-Ds, and not only for options with a cost above \$100 million.

ENA supports the AER's focus on transparency around the approach and assumptions underpinning cost estimates, rather than being prescriptive on the cost estimation approach itself, which may appropriately vary across NSPs and across different types and sizes of projects. ENA also supports the AER's draft amendments being non-prescriptive on the inclusion of contingency allowances (as for many projects cost estimates at the RIT stage do not generally include contingencies for specific risks).

ENA is generally supportive of greater transparency relating to the cost estimates presented as part of RITs. However, as noted in our earlier submission, it is important that the information provided can be tailored to the particular investment and circumstances, so that consumers are provided with meaningful information. ENA therefore suggests that the amended guidelines avoid words such as 'maximising' the transparency of how cost estimates are derived, and are instead framed around 'greater' transparency (which is consistent with the AER's discussion in its Explanatory Statement¹²).

It is also important that the information provided does not reveal commercially sensitive information, or information that may indirectly impact the cost of future projects by affecting tender outcomes. In this regard, information on land values and unit rates for routine project works may be particularly sensitive.

¹² AER Explanatory Statement, p, 2.

In relation to providing a breakdown of the major components of the cost estimate, ENA considers that alignment with the asset and cost classes included in regulatory proposals is likely to represent an appropriate level of detail in most cases.

The AER recognises in its Explanatory Statement that there may be issues of confidentiality with providing detailed cost information.¹³ ENA suggests that confidentiality concerns are explicitly recognised in the wording of the guidelines:¹⁴

“Maximising Increasing the transparency of how a cost estimate of a credible option is arrived at is important. This includes, to the extent possible (and considering confidentiality concerns), identifying and disclosing the component parts or breakdown of that cost estimate.

Further, the draft amendments to the RIT-T and RIT-D Application Guidelines that, for each credible option, a proponent *must specify* various aspects of the cost estimation are not consistent with:

- » the AER’s expectation that costs be broken down *to the extent possible*¹⁵; or
- » Rules obligations for proponents for RIT-Ts for non-actionable Integrated System Plan (ISP) projects, and RIT-D projects, to provide total indicative capital and operating and maintenance costs *to the extent practicable*, for credible options.¹⁶

To address this issue, ENA’s marked-up edits to the RIT-T Application Guidelines add ‘to the extent practicable’ to the end of the text the leads into the list of elements of cost estimates that the AER suggests proponents specify for credible options. Although the Rules do not limit the extent to which costs for credible options for actionable ISP projects are to be quantified¹⁷, ENA considers the amendments we propose in the RIT-T Application Guidelines are also appropriate for section 4.3.4A of the CBA Guidelines.

Further, ENA has proposed also adding the words ‘and in a manner which is fit for purpose for that stage of the RIT-T’ to the end of this sentence in the amended guidelines. This more clearly allows the NSP to provide the required transparency in a way which is tailored to the nature of the project (e.g., a \$7 million Business As Usual project vs a \$100 million major project) and to the stage of the RIT-T assessment.

In terms of the proposed wording of the guidance on contingency allowances, ENA suggests amending the wording of the guidelines to recognise the AER’s intent that

¹³ AER Explanatory Statement, p. 16.

¹⁴ AER RIT-T Application Guidelines – draft amendments, section 3.5A.2. The AER has proposed similarly worded guidance for the other guidelines.

¹⁵ Ibid.

¹⁶ NER clauses 5.16.4(b)(6)(v) and 5.17.4(e)(6) (emphasis added).

¹⁷ NER clause 5.16A.4(d)(4).

the transparency requirements apply where the NSP has included a *material* contingency allowance.

ENA also suggests the following sentence in the guidelines (which imposes a binding requirement on the NSP) is removed, as it is not compatible with the role of cost estimates at the RIT stage, and will typically become relevant only at the time of a Contingent Project Application (CPA):

‘the methodologies and processes in place to minimise the likelihood of spending the contingency allowance.’¹⁸

Early works

ENA notes the AER’s draft decision not to provide additional guidance on the activities that may fall within the definition of ‘early works’ at this stage, but to instead wait for the expected Rule change that may allow early works to proceed ahead of RIT completion.

ENA does not agree with the AER’s conclusion that ‘once the RIT is satisfied, there is little practical purpose to distinguishing early works from other activities.’¹⁹ Under the existing Rules, following completion of the RIT-T for actionable ISP projects, TNSPs may lodge an initial CPA covering early works activities. As highlighted in ENA’s earlier submission, the provision of additional guidance on the types of activities that may be accepted by the AER as part of an early works CPA may provide greater certainty for both TNSPs and consumers, even under the current Rules.

Further, the AER highlights in its Explanatory Statement that even where activities fall within the AEMC’s description of ‘early works’, the AER may not consider additional cost recovery for those activities to be appropriate, including because they should fall within ‘preparatory activities’ which are covered by the TNSP’s revenue allowance.²⁰ ENA has previously highlighted the cost recovery uncertainty for unforeseen preparatory activities,²¹ and would be concerned if the AER were to disallow cost recovery for early works activities on the basis that those activities are already funded through regulatory allowances, whilst at the same time not allowing NSPs to seek cost pass through for a material increase in preparatory activities.

¹⁸ AER RIT-T Application Guidelines – draft amendments, section 3.9.4. The AER has proposed similarly worded guidance for the other guidelines.

¹⁹ AER Explanatory Statement, p. 21.

²⁰ AER Explanatory Statement, p. 21.

²¹ ENA submission to AEMC Transmission Planning and Investment Review, Stage 2 Draft Report, 14 July 2022, p.5 and p.8.

Other issues

In addition to the matters discussed above, ENA has also identified areas of the AER's draft guideline amendments where the wording could be improved or clarified. Given the likely binding nature of some of the AER's amended guidance, it is important that the wording of the guidelines is sufficiently clear and precise.

ENA has provided a marked-up version of the AER's proposed amendments to the RIT-T Application Guidelines alongside this submission to illustrate these changes, noting that similar changes would be appropriate for the other guidelines. The marked-up version also suggests improved or clarified wording in some cases.

ENA also notes that the exact wording of the amendments proposed across the three guidelines is not always consistent, even where the substance of the proposed guidance is the same. It would be preferable if the wording adopted was consistent, as far as possible, to avoid confusion.

Finally, ENA suggests the AER include in the RIT-T and RIT-D Application Guidelines a list of the binding elements of the respective guidelines, similar to that currently included in Appendix A of the CBA Guidelines. This would assist all parties in being able to readily monitor compliance. We also note that Appendix A in the CBA Guidelines will need to be updated to reflect the new areas of guidance provided by the AER.

Regulatory investment test for transmission

Application guidelines

ENA mark-up

Note: ENA's main submission suggests further changes to these guidelines not captured in this mark-up

July 2023



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AER Reference: 63054

Amendment Record

Version	Date	Pages
01	29 June 2010	76
02	18 September 2017	75
03	14 December 2018	105
04	25 August 2020	99
05	xxxxx	xxxx

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Shortened forms

Shortened form	Full form
ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
ALARP	as low as reasonably practicable
BAU	business-as-usual
conclusions report	project assessment conclusions report
consultation report	project specification consultation report
draft report	project assessment draft report
HILP event	high impact low probability event
IASR	inputs, assumptions and scenarios report
ISP	integrated system plan
MVA _r	mega volt-amperes (reactive)
MW	megawatt
MWh	megawatt hour
NEM	national electricity market
NEO	National Electricity Objective
NER	National Electricity Rules
network business	a distribution or transmission network service provider
REC	renewable energy certificate
RET	renewable energy target
RIT–D	regulatory investment test for distribution
RIT–T	regulatory investment test for transmission
SRMC	short-run marginal cost
TNSP	transmission network service provider
VCR	value of customer reliability

1 Nature and authority

1.1 Introduction

Consistent with the requirements of clause 5.16.2 of the National Electricity Rules (NER), this document (the RIT–T application guidelines) sets out guidance for the operation and application of the regulatory investment test for transmission (the RIT–T) for RIT–T projects that are not actionable integrated system plan (ISP) projects.

1.2 Authority

Clause 5.16.2 of the NER requires the Australian Energy Regulator (AER) to develop and publish, in accordance with the transmission consultation procedures, guidelines for the operation and application of the RIT–T for RIT–T projects that are not actionable ISP projects.

The RIT–T application guidelines must:

- give effect to and be consistent with the relevant provisions of the NER¹;
- provide guidance on:
 - the operation and application of the RIT–T;
 - the process to be followed in applying the RIT–T; and
 - how we will address and resolve disputes raised on RIT–T applications; and
- provide guidance and worked examples as to:
 - what constitutes a credible option;
 - acceptable methodologies for valuing the costs of a credible option, [including any acceptable cost estimate classification systems](#);
 - what may constitute an externality under the RIT–T;
 - the classes of market benefits to be considered;
 - the suitable modelling periods and approaches to scenario development;
 - acceptable methodologies for valuing the market benefits, including option value, competition benefits and market benefits that accrue across regions;
 - the appropriate approach to undertaking sensitivity analysis;
 - appropriate approaches to assessing uncertainty and risks, [including any appropriate role for contingency allowances](#); ~~and~~
 - when a person is sufficiently committed to a credible option for reliability corrective action to be a proponent; [and](#)

¹ NER cl, 5.15.2, 5.16.2–4, and rule 5.16B.

- [the purpose of, and appropriate approach to developing, RIT reopening triggers, as well as examples of potential RIT reopening triggers and the actions that may be taken in response to a RIT reopening trigger being triggered.](#)²

1.3 Role of the RIT–T application guidelines

RIT–T proponents must apply the RIT–T to all proposed transmission investments that are not actionable ISP projects, except in the circumstances described in NER clause 5.16.3(a).

These RIT–T application guidelines provide guidance on how RIT–T proponents will apply the RIT–T (including the process they must follow), and how we will address and resolve RIT–T disputes.

RIT–T proponents should read the RIT–T application guidelines in conjunction with the requirements in the RIT–T instrument and the relevant clauses of the NER.

1.4 Definitions and interpretation

In these RIT–T application guidelines, the words and phrases have the meaning given in the NER, or otherwise in the RIT–T instrument or glossary.

1.5 Process for revision

We may amend or replace these RIT–T application guidelines from time to time in accordance with the transmission consultation procedures and NER clause 5.16.2(e).

1.6 Version history and effective date

A version number and an effective date of issue will identify every version of these RIT–T application guidelines.

Each version of these RIT–T application guidelines will be effective from its effective date of issue, and RIT–T proponents should apply it as soon as practical. However, for compliance purposes concerning a RIT–T application, we will only have regard to the guidance that was in effect when a RIT–T proponent initiated the RIT–T in question. In this context, initiated means from the publication of a project specification consultation report (consultation report).

² We provide this guidance in section 3.2.4 as required under NER cl. 5.16.2(c)(9) for the purposes of NER cl. 5.15.2(b)(7).

2 Overview of the RIT–T

RIT–T proponents must apply the RIT–T in accordance with the procedures under NER clause 5.16.4 to assess the economic efficiency of proposed investment options. The RIT–T aims to promote efficient transmission investment in the national electricity market (the NEM) by promoting greater consistency, transparency and predictability in transmission investment decision making.

2.1 Purpose of the RIT–T

NER clause 5.15A.1(c) states that the purpose of the RIT–T is to:

... identify the *credible option* that maximises the present value of net economic benefit to all those who produce, consume and transport electricity in the *market* (the *preferred option*). For the avoidance of doubt, a *preferred option* may, in the relevant circumstances, have a negative *net economic benefit* (that is a net economic cost) to the extent the *identified need* is for *reliability corrective action* or the provision of *inertia network services* required under clause 5.20B.4 or the provision of *system strength services* required under clause 5.20C.3.

Fulfilling this purpose contributes to achieving the National Electricity Objective (NEO) to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity.³ Before investing in a large transmission project to meet a need on the transmission network, a RIT–T proponent must consider all credible options to meet that need, before selecting the option that maximises the net economic benefit across the market. This reduces the risk that consumers will pay for inefficient investments.

Requiring RIT–T proponents to consider all credible options, including where there is a nonnetwork proponent, promotes an environment where competition can occur and the most efficient investments go ahead. For instance, requiring RIT–T proponents to consider nonnetwork options on an equal footing supports efficient contestable market development. Also, in requiring that the most efficient investments to go ahead, the RIT–T promotes a predictable network development framework around which competitive investments in the NEM can be made without unnecessary risks arising from inefficient investment. All these factors encourage efficient outcomes in the longer term.

The RIT–T further promotes investment efficiency by imposing transparency and accountability on major transmission investment decisions. This contributes to the NEO to the extent that other efficiency incentives under regulatory regime are imperfect, or relatedly, to the extent that the economic interests of the RIT–T proponent differ from what maximises the net economic benefit across the market.

2.2 Projects subject to a RIT–T assessment

NER clause 5.16.3(a) requires a RIT–T proponent to apply the RIT–T to a RIT–T project that is not an actionable ISP project unless the project falls under defined circumstances (as discussed later in this section). NER clause 5.10.2 defines a RIT–T project that is not otherwise an actionable

³ National Electricity Law, Section 7.

ISP project as: a project to address an identified need that a transmission network service provider (TNSP) has identified, or a joint planning project if:

- at least one potential credible option to address the identified need includes investment in a network or non-network option on a transmission network (other than dual function assets) with an estimated capital cost greater than the cost threshold that applies under NER clause 5.16.3(a)(2); or
- the network service providers (network businesses) affected by the joint planning project have agreed that the RIT–T should be applied to the project.

A RIT–T proponent does not need to apply the RIT–T in the following circumstances:

- The RIT–T project is required to address an urgent and unforeseen network issue that would otherwise put at risk the reliability of the transmission network (see section 2.2.1).
- The estimated capital cost of the most expensive technically and economically feasible option to address the identified need is less than the RIT–T cost threshold (as varied in accordance with a 'RIT–T cost threshold' determination).⁴ For an explanation of what is 'economically feasible', see section 2.2.2. For an explanation of how external capital contributions relate to this RIT–T exemption, see section 2.2.3.
- The proposed expenditure (a) relates to maintenance, and (b) is not intended to augment the transmission network or replace network assets.
- The proposed investment is intended to re-route one or more paths of the network for the long term and has a substantial primary purpose other than to augment the network. The RIT–T proponent must reasonably estimate that the investment will cost less than the RIT–T cost threshold⁵ or is likely to have no material impact on network users.
- The identified need can only be addressed by expenditure on a connection asset, which provides services other than prescribed transmission services or standard control services. This is because the TNSP would be providing a specific customer with a connection service, and would be charging them for that service.
- The cost of addressing the identified need is to be fully recovered through charges other than charges in respect of prescribed transmission services or standard control services. For an explanation of how external capital contributions relate to this RIT–T exemption, see section 2.2.3.
- The proposed expenditure relates to a 'protected event emergency frequency control scheme' investment and is not intended to augment the transmission network.
- The proposed expenditure is an inertia service payment or a system strength service payment.

⁴ Under clause 5.15.3 of the NER, we must review RIT–T cost thresholds every three years. We will publish details regarding any review of the RIT–T thresholds (including any revisions to this threshold) on our website www.aer.gov.au. This threshold was \$6 million at the time of drafting.

⁵ For further details see the previous footnote.

- The proposed expenditure is for network investment that the TNSP undertakes to satisfy its obligation as an Inertia Service Provider or System Strength Service Provider under NER clause 5.20B.4 or clause 5.20C.3, respectively and:
 - immediately prior to the Australian Energy Market Operator (AEMO) giving the shortfall notice, the TNSP was not obligated to provide the inertia network services for that inertia sub-network or the system strength services for that fault level node; and
 - the TNSP has less than 18 months after the notice is given by AEMO to make the inertia network or system strength services available.

In determining whether a RIT–T proponent must apply the RIT–T to a proposed project, that proponent must not treat different parts of an integrated solution to an identified need as distinct and separate options.⁵

A TNSP must apply the RIT–T to an asset replacement program if the expected capital costs of the program are above the RIT–T cost threshold and if the program is to address an identified need. For applying this guidance, we consider that an asset replacement program to address an identified need is a proactive program replacing multiple assets of the same type as part of one plan to meet a network investment objective. For example, this might include a program to proactively replace a large number of protection relays prior to failure. This type of program might be driven by cost savings from bulk replacement and expected benefits from avoiding costs associated with an increased probability of failure. For specific information on performing economic assessments on replacement programs, see our industry practice application note on asset replacement planning.⁶

For completeness, asset replacement programs for the purpose of the above guidance differ from ongoing efforts to reactively replace multiple small assets, such as ongoing work to replace pylons that have failed inspection or serviceability tests. We would expect that this latter type of expenditure would be captured in the revenue allowance as business-as-usual (BAU) replacement expenditure.

NER clause 5.16.3(d) requires that where a TNSP does not need to apply the RIT–T to a proposed investment (with the exception of funded augmentations)⁷, it must ensure, acting reasonably, that the investment is planned and developed at least cost over the life of the investment. That is, the TNSP must still act reasonably to plan and deliver the investment efficiently.

More generally, since the principles behind the RIT–T represent good practice, we encourage TNSPs to perform transparent efficiency assessments, engage effectively with their stakeholders, and procure solutions competitively wherever possible. To assist in the latter, we encourage TNSPs to proactively develop relationships with non-network businesses and make useful and user-friendly data available in their annual planning reports and other relevant documents. TNSPs should use their discretion in determining the rigour they apply to their investment

⁵ See NER, cl. 5.16.3(e).

⁶ AER, *Industry practice application note: Asset replacement planning*, January 2019.

⁷ A funded augmentation is a transmission network augmentation for which a TNSP is not entitled to receive a charge under NER chapter 6A.

decisions, which should be commensurate with the magnitude and risks associated with the investment at hand.

2.2.1 Urgent and unforeseen investments

As outlined in NER clause 5.16.3(a)(1), a RIT–T proponent does not need to apply the RIT–T to a RIT–T project to address an urgent and unforeseen network issue that would otherwise put the reliability of the transmission network at risk. Under NER clause 5.16.3(b), a RIT–T project is only subject to this exemption if:

- it is necessary that the assets or services to address the issue be operational within six months of the issue being identified;
- the event or circumstances causing the identified need was not reasonably foreseeable by, and was beyond the control of, the network business (or businesses) that identified the identified need;
- a failure to address the identified need is likely to materially and adversely affect the reliability and secure operating state of the transmission network; and
- it is not a contingent project.⁸

2.2.2 Economically feasible

Under NER clause 5.16.3(a)(2), a RIT–T proponent need not apply the RIT–T where the most expensive option to address the identified need that is technically and economically feasible is less than the RIT–T cost threshold. We provide this guidance because the NER do not define the term, 'economically feasible' for the purpose of this clause.

Whether an option is economically feasible will depend on the particular circumstances surrounding the RIT–T assessment. However, as general guidance, an option is likely to be economically feasible where its estimated costs are comparable to other credible options that address the identified need. One important exception to this general guidance applies where a credible option or options are expected to likely deliver materially higher market benefits. In these circumstances, the option may be 'economically feasible' despite the higher expected cost.

2.2.3 Capital cost thresholds and external contributions

A RIT–T project is exempt from a RIT–T application if the estimated capital cost of the most expensive option to address the identified need that is technically and economically feasible is less than the RIT–T cost threshold.⁹ Since the NER refer to the capital cost of an option, an external financial or capital contribution would produce an exemption if it reduced the capital cost of the option to be below the RIT–T cost threshold.

In practice, this means a RIT–T application is not required for a RIT–T project if an external contribution results in the project falling below the RIT–T cost threshold. In these circumstances,

⁸ We determine contingent projects under NER clause 6A.8.1(b) as part of a transmission revenue determination.

⁹ NER clause 5.16.3(a)(2). The RIT–T cost threshold is currently \$6 million and will remain \$6 million until at least end-2021. See AER, *Final determination: Cost thresholds review*, November 2018.

the external contribution means that, to the extent of that contribution, the costs of the project do not need to be recovered from electricity consumers via the regulated charges of the relevant network business (or businesses).

3 Operation and application of the RIT–T

This part of the RIT–T application guidelines provides guidance on the operation and application of the RIT–T. The broad steps for applying the RIT–T are:

1. identify a need for the investment, known as the identified need (section 3.1);
2. identify a set of credible options to address the identified need (section 3.2);
3. characterise the base case, under which to compare credible options (section 3.3);
4. identify reasonable inputs to include in the cost benefit analysis (section 0);
5. quantify the expected costs of each credible option (see section 3.5);
6. identify what classes of market benefits to quantify (see section 3.6);
7. quantify the expected market benefits of each credible option, by:
 - (a) identifying a set of reasonable scenarios under which to derive states of the world to compare the market benefits of that credible option relative to the base case; and
 - (b) calculating the expected market benefit of that credible option over a probability weighted range of reasonable scenarios (sections 3.7, 3.8, 3.9 and appendix A); and
8. quantify the expected net economic benefit of each credible option and identify the preferred option as the credible option with the highest expected net economic benefit (section 3.10).

3.1 Identified need

Chapter 10 of the NER defines an identified need as the objective a network business seeks (or network businesses seek) to achieve by investing in the network. Either a network or a non-network option may address an identified need.

An identified need may consist of:

- an increase in the sum of consumer and producer surplus in the NEM;
- reliability corrective action, as defined in NER 5.10.2;
- the provision of inertia network services required under NER clause 5.20B.4; or
- the provision of system strength services required under NER clause 5.20C.3.

The following guidance is relevant to identified needs for reliability corrective action:

- NER 5.10.2 defines reliability corrective action as a network business' investment in its network to meet 'the service standards linked to the technical requirements of schedule 5.1 or in applicable *regulatory instruments*¹⁰ and which may consist of *network options* or *non-network options*'.

¹⁰ See NER chapter 10 for a definition of 'applicable regulatory instruments'.

- Applicable regulatory instruments include all laws, regulations, orders, licences, codes, determinations and other non-NER regulatory instruments that apply to Registered Participants to the extent that they regulate or relate to network: access, connection, services, service price or augmentation. Given this, the matters covered by applicable regulatory instruments are quite broad.
- The capital expenditure objectives in NER clause 6A.6.7(a) should guide RIT–T proponents when considering what service level outcomes are required to meet the above service standards.

In all cases, it is essential that RIT–T proponents express the identified need as the achievement of an objective or end, and not simply the means to achieve the objective or end. This objective should be expressed as a proposal to electricity consumers and be clearly stated and defined in RIT–T reports¹¹, as opposed to being implicit. Framing the identified need as a proposal to consumers should assist the RIT–T proponent in demonstrating why the benefits to consumers outweigh the costs. That is, the RIT–T proponent should articulate its investment objective to increase consumer and producer surplus in the NEM or undertake reliability corrective action as an objective to deliver a benefit or benefits to electricity consumers.

Framing an identified need as an objective more broadly, rather than a means to achieve an objective, should prevent biasing the development of credible options towards a particular solution. NER clause 5.15.2(b) prescribes that RIT–T proponents must consider all options that could reasonably be considered credible options. In doing so, RIT–T proponents must take several factors into account; including energy source, technology, ownership, the extent it enables electricity trading, whether it is a network option or a non-network option, whether it is intended to be regulated, whether it has a proponent, and any other reasonable factor. RIT–T proponents should consider these factors without bias. A description of an identified need should not mention or explain a particular method, mechanism or approach to achieving a desired outcome.

For the above reasons, it is important to frame the identified need well from the start of the RIT–T application process. On this basis, RIT–T proponents might find it valuable to engage with key stakeholders (including consumer representatives and ourselves) on framing the identified need early on, potentially even prior to formally commencing the RIT–T process.

Example 1: Framing an identified need

A RIT–T proponent has concerns over the levels of reactive power near a terminal station and needs better voltage support. It considers that installing additional capacity banks would be a good way to provide this support.

The RIT–T proponent should frame the identified need as:

- an increase in producer and consumer surplus, reliability corrective action as defined in NER 5.10.2, the provision of inertia network services under NER clause 5.20B.4, or the provision of system strength services under NER clause 5.20C.3. If the identified need is for reliability corrective action, the identified need must point to the clear service

¹¹ That is, the reports the RIT–T proponent must publish under NER clause 5.16.4.

standard obligation to justify the network investment in question. If otherwise, and if neither clauses 5.20B.4 or 5.20C.3 apply, the identified need must be driven by an increase in consumer and producer surplus;

- an objective, rather than a means to achieve an objective. In this example, an appropriate objective would be 'enhancing the voltage support in the vicinity of the terminal station'. In contrast, a means to achieve the objective might be, 'installing additional capacitor banks at the terminal station'; and
- a proposal to consumers. To assist consumers in engaging with the RIT–T application, it is valuable for them to understand why it is in their interest to meet the identified need. Given this, in describing an identified need, a RIT–T proponent may find it useful to explain what will or may happen if it performs BAU activities rather than taking a specific action to address the identified need. For example, better voltage support might deliver benefits to consumers by increasing the quality of electricity supply, and preventing brownouts, blackouts and damaged electrical appliances.

3.2 Credible options

This section provides guidance on how to apply NER clause 5.15.2(a), which provides that a credible option is an option (or group of options) that:

- addresses (or address) the identified need. That is, achieves the objective that the RIT–T proponent seeks to achieve by investing in the network;
- is (or are) commercially and technically feasible; and
- can be implemented in sufficient time to meet the identified need. That is, can be implemented to meet any specific timing imperatives of the RIT–T proponent's objective.

To the extent possible, RIT–T proponents should construct credible options using individual options that meet identified needs over broadly similar timeframes. This facilitates the use of similar modelling periods (see section 3.12) and increases the transparency and robustness of the analysis.

For meeting a service standard, the RIT–T proponent's choice of credible options should reflect the degree of flexibility offered by that service standard. For example, a standard might refer to maximum levels under the system average interruption duration index and the system average interruption frequency index across the RIT–T proponent's network over a year. In this case, the RIT–T proponent should consider options at various locations on its network if some credible options could be more effective in limiting the network-average interruptions that increase these indexes than if it restricted its attention to options in a single area.

In addition to helping stakeholders interpret the elements of NER clause 5.15.2(a), this section also provides guidance on determining a reasonable number and range of credible options, and on developing credible options with option value.

3.2.1 Addressing the identified need

As discussed in section 3.1, an identified need is the objective that a network business (or network businesses, in the case of joint planning) seeks (or seek) to achieve by investing in the

network. An option addresses an identified need if the RIT–T proponent reasonably considers that the option would, if commissioned within a specified time, be highly likely to meet that identified need.

Since a credible option can be an option or group of options that address an identified need, a set of projects may constitute one credible option if they form one integrated solution to meet an identified need.

Example 2 provides guidance on two different types of identified needs, along with credible options to meet each of those identified needs.

Example 2: Identified need and credible options

Identified need driven by service standards

Changing patterns of generation investment have increased the likelihood of breaching voltage service standards in the next few years.

The identified need in this example is to ensure that voltage standards as outlined in Schedule 5.1 of the NER continue to be satisfied. In stating this identified need, we would expect the RIT–T proponent to explicitly reference the relevant NER clause (or clauses), as well as specify the timing and extent of the breach expected.

An example of a credible option to address this identified need is the installation of one or more voltage control network elements, such as a static volt-ampere reactive compensator.

Identified need driven by market benefits

The identified need in this example is an (expected) increase in net economic benefits compared to the base case, which is expected to benefit electricity consumers through lower electricity costs. In formulating credible options to meet this identified need, we would expect the RIT–T proponent to reference the driver (or drivers) of the net economic benefits expected to flow from the credible option. For instance, a transmission augmentation could be justified if it was expected to reduce variable operating costs from facilitating the substitution of high-fuel cost plant with low-fuel cost plant, thereby lowering generation costs for electricity consumers.

An example of a credible option to address this identified need is the augmentation of network element(s) that would increase the capacity of the area's existing link.

Identified need driven by safety

Routine inspections of a substation have revealed that twelve transformer bushings installed in the 1960s and 1970s are now in poor condition. If the identified bushings remain in service, there is an increased likelihood that a number of these assets will fail in future years, which could result in projectiles, fires and oil spills that present an intolerable risk to those in the immediate vicinity, and potentially the wider area.

This situation might lead to an identified need that is driven by an increase in consumer and producer surplus if there is a NEM-wide economic justification for addressing that safety risk. For instance, credible options that prevent the safety risk from materialising may avoid involuntary load shedding and reduce operating and maintenance costs incurred by other parties.

Where an applicable jurisdictional Electricity Safety Act requires that safety risks be managed in accordance with the 'As Low As Reasonably Practicable' (ALARP) principle, this requirement might justify valuing safety risks using a 'gross disproportionate factor'. For example, a gross disproportionate factor might include valuing death at three, six or 10 times the value of statistical life. The RIT–T proponent must justify its use of any gross disproportionate factor and reference the compliance requirement driving its use of that factor.

3.2.2 Commercially and technically feasible

An option is commercially feasible under NER clause 5.15.2(a)(2) if a reasonable and objective operator, acting rationally in accordance with the requirements of the RIT–T, would be prepared to develop or provide the option in isolation of any substitute options.

NER clause 5.15.2(d) prevents a RIT–T proponent from rejecting an option that would otherwise satisfy the RIT–T on the basis that it lacks a proponent. Such an option would be commercially feasible because, if undertaken, it would satisfy the RIT–T and therefore provide the investor with a reasonable expected return. This requirement prevents a RIT–T proponent from 'gaming' the RIT–T by only agreeing to act as a proponent for a network option that is over-engineered, more expensive and less net beneficial than other network options. Example 3 below provides an example of this.

An option is technically feasible if there is a high likelihood that it will, if developed, provide the services that the RIT–T proponent has claimed it could provide for the purposes of the RIT–T assessment. In providing these services, the option should also comply with relevant laws, regulations and administrative requirements. Technical feasibility will always turn on the relevant facts and circumstances, although example 3 provides a brief stylised example.

Example 3: Feasibility of options

Commercial feasibility

The most likely option in a particular area for enhancing the sum of consumer and producer surplus is to augment an existing 150 km transmission line between a group of generators and a major load centre.

However, the RIT–T proponent refuses to act as a proponent for this option and thereby claims that the option is not a credible option for enhancing net economic benefits. Instead, the RIT–T proponent proposes a more expensive option involving a line following a longer (300 km) route than the existing line.

In this case, the cheaper augmentation must be considered a credible option, because a reasonable and objective RIT–T proponent would be willing (in isolation of any other substitute projects it might have in mind) to construct it if it passed the cost benefit analysis set out in the RIT–T.

Technical feasibility

A non-network proponent has suggested a local geothermal generation option as an alternative to the network option above. According to the proponent, the local geothermal option would provide the same services as the RIT–T proponent's proposed network option.

However, the RIT–T proponent identifies that the proposed location for the geothermal option displays geological characteristics that are expected to challenge the technical viability of geothermal generation. The RIT–T proponent also identifies that there has been little testing of geothermal technology in locations with similar geological conditions in Australia or internationally. In this case, it could exclude the geothermal plant from being considered as a credible option due to a lack of technical feasibility.

3.2.3 Developing credible options with option value

A RIT–T proponent may find value in retaining flexibility to respond to changing market developments or scenarios as they emerge where there is material uncertainty and the option/s it is considering involve a sunk or irreversible action. For example, where there is uncertain future demand for connections from wind generators at a remote connection point, it may be efficient for the RIT–T proponent to configure the connection assets so they can easily augment them in the future should additional demand for connections at this connection point arise.

A credible option may include a decision rule or policy specifying, not just an action or decision to take now, but also an action or decision to take in the future if the appropriate market conditions arise. For example, where future demand growth is uncertain, the following may all be legitimate credible options:

- Option (a): fully upgrade a transmission line in the immediate term to accommodate all likely demand growth over the next 15–20 years.
- Option (b): upgrade a transmission line to cover likely demand growth in the next five years (without any further consideration of the potential for further growth in the future) coupled with a generic non-network option if necessary, following a decision based on the same 'decision rule' as for option (c) (see below). While this option should be lower cost than Option (a) in most if not all scenarios, it should also have lower market benefits than Option (a), particularly after year five under higher demand scenarios.
- Option (c): upgrade a transmission line as per Option (b), but also allow for sufficient extra space (perhaps by installing larger towers than necessary) to allow for a relatively low-cost expansion of the network following a decision based on a 'decision rule' (for example, if peak demand reaches a specified level). The extra space provided under this option would likely incur an additional up-front cost relative to Option (b). To capture the higher market benefits of this option relative to Option (b), the RIT–T proponent would need to include a scenario where peak demand reaches the specified level, and then model the costs and benefits of the second stage expansion versus the costs and benefits of the non-network supplementary project that would be triggered under option (b).

For clarity, when a decision rule leads to a new stage of the RIT–T project ('stage two'), the RIT–T proponent should:

- transparently update stakeholders on how it applied its decision rule to commence stage two, such as by providing an addendum to its project assessment conclusions report (conclusions report); and
- apply a new RIT–T before commencing the second stage of the RIT–T project if:
 - the stage two investment passes the RIT–T cost threshold; and
 - there has been a material change in circumstances beyond the contingencies explored in the decision rule. As an example, while

the decision rule under Option (c) above was based on peak demand reaching a specified level, there may have been a material change in input costs that was not consistent with stage two of the preferred option identified. Another material change in circumstances could be the formerly unforeseen availability of an alternative credible option, such as demand response provided by a virtual power plant program.

The ability of a RIT–T proponent to formulate credible options incorporating a decision rule or policy enables the RIT–T cost benefit analysis to include option value as a potential source of market benefit. Section 3.9 discusses this further by providing guidance on identifying credible options where there is a material degree of uncertainty.

3.2.4 Number and range of credible options

NER clause 5.15.2(b) requires a RIT–T proponent to consider all options it could reasonably classify as credible options, taking into account:

- energy source;
- technology;
- ownership;
- the extent to which the credible option enables intra-regional or inter-regional trading of electricity;
- whether it is a network or non-network option;
- whether the credible option is intended to be regulated;
- whether the credible option has a proponent; and
- any other factor that the RIT–T proponent reasonably considers should be taken into account.

The number of credible options that a RIT–T proponent assesses for meeting a particular identified need should be proportionate to the magnitude of the likely costs of any credible option. For example, if the RIT–T proponent reasonably estimates that a credible option to meet an identified need was \$50 million, then it should consider a larger number and range of credible options than if the estimated cost of most credible options was around \$10 million, all other things being equal.

Criteria for proponents of credible options

NER clause 5.16.2(c)(9) requires the RIT–T application guidelines provide to guidance on when a person is sufficiently committed to a credible option for reliability corrective action to be characterised as a proponent. Specifically, this guidance is for the purposes of NER clause 5.15.2(b)(7), which requires RIT–T proponents to consider all options that could reasonably be considered as credible options, taking into account whether the credible option has a proponent.

We consider a person can be characterised as a proponent of an option where they have identified themselves to the RIT–T proponent in writing that they are a proponent of an option and have reasonably demonstrated a willingness and potential ability to devote or procure the required human and financial resources to:

- refine and develop the technical specifications of the option if the RIT–T proponent agrees to consider the option as a credible option under the RIT–T application; and
- develop the option if it is identified as the preferred option under the RIT–T. This requires, for example, that the person has expressed a willingness to accept a reasonable network support agreement to develop the credible option for a price no higher than what reasonably reflects the costs of the credible option applied in the relevant RIT–T assessment.

There may be more than one proponent for a given credible option.

3.3 Characterising the base case

The base case is where the RIT–T proponent does not implement a credible option to meet the identified need, but rather continues its 'BAU activities'. 'BAU activities' are ongoing, economically prudent activities that occur in absence of a credible option being implemented. For RIT–T projects concerning asset retirement, replacement or de-rating decisions, the following costs are associated with BAU activities:

- Operational, maintenance and minor capital expenditure (below the RIT–T cost threshold) required to allow the ageing element to remain in service as effectively as possible for as long as possible.
- Credible BAU expenditure relating to the deteriorating asset to manage safety risk, environmental risk and equipment protection to the extent this expenditure meets legal obligations or is consistent with efficient industry practice. The RIT–T proponent should also consider any quantified 'risk costs' consistent with its BAU risk mitigation and management activities and with reference to our 'industry practice application note for asset replacement planning'.¹²

Generally¹³, the trigger point for the timing of the credible option for a replacement RIT–T project would be when the present value of the monetised service costs exceed the present value of the replacement project costs.

Example 4 illustrates characterisation of the base case where the identified need for a credible option is to increase the sum of consumer and producer surplus in the NEM.

¹² AER, *Industry practice application note: Asset replacement planning*, January 2019.

¹³ There may be exceptions, such as when an identified need is for reliability corrective action.

Example 4: Characterising the base case for market benefit driven projects

Augmentation project to provide a net economic benefit

A RIT–T proponent is considering a network augmentation to avoid an increase in the expected volume of unserved energy as load at a particular location on its network grows.

No mandatory service standard or regulatory instrument is driving the augmentation to avoid expected load shedding, nor are requirements under clause 5.20B.4 or 5.20C.3 of the NER. This implies that the identified need must be driven by an increase in the sum of consumer and producer surplus in the NEM. Accordingly, the base case for the RIT–T assessment must refer to a state of the world in which the RIT–T proponent does not pursue the augmentation project nor implement any other credible option to meet the identified need.

While this base case option in the face of ongoing load growth may eventually result in what appears to be unrealistically high levels of expected unserved energy, what is important from the perspective of a RIT–T assessment is that the base case provides a clear reference point for comparing the performance of different credible options.

The RIT–T assessment would then involve a comparison of:

- the net economic benefit available from the RIT–T proponent developing the augmentation option as against the base case; to
- the net economic benefit available from other relevant credible options as against the base case.

The preferred option is the option that maximises the net economic benefit across the market. If no credible option yields a net economic benefit, this means the base case (that is, BAU activities) represents the best course of action.

Replacement project to provide a net economic benefit

A RIT–T proponent expects the condition of a network element to result in increasing volumes of expected unserved energy over time as the network element becomes increasingly prone to failure.

No mandatory service standard or a regulatory instrument requires the RIT–T proponent to avoid an expected increase in load shedding. Therefore, the identified need must be driven by an increase in the sum of consumer and producer surplus in the NEM. Accordingly, the base case for the RIT–T assessment should refer to a state of the world where the RIT–T proponent does not retire the poor condition element, nor implement any other relevant credible option. In this base case, the RIT–T proponent will still incur BAU operating, maintenance and minor capital (below the RIT–T cost threshold) expenditure to allow the network element to remain in service effectively for as long as possible.

While this base case option may eventually result in a complete and irreparable failure of the poor condition element and very high volumes of expected unserved energy, what is important from the perspective of a RIT–T assessment is that the base case provides a clear reference point for comparing the performance of different credible options.

The RIT–T assessment will then involve a comparison of:

- the net economic benefit available from replacing the poor condition network element as against the base case; to
- the net economic benefit available from other relevant credible options as against the base case.

The preferred option is the option that maximises the net economic benefit across the market. If no credible option yields a net economic benefit, it means the base case (that is, BAU activities) represents the best course of action.

Where the identified need for a credible option is to meet any of the service standards linked to the technical requirements of schedule 5.1 or in applicable regulatory instruments, the base case may reflect a state of the world in which those service standards are violated. However, this does not alter the need to use a state of the world in which no credible options are incorporated to provide a consistent point of comparison across all credible options for meeting those mandatory requirements. This is consistent with the requirement in NER clause 5.15A.2(b)(1) that the RIT–T be based on a cost benefit analysis that includes an assessment of a situation in which no option is implemented.

Example 5 illustrates how to characterise the base case where the identified need for a credible option is to meet any of the service standards linked to the technical requirements of schedule 5.1 or in applicable regulatory instruments—that is, reliability corrective action.

Example 5: Characterising the base case for meeting a service standard

Augmentation project to meet a service standard obligation

A RIT–T proponent is considering a network augmentation to meet service standards contained in an applicable jurisdictional regulatory instrument as load grows. That is, reliability corrective action is driving the need for the RIT–T project. The standard obliges the RIT–T proponent to meet service standards in the form of maximum levels of load at risk with a single credible contingency.

The RIT–T proponent must identify the credible option that maximises net economic benefit while meeting the standard. If no credible option that meets the standard offers a net economic benefit, the RIT–T proponent must identify the credible option that minimises the net economic detriment while meeting the standard. The RIT–T proponent must assess credible options against a base case where it does not implement a credible option to address the identified need, but rather conducts BAU activities.

The RIT–T proponent must consider credible options that take advantage of whatever flexibility the service standard obligation offers to maximise the net economic benefit or minimise the net economic cost of meeting the standard in question. This could mean

considering options that relate to different locations on the network, that reduce levels of load at risk, or where a given option is implemented at different points in time.

While this base case option may eventually result in a complete and irreparable failure of the poor condition element and very high volumes of expected unserved energy, what is important from the perspective of a RIT–T assessment is that the base case provides a clear reference point for comparing the performance of different credible options.

The RIT–T assessment will then involve a comparison of:

- the net economic benefit available from replacing the poor condition network element as against the base case; to
- the net economic benefit available from other relevant credible options as against the base case.

The preferred option is the option that maximises the net economic benefit across the market. If no credible option yields a net economic benefit, it means the base case (that is, BAU activities) represents the best course of action.

3.4 Selecting reasonable inputs

Except for specific circumstances, RIT–T proponents must adopt the inputs, assumptions and scenarios from the most recent inputs, assumptions and scenarios report (IASR). These circumstances are where the RIT–T proponent has demonstrated why a new, omitted or varied input, assumption or scenario is necessary. For example, it might be reasonable for a RIT–T proponent to do the following:

- Vary a parameter from the most recent IASR if there has been a material change that AEMO would, but is yet to reflect in, a subsequent IASR, ISP or ISP update. For example, this might include a material change in circumstances, such as where the AER has published updated VCR values that AEMO is yet to incorporate in the IASR. Where a material change is not a change in circumstances or facts (for example, a change in the RIT–T proponent's understanding or assessment of the facts, rather than a change in the facts themselves), the RIT–T proponent might choose to attain written confirmation of the change from AEMO.
- Add a parameter to what is set out in the most recent IASR where the scope of the identified need is such that the ISP did not explore parameters relevant to the RIT–T project. For example, a parameter relating to a specific jurisdictional service standard might meet this category.

In general, if a RIT–T proponent requires an input, assumption or forecast that is not provided in the most recent IASR, it should use:

- inputs based on market data where this is available and applicable;
- assumptions and forecasts that are transparent and from a reputable and independent source, such as other material AEMO has published; and □ up-to-date and relevant information.

3.4.1 Discount rates

The RIT–T specifies that:¹⁴

18. The RIT–T proponent must adopt the discount rate from the most recent inputs, assumptions and scenarios report unless it provides demonstrable reasons why a variation is necessary. If the *RIT–T proponent* decides to vary this parameter, this variation must be consistent with paragraph 19.

19. The present value calculations must use a commercial discount rate appropriate for the analysis of a private enterprise investment in the electricity sector. The discount rate used must be consistent with the cash flows being discounted.

Consistent with the RIT–T requirement, present value calculations in the ISP must use a commercial discount rate appropriate for the analysis of a private enterprise investment in the electricity sector. Given this consistency, it should be suitable for RIT–T proponents to apply the discount rate that AEMO has applied in the most recent ISP.

Where there are demonstrable reasons for why a RIT–T application should employ a different discount rate to that used in the most recent ISP, the RIT–T provides the flexibility to adjust the discount rate to reflect the risks that different types of projects carry. We expect these adjustments would vary between identified needs rather than between credible options to address a specific identified need. It will typically be best practice to capture the relative riskiness of different credible options through scenario analysis rather than by using different discount rates (see section 3.8 on scenario analysis).

Considering the above, as a default, a RIT–T proponent should use the same discount rate for different credible options to address a given identified need. If a RIT–T proponent has a sound reason to depart from this default by using a different discount rate for a particular credible option, it must:

- clearly and transparently provide this reasoning, including providing supporting evidence; and
- show if or how this decision affects the ranking of credible options.

Since the discount rate is a particularly important parameter for estimating the present value of long-term projects, we expect RIT–T proponents to explore:

- whether, as part of its scenario analysis, there is reason to include reasonable scenarios with different discount rates. If it includes a scenario with a lower-than-expected discount rate, it would also be reasonable to explore a scenario with a higher-than-expected discount rate. As required in the RIT–T, the regulated cost of capital should be the lower bound; and

¹⁴ , August 2020, paragraphs 18–19.

- when sensitivity testing the outcome of its cost benefit analysis, if applicable, illustrate 'boundary values' for discount rates at which the preferred option changes. The RIT–T proponent can then discuss the plausibility of those values and analyse this risk.

3.4.2 Value of customer reliability

The value of customer reliability (VCR), typically reported in dollars per kWh, is an important parameter for estimating classes of market benefits that relate to reliability, such as changes in voluntary and involuntary load curtailment.

A RIT–T proponent should use the VCR estimates that we publish and update annually.

VCRs used in RIT–T applications should reflect the weighted mix of customers that the option affects, and if applicable, the nature and type of reliability issue being modelled (for example, whether there is a widespread and long duration outage).

When sensitivity testing the outcome of its cost benefit analysis, if applicable, we expect a RIT–T proponent to illustrate 'boundary values' for VCRs at which the preferred option changes. The RIT–T proponent can then discuss the plausibility of those values and analyse this risk. For a more general discussion on sensitivity analysis, see section 3.8.

3.5 Valuing costs

In the RIT–T, costs are the present value of a credible option's direct costs. These must include the following classes of costs:¹⁵

- Costs incurred in constructing or providing the credible option.
- Operating and maintenance costs over the credible option's operating life. For clarity, a consequence of this is that, if the modelling period is shorter than the life of the credible option, the RIT–T proponent would incorporate the operating and maintenance costs (if any) for the remaining years of the credible option into the terminal value.
- Costs of complying with relevant laws, regulations and administrative requirements (see section 3.5.1).

There may be material uncertainty regarding the costs of a credible option when the RIT–T proponent undertakes the RIT–T assessment. See section 3.9 for guidance and worked examples on dealing with this uncertainty.

Particularly for, but not limited to, asset replacement projects or programs, there are costs resulting from removing and disposing of existing assets, which a RIT–T assessment should recognise. RIT–T proponents should include these costs in the costs of all credible options that require removing and disposing of retired assets. For completeness, the RIT–T proponent would exclude these costs from the 'BAU' base case, which section 3.3 defines.

3.5.1 The cost of complying with laws and regulations

¹⁵ , August 2020, paragraph 5.

In some cases, a RIT–T proponent may have a choice as to how it complies with a law, regulation or administrative requirement. For example, the RIT–T proponent may lawfully choose to pay a financial amount rather than undertake some other action (which is otherwise necessary to comply with the relevant law, regulation or legal instrument). If the financial amount is smaller than the costs of undertaking some other action, the RIT–T proponent may treat the financial amount as part of that credible option's costs.

A RIT–T proponent must exclude from its analysis, the costs (or negative benefits) of a credible option's harm to the environment or to any party that is not prohibited under the relevant laws, regulations or legal instruments. This places the onus on policy makers to prohibit certain activities or to value various types of harm and impose financial penalties accordingly. The RIT–T has no role in prohibiting or penalising activities that policy does not prohibit or penalise.

To the extent that market participants in the NEM may be required to pay a tax, levy or other payment for non-compliance with a renewable energy target (RET) scheme, or any other government policy in a particular state of the world, the RIT–T will capture this in a credible option's market benefits, rather than in a credible option's costs.

Example 6 demonstrates how compliance obligations can result in internalising costs that would otherwise be unpriced externalities.

Example 6: Costs of a credible option

Un-priced externality

To meet an identified need, a RIT–T proponent identifies as a credible option the development of a local gas-fired peaking generator in close proximity to an existing hotel.

The present value of the generator's expected construction and operating costs is \$120 million. The RIT–T proponent expects that developing the generator will reduce the hotel's earnings due to a loss of visual amenity – the present value of this loss is \$5 million. There are no planning standards, consents or other requirements to protect the hotel against this loss.

In the absence of any planning standards, consents or other requirements hindering its development, the costs of the credible option remain \$120 million. The 'negative externality' created by the generator's development and borne by the hotel is not regulated or legislated by any relevant law, regulation or administrative requirement and hence does not form part of the costs of the credible option.

Penalised externality

Continuing from above, assume that a regulatory body allows development of the credible option contingent on the developer of the generator paying for landscaping to conceal the generator and reduce the harm to the visual amenity of the hotel's guests. The present value of this landscaping is \$5 million.

In this case, the costs of the credible option would be $120 + 5 = \$125$ million. The \$5 million is now included as part of the costs of the credible option since a relevant regulatory body required the generator's development be contingent on this expense.

3.5.2 The treatment of land

Given that the cost of land may be a cost incurred in constructing or providing a credible option¹⁶, the value of land should be included as part of a RIT–T assessment. The purpose of the RIT–T is to identify the credible option that maximises the present value of the net economic benefit to all those who produce, consume and transport electricity in the market. Therefore, the RIT–T proponent should assess all credible options at present values. The RIT–T proponent should therefore use the market value of land when assessing the costs incurred in constructing or providing credible options.

For clarity, strategic land purchases (that is, acquiring an easement in advance of making an investment decision to build on that land) need not trigger a RIT–T. However, the market value of land should be included in a RIT–T application that explores building on a previously acquired easement (that is, land should not be treated as a sunk cost, to the extent that it can otherwise be sold).

3.5 A Cost estimation

3.5.A.1 Cost estimation accuracy [See also comments in ENA submission]

Where the estimated capital costs of a credible the preferred option exceeds \$100 million (as varied in line with the amount applying under NER 5.16.4(k)(10)(i)), a RIT–T proponent must:¹⁷

- in a RIT–T application, outline the process it has put in place, or intends to apply, to maximise ensure the appropriate accuracy of all estimated costs, and [Note: ENA suggests this requirement could be deleted, as its duplicative of 3.5A.2]
- consider applying the cost estimate classification system published by the Association for the Advancement of Cost Engineering (AACE), and
- if it does not apply the AACE cost estimate classification system, provide reasons to explain why.

This requirement does not apply where the preferred option relates to a program of works, but where no individual component of that program has an estimated capital cost above \$100 million (as varied in line with the amount applying under NER 5.16.4(k)(10)(i)).

TNSPs are not required to apply a specific classification level within the AACE classification system, but must set out what level of accuracy they have assumed and why the cost estimate falls within the specified class. The AACE classification adopted may appropriately vary both across credible options within the same RIT–T, and at different stages of the RIT–T process, provided that in each case the cost estimates provide an appropriate basis for ranking the credible options under the RIT–T.

We also encourage all RIT–T proponents, where the estimated capital costs of the preferred a credible option is less than \$100 million (as varied in line with the amount

applying under NER 5.16.4(k)(10)(i)), to consider outlining the process it intends to apply to ~~maximise~~ ensure the appropriate accuracy of all cost estimates.

3.5A.2 Additional cost estimation information and contingency allowances

Maximising Increasing the transparency of how a cost estimate of a credible option is arrived at is important. This includes, to the extent possible (and considering confidentiality concerns), identifying and disclosing the component parts or breakdown of that cost estimate.

¹⁶ NER, cl. 5.15A.2(b)(8)(i).

¹⁷ NER, cl. 5.16.2(c)(2).

Accordingly, for each credible option, a RIT–T proponent must specify **to the extent practicable and in a manner which is fit for purpose for that stage of the RIT–T:**

- [all key inputs and assumptions adopted in deriving the cost estimate](#)
- [a breakdown of the main components of the cost estimate](#)
- [the methodologies and processes applied in deriving the cost estimate \(e.g. market testing, unit costs from recent projects, and engineering-based cost estimates\)](#)
- [the reasons in support of the key inputs and assumptions adopted and methodologies and processes applied](#)
- [the level of any **material** contingency allowance that have been included in the cost estimate, and the reasons for that level of contingency allowance \(see section 3.9.4\).](#)

3.6 Market benefit classes

The RIT–T instrument defines market benefit and sets out the classes of benefits to include when applying the RIT–T to projects that are not actionable ISP projects.¹⁸ Section 3.7 and appendix A provide guidance on calculating market benefits. For instance, appendix A provides guidance and worked examples on calculating the classes of market benefits listed in NER section 5.15A.2(b)(4), which include:

- changes in fuel consumption arising through different patterns of generation dispatch;
- changes in voluntary load curtailment;
- changes in involuntary load shedding, with the market benefit to be considered using a reasonable forecast of the value of electricity to consumers;
- changes in costs for parties, other than the RIT–T proponent, due to differences in: the timing of new plant, capital costs, and operating and maintenance costs;
- differences in the timing of expenditure;
- changes in network losses;
- changes in ancillary services costs;
- competition benefits; and
- any additional option value (where this value has not already been included in the other classes of market benefits) gained or foregone from implementing that credible option with respect to the likely future investment needs of the market.

This section provides guidance on:

- when a class of market benefit is material and should be quantified in a RIT–T application; and

¹⁸ AER, *RIT–T*, August 2020, paragraphs 7 and 11.

- how an additional class of market benefit can be added to the classes defined above.

3.6.1 Material classes of market benefits

Under the RIT–T instrument, a RIT–T proponent must include all classes of market benefits unless:¹⁹

- it can provide reasons for why a particular class of market benefit is unlikely to materially affect the outcome of the credible options assessment; or
- it expects the cost of undertaking the analysis to quantify the market benefits will be disproportionate to the scale, size and potential benefits of the credible options.

The classes of market benefits that a RIT–T proponent should consider will depend on the circumstances surrounding the individual RIT–T assessment and the credible options under consideration. For example, where a credible option is not expected to affect the wholesale market, a number of the classes of market benefit listed in the RIT–T instrument, such as competition benefits and changes in fuel consumption arising through different patterns of generation dispatch, will not be material and therefore will not need to be estimated.

3.6.2 Additional classes of market benefits

Under the RIT–T instrument, a RIT–T proponent must also consider classes of market benefits that:²⁰

- the RIT–T proponent determines relevant; and
- we have agreed to in writing before the RIT–T proponent publishes its consultation report.

If a RIT–T proponent quantifies an additional class of market benefit in its RIT–T assessment, we will consider it. However, a RIT–T proponent must receive our approval to include an additional class of market benefit before it makes its consultation report available to other parties.

When determining whether to approve a new class of market benefit, we will consider whether the proposed benefit:

- should already be reflected in another market benefit class. If it is effectively a component of a pre-existing class of market benefits, there is no need to introduce a new class. In these cases, the RIT–T proponent should consider whether it should perform an additional calculation to add this 'sub-component' into the market benefit class. If it has already captured this benefit indirectly, it should not perform a separate calculation that would result in double counting the value of the market benefit; and

¹⁹ August 2020, paragraphs 12–13 and as required by NER clauses 5.15A.2(b)(5)–(6).

²⁰ AER, *RIT–T*, August 2020, subparagraph 11(k) and as required by NER clause 5.15A.2(b)(4)(x)(A).

- would accrue to a producer, consumer or transporter of electricity in the market. If the class of benefit falls outside the scope of the market, the RIT–T proponent should not include it in its cost benefit analysis (see section 3.11 for a discussion on externalities).

3.7 Methodology for valuing market benefits

The total benefit of a credible option includes the change in:

- consumer surplus, being the difference between what consumers are willing to pay for electricity and the price they are required to pay; and
- producer surplus, being the difference between what electricity producers and transporters are paid for their services and the cost of providing those services (excluding the costs of the credible option).

As set out in the RIT–T, the market benefit of a credible option is obtained by:

- i. comparing, for each relevant reasonable scenario, the state of the world with the credible option in place against the state of the world in the base case; and
- ii. weighting any positive or negative benefit derived in (i) by the probability of each relevant reasonable scenario occurring.

This comparison may reveal that a credible option results in both positive and negative effects on the market. The calculation must therefore reflect a netting-off process, that accounts for the positive and negative effects of a credible option in the market across all the relevant classes of market benefits. This process may result in a credible option having a positive or negative market benefit.

Appendix A provides guidance and worked examples for each class of market benefit referred to in NER clause 5.15A.2(b)(4). In addition, the following sections provide guidance on valuing market benefits **for a given credible option**, which involves three key steps:

1. **deriving** the states of the world with and without the credible option in place in each reasonable scenario;
2. **comparing** the relevant states of the world with and without the credible option in place in each reasonable scenario to derive the market benefit of the credible option in each reasonable scenario; and
3. **weighting** the market benefits arising in each reasonable scenario by the probability of that reasonable scenario occurring.

3.7.1 Deriving states of the world in each reasonable scenario

For each credible option, a RIT–T proponent must develop two states of the world (one with the credible option in place and the other being the base case with no option in place) for each reasonable scenario. This allows the RIT–T proponent to later derive the market benefits of an option by comparing these states of the world, and then probability weighting those benefits across a range of reasonable scenarios.

Explanatory box 1 explains the difference between a 'state of the world' and a 'reasonable scenario'.

Explanatory box 1: States of the world and reasonable scenarios

Reasonable scenarios are independent of the credible option, whereas states of the world are dependent on the credible option.

A state of the world is a detailed description of all of the relevant market supply and demand characteristics and conditions likely to prevail in a reasonable scenario if a credible option proceeds or in the base case. A state of the world should be internally consistent in that all aspects of the state of the world could reasonably coexist.

Crucially, the pattern of new generation development (incorporating capacity, technology, location and timing) should vary depending on which credible option (if any) proceeds.

Therefore, each credible option and the base case will be associated with a different state of the world in each reasonable scenario, reflecting different patterns of generation investment and other characteristics and conditions in that reasonable scenario.

A reasonable scenario is a set of variables or parameters that are not expected to change across each of the relevant credible options or the base case. For example, the

following variables should be independent of the credible options and considered as components of each reasonable scenario:

- levels of economic growth and the associated level of base electricity demand;
- level of population growth and the associated level of base electricity demand;
- the unit capital and operating costs of generation plant (in \$/MW or \$/MWh);
- the value of any environmental penalties; and
- the value of unserved energy.

The RIT–T instrument requires the RIT–T proponent to include any of the ISP scenarios from the most recent IASR that are relevant unless it provides demonstrable reasons for why adding, omitting or varying a relevant ISP scenario is necessary. Moreover, if no ISP scenarios are relevant, the RIT–T proponent must form reasonable scenarios consistently with the requirements for reasonable scenarios as set out in the RIT–T instrument.²³

For the avoidance of doubt, given demand is likely to vary between different scenarios, to the extent that a demand-side option affects peak demand under each of these reasonable scenarios, this effect should be accounted for in the states of the world associated with that option in each of those reasonable scenarios. This ensures that the benefits of the demand-side option are transparently calculated separately in scenarios with different levels of demand, because the demand-side option's benefits may vary according to the forecast demand in each scenario.

Notwithstanding the need for probability-weighting market benefits to derive the market benefit of a credible option, RIT–T proponents will continue to provide details of the estimated market benefits of a credible option under each reasonable scenario.

All assets and facilities that exist during a RIT–T application must, at least initially, form part of all relevant states of the world (both with and without the credible option in place and in all reasonable scenarios). Beyond taking account of existing assets and facilities, a state of the world must capture the future evolution of and investment in generation, network and load. To capture this, the RIT–T instrument requires the RIT–T proponent to include appropriate:²¹

- Committed projects: these must form part of all states of the world, consistent with the treatment of existing assets and facilities.
- Actionable ISP projects: these must form part of all states of the world, consistent with the treatment of committed projects unless the level of analysis required to include the

²¹ AER, *RIT–T*, August 2020, paragraphs 25–28. Also see the Glossary of the RIT–T for definitions of committed, anticipated and modelled projects.

actionable ISP project is disproportionate to the scale and likely impact of the credible options under consideration.²²

- Anticipated projects: the RIT–T proponent must use the ISP, and where absent from the ISP, its reasonable judgement to include these in all **relevant** states of the world.
- Modelled projects: appropriate market development modelling will determine which modelled project to include in a given state of the world. For completeness, where a RIT–T proponent adopts the market modelling from the most recent ISP, ISP projects that are not actionable ISP projects (that is, future ISP projects and ISP development opportunities) will usually be modelled projects.

Explanatory box 2: What is market development modelling in the RIT–T?

Market development modelling forecasts what kinds of projects (in particular, but not limited to, generation projects) would be developed in the longer term, both with and without the credible option proceeding.

The RIT–T requires market development modelling, in so far as practicable, be adopted from the most recent ISP, and should in general be on a least-cost/central planning-style basis.²⁶ This modelling should be orientated towards minimising the cost of serving load (or allowing load to remain unserved if that is least cost) while meeting minimum reserve levels (least-cost market development modelling). It may also treat the reserve margin that AEMO develops as an exogenous input. The RIT–T instrument specifies that, in general, market development modelling should be undertaken on a 'least-cost' basis.²⁷ This is because least-cost market development modelling relies on relatively uncontroversial assumptions and methodologies (derived from operations research).

The RIT–T instrument also allows, where appropriate, market development modelling on a private benefit basis (market-driven market development modelling).²⁸ RIT–T proponents may choose to undertake market-driven market development modelling as a sensitivity because assumptions regarding plant bidding behaviour and ownership may strongly influence the results.

Market development modelling is important as it helps determine a credible option's market benefits in a given reasonable scenario by assisting RIT–T proponents to derive modelled projects in the presence and absence of a credible option. For example, market development modelling may assist in determining whether—in reasonable scenarios with different demand forecasts—a network option is likely to lead to the deferral (or advancement) of new generation investment compared to the relevant base case. To the extent it does, this would constitute a positive (or negative) contribution to the market benefit of the credible option, respectively, in each of those reasonable scenarios.

²² This is to align with NER cl. 5.15A.2(b)(2), which specifies that the RIT–T must 'not require a level of analysis that is disproportionate to the scale and likely impact of each of the credible options being considered'.

Example 7: Market development modelling—states of the world

Consider an identified need to meet a mandatory service standard. Assume there are two credible options— a network and a demand-side option.

This will require deriving three states of the world (and consequently, three market development paths) for each reasonable scenario. These include where: (1) neither credible option is implemented (the base case), (2) the network option is implemented, and (3) the demand-side option is implemented.

3.7.2 Deriving and weighting market benefits

Deriving the market benefit of a credible option in a given reasonable scenario entails comparing the state of the world with the option in place against the base case state of the world. Section 3.7.3 describes how to achieve this for each class of market benefit.

A RIT–T proponent will then apply this derivation across all reasonable scenarios, as shown in example 8.

Example 8: Market development modelling—deriving and weighting market benefits across states of the world

This example continues from example 7 where there are two credible options— a network and a demand-side option. Assume the RIT–T proponent demonstrates that three reasonable scenarios from the most recent IASR are relevant (and these scenarios are based around high, medium and low demand). In this example, the RIT–T proponent must:

- **derive** separate states of the world for the network option, demand-side option and base case across the high, medium and low demand scenarios; and
- **compare** the credible option and base case states of the world under the high, medium and low demand scenarios.

This will require nine market development modelling paths to establish nine states of the world:

1. network option with high demand;
2. demand-side option with high demand;
3. base case with high demand;
4. network option with medium demand;
5. demand-side option with medium demand;
6. base case with medium demand;
7. network option with low demand;
8. demand-side option with low demand; and
9. base case with low demand.

It will then be necessary to compare (1) and (2) against (3), (4) and (5) against (6) and (7) and (8) against (9). This should yield the market benefits of the network option and the demand-side option in each of the three reasonable scenarios.

For this example, assume that the network option has a market benefit of:

- \$30 million in a high demand scenario;
- \$20 million in a medium demand scenario; and
 - \$10 million in a low demand scenario.

Further assume that the demand-side option has a market benefit of:

\$40 million in a high demand scenario;

- \$10 million in a medium demand scenario; and
- \$5 million in a low demand scenario.

The final step is to weight the market benefits of each credible option arising in each reasonable scenario to derive the market benefit of that credible option.

- Drawing from the above example, assume that the probability of a:
 - high demand scenario is 50 per cent;
 - medium demand scenario is 40 per cent; and
 - low demand scenario is 10 per cent.

Under these assumptions, the market benefit of the:

- network option is \$24 million (being $0.5 \times \$30\text{m} + 0.4 \times \$20\text{m} + 0.1 \times \10m).

demand-side option is \$24.5 million (being $0.5 \times \$40\text{m} + 0.4 \times \$10\text{m} + 0.1 \times \5m).

3.7.3 Categories of market benefits

Broadly speaking, the market benefit of a credible option can be obtained from savings in:

- capital costs, including the costs of generation and network assets;
- operating costs, including fuel costs, network losses, ancillary services, as well as voluntary and involuntary load reduction; and
- the costs of meeting environmental targets, such as a RET or similar developments.

This section provides guidance and worked examples on estimating these categories of savings.

Capital cost savings

A RIT–T proponent can primarily estimate savings in capital costs by comparing the patterns of plant development in different states of the world under a given reasonable scenario. This

entails computing capital cost savings by comparing the development pattern of committed, actionable ISP, anticipated and modelled projects under each credible option to that under the base case.

Example 9: Capital costs under different states of the world

Assume that:

- the identified need is to meet a mandatory service standard;
- two credible options exist: a network option and a demand-side option;
- the discount rate is 7 per cent; and
- the RIT–T proponent can demonstrate that there is only one relevant reasonable scenario, such that there are three states of the world:
 - The base case state of the world where neither credible option is developed and a modelled project is developed in year 5 at a capital cost of \$150 million.
 - The demand-side option state of the world, where only the demand-side option is developed, and the same modelled project is developed in year 7 at a capital cost of \$150 million.
 - The network option state of the world, where only the network option is developed, and no modelled projects are developed over the duration of the analysis.

Under these assumptions, the contribution of capital cost savings to the market benefit of each credible option can be calculated as follows:

- For the network option, the benefit of avoiding the \$150 million modelled project in year 5 that is otherwise required in the base case state of the world. The present value of this avoided cost is $\frac{150}{(1.07)^5} = \$107$ million.
- For the demand-side option, the benefit of deferring the \$150 million modelled project in year 5 under the base case and demand-side states of the world to year 7 by:
 - calculating the present value of modelled project in year 5 = \$107 million;
 - and ○ deducting from this the present value of modelled project in year 7 ($\frac{150}{(1.07)^7} = \$93$ million) to get \$107 million – \$93 million = \$14 million.

In this example, taking into account only the capital cost effects, the network option results in the greatest market benefit.

Note that despite these positive contributions to market benefit, neither credible option may produce positive net economic benefits if the expected costs exceed the expected market benefits.

Operating cost savings

Savings in operating (such as fuel), maintenance and load reduction costs can be obtained by comparing the market dispatch outcomes in different states of the world.

Example 10: Operating costs under different states of the world

The following example builds on example 9, and makes the following assumptions:

- In the base case state of the world, the present value of:
 - fuel resource costs = \$80 million; and
 - unserved energy costs = \$40 million.
- In the network state of the world, the present value of:
 - fuel resource costs = \$100 million; and
 - unserved energy costs = \$2 million.
- In the demand-side state of the world, the present value of:
 - fuel resource costs = \$80 million; and
 - unserved energy costs = \$26 million.

Under these assumptions, the contribution of operating cost savings to the market benefits of each credible option can be calculated as follows:

network option: $(80 + 40) - (100 + 2) = \18 million; and demand-side option: $(80 + 40) - (80 + 26) = \14 million.

The RIT–T instrument allows RIT–T proponents to adopt market development modelling from the ISP, insofar as practicable.²³ This recognises that AEMO's market development modelling is likely to represent best practice, but RIT–T applications that are not exploring actionable ISP projects may not necessarily require this level of market modelling. For instance, where changes in outcomes in the wholesale spot market do not materially affect the market benefits of any credible option under consideration, it may be appropriate to limit the modelling of market benefits to load-flow modelling. Such modelling must incorporate realistic treatments of relevant plant and network characteristics and forecast load.

²³, August 2020, paragraph 29.

Cost savings in meeting mandated targets

Savings in capital and operating costs incurred in meeting any environmental, reliability or other mandated targets (for example, the Australian or jurisdictional RETs or Retailer Reliability Obligation) can be calculated by comparing plant development and market dispatch outcomes for a credible option to the base case.

In the absence of any price caps or penalties, it is reasonable to assume that the market will meet an applicable mandated target, like the RET. Using the RET as an example, a RIT–T proponent could assume that the price of a renewable energy certificate (REC) would rise to the level necessary to induce compliance with the target. Therefore, under any state of the world, the benefits from meeting that target will be identical and need not be included in the RIT–T application. Rather, the differences in other capital and operating costs under the RIT–T application will reflect any differences in the resource costs of meeting these targets under different states of the world.

However, it may be that there is a cap on prices (RECs, in the case of the RET) or a penalty for not meeting the relevant target. It would be reasonable to assume that this cap or penalty reflects the maximum per unit benefit to the NEM of providing the relevant service (renewable energy, in the case of the RET). In such a case, it is possible that it will not be net beneficial for the NEM to meet the target as the cost of meeting it could exceed the benefits, as indicated by the level of the cap/penalty. As such, a RIT–T proponent can consider the benefits associated with the target in each state of the world equivalent, even where the target is not met due to it being lower cost to pay the cap/penalty price.

Using the RET as an example, in a state of the world where the RET is not met, the amount of renewable energy short of the target will be valued at the capped price and contribute to the resource costs incurred in that state of the world. Comparing the resource costs in different states of the world may then make a positive or negative contribution to the market benefits of a credible option.

Under the RET, certificate purchases represent tax deductible business expenses. However, penalties such as those to be imposed on parties who surrender insufficient RECs are generally not tax deductible expenses. Due to the asymmetric tax treatment of permit compared to penalty expenditures, the RET penalty price for the purposes of applying the RIT–T should be ‘grossed up’ by the applicable company tax rate to ensure that the penalty price is consistent with the post-tax REC price faced by market participants.

For example assuming a company tax rate of 30 per cent and an unadjusted penalty price of \$50, the ‘grossed up’ penalty price for the RIT–T analysis is:

$$Penalty_{GU} = \frac{Penalty}{1-t} = \frac{\$50}{1-0.3} = \$71.42$$

By grossing this price up, the calculation of market benefits in the RIT–T application should reflect direct impacts on those that produce, consume and transport electricity in the market. This means that rational risk-neutral participants will choose to expend up to \$71.42/MWh to avoid breaching the target. The value to the market of meeting the target in this example is also \$71.42/MWh.

Example 11: Cost savings in meeting a renewable energy target

A legislatively imposed RET scheme exists whereby a certain proportion of electricity generated must come from certified renewable sources.

The scheme uses RECs as an instrument to achieve the RET. One REC represents 1 MWh of renewable generation. A penalty price of \$35/MWh is imposed—this means that for each MWh of energy by which the target is not met, a penalty of \$35/MWh is incurred (this equates to a grossed-up penalty price of \$50/MWh).

The credible option in question is the construction of a transmission link between two regions: a region with abundant, relatively cheap renewable generation and low load (Region A) and a region with limited, relatively expensive renewable generation and high load (Region B).

Assume the following occurs in the base case:

- The price of RECs is \$50/MWh (that is, the price of RECs is set at the grossed-up penalty price) and the market ‘chooses’ to pay the penalty price of \$35/MWh and not meet the renewable target.
- The renewable target is 50,000 MWh per year over the period of the analysis.
- The present value of operating and capital costs over the period of the analysis is \$500 million.
 - Based on these assumptions, the annual cost of not meeting the renewable target is $50,000 \text{ MWh} \times \$50 = \$2.5 \text{ million}$. If we assume the present value of these costs over the period of the analysis is \$17.5 million, then the present value of operating, capital and penalty costs in the base case is $\$500 \text{ million} + \$17.5 \text{ million} = \$517.5 \text{ million}$.

Assume the following occurs **with** the credible option:

- The price of RECs is \$40/MWh. Assume the market meets annual renewable targets over the period of the analysis.
- The present value of operating and capital costs over the period of the analysis is \$510 million. This is slightly higher than in the base case (where capital and operating costs sum to \$500 million) because of:
 - higher capital costs (greater investment in renewable generation occurs); and
 - lower operating costs (additional renewable generation displaces thermal plant).

Based on these assumptions, while the present value of operating and capital costs over the period is slightly higher when the credible option is in place, this is more than offset by avoiding penalty costs under the RET. Specifically, the market benefit of the credible option based on operating, capital and avoided RET penalty costs is $\$517.5 \text{ million} - \$510 \text{ million} = \$7.5 \text{ million}$.

Benefits accruing across regions

NER clause 5.15A.2(b)(10)(iii) requires the RIT–T to specify acceptable methodologies for estimating market benefits that may occur outside the RIT–T proponent's network. Similarly, the RIT–T application guidelines must include guidance and worked examples on the acceptable methodologies for valuing market benefits that accrue across regions.

The method outlined above for calculating market benefits implicitly includes market benefits arising across all regions in the NEM. For the avoidance of doubt, the RIT–T instrument provides that the methodology for calculating market benefits must capture any market benefits arising in the RIT–T proponent's region as well as all other NEM regions.²⁴ Given this, our more general guidance on estimating benefits is also applicable to quantifying benefits that accrue in multiple regions. RIT–T proponents need not separately quantify benefits that arise in each region of the NEM.

Nevertheless, in calculating benefits that accrue to other regions in the NEM, we expect the most recent ISP to guide RIT–T proponents when evaluating how different credible options will fit into or affect the broader development of the NEM. Specifically, the ISP will guide RIT–T proponents in this way by providing:

- actionable ISP projects for RIT–T proponents to include in all states of the world wherever relevant/material, consistent with the treatment of committed projects; and
- other ISP projects to include in states of the world, as determined by the market modelling used in the ISP.

To extent that the most recent ISP provides insufficient information to aid the RIT–T proponent in calculating inter-regional benefits, the RIT–T proponent should liaise with producers, consumers and transporters of electricity in other regions of the NEM to inform their understanding of how different credible options will affect them. If the RIT–T proponent is exploring credible options that it expects will 'materially affect' another electricity network, we would expect the RIT–T proponent to instigate a joint-planning project with that other electricity network. In this context, 'materially affect' means it will create an identified need sufficiently large that it will require a RIT–T project or a regulatory investment test for distribution (RIT–D) project to meet it.

3.8 Reasonable scenarios and sensitivities

This section provides guidance on forming reasonable scenarios, including:

- general guidance on selecting reasonable scenarios (section 3.8.1);
- using sensitivity analysis to [guide the selection of select](#) reasonable scenarios (section 3.8.2);
- how reasonable scenarios affect the computational effort (section 3.8.3); and

²⁷ , August 2020, paragraph 23.

- [how using](#) scenario analysis can [to](#) capture high impact low probability (HILP) events (section 3.8.4).

3.8.1 Selecting reasonable scenarios

The RIT–T instrument requires RIT–T proponents to include any of the ISP scenarios from the most recent IASR that are relevant, unless:²⁵

- the RIT–T proponent demonstrates why it is necessary to vary, omit or add a reasonable scenario to what was in the most recent IASR; and
- the new or varied reasonable scenarios are consistent with the requirements for reasonable scenarios set out in the RIT–T instrument.

Where no scenarios from the ISP are relevant to the RIT–T application, the RIT–T proponent must form reasonable scenarios consistently with the requirements for reasonable scenarios in the RIT–T instrument. In these circumstances, the RIT–T proponent should refer to the guidance in this section when developing reasonable scenarios.

For clarity, we expect there will be RIT–T applications where no ISP scenarios are relevant. This is because, in general, ISP scenarios will only likely to be relevant where wholesale market outcomes are a material driver of market benefits, and undertaking market modelling is therefore appropriate. Given the RIT–T cost threshold is small relative to many actionable ISP projects²⁶ and many RIT–T projects will be intra-regional projects (including replacement projects), it is likely that many of these RIT–T projects will be relatively modest in size and scope compared to ISP projects. This is such that the analysis set out in the ISP might be too comprehensive to be fit for purpose.

It is also worthwhile acknowledging that there may also be circumstances where market modelling is required, but only a sub-set of the ISP scenarios are relevant (for instance, if the ISP scenarios explore risks that are not relevant to the RIT–T application). Similarly, there may be circumstances where there are demonstrable reasons to vary an ISP scenario. The guidance below on selecting a range of reasonable scenarios is also useful for these circumstances.

Under the RIT–T instrument, the number and choice of reasonable scenarios must be appropriate to the credible options under consideration. Specifically, the choice of reasonable scenarios must reflect any variables or parameters that are likely to affect:²⁷

- the ranking of the credible options, where the identified need is for reliability corrective action, inertia network services or system strength services. In these cases, only the ranking (as opposed to the sign) of credible options' net economic benefits is important; and

²⁵ AER, *RIT–T*, August 2020, subparagraph 20(b).

²⁶ This threshold was \$6 million at the time of drafting. Under clause 5.15.3 of the NER, we must review RIT–T cost thresholds every three years for changes in input costs.

²⁷ , August 2020, paragraph 23.

- the ranking or sign of the net economic benefit of any credible option where the identified need is not for reliability corrective action, inertia network services or system strength services. In these cases, the preferred option must have a positive net economic benefit.

The appropriate number and choice of reasonable scenarios could vary depending on the credible options under consideration. This recognises that NER clause 5.15A.2(b)(2) requires RIT–T proponents to apply the RIT–T to a level of analysis that is proportionate to the scale and likely impact of each credible option. Given this, when forming reasonable scenarios, we recommend RIT–T proponents:

- use the information provided in the ISP in the first instance (see section 0);
- use sensitivity analysis to assist in determining an appropriate set of reasonable scenarios. We describe this approach in section 3.8.2;
- as a principle, be conscious of the current NEM reforms and relevant policy developments, including, where relevant:
 - electricity pricing reforms;
 - the development of new markets and products, such as demand response markets and products that allow consumers to select their own price-reliability preference; and
 - policies relating to features of the NEM, such as those concerning carbon emissions, renewable energy, reliability, energy security and other factors. For example, if evidence supports there being a reasonable possibility of a policy change (including introducing a new policy or altering/withdrawing a current policy) that could affect the ranking and/or sign of credible options, the RIT–T proponent should include a reasonable scenario where this policy change occurs; and
- construct scenarios that are genuinely reasonable, in that they comprise of internally consistent parameters so that they can define a reasonable range of plausible states of the world.

3.8.2 Testing sensitivities to select reasonable scenarios

This section explains how developing reasonable scenarios can involve a process of applying sensitivity analysis to key inputs that will likely affect the performance of credible options. Such inputs might relate to technology costs, fuel costs, distributed generation and storage growth.

Where the estimated capital costs of a credible the preferred option exceeds \$100 million (as varied in line with the amount applying under NER 5.16.4(k)(10)(i)), a RIT–T proponent must undertake sensitivity analysis by varying one or more inputs and/or assumptions. We also encourage all RIT–T proponents, where the estimated costs of a credible the preferred option is less than \$100 million, to consider undertaking sensitivity analysis as well.

If a reasonable change to a parameter/variable affects the ranking or sign of credible options by net economic benefit, this would provide a demonstrable reason to include a reasonable

scenario that is consistent with that change in parameter/variable value. For example, sensitivity analysis might show that the relative performance of credible options changes if there are lower than expected technology costs. This would provide a basis for the RIT–T proponent to include a reasonable scenario based on lower than expected technology costs.

Explanatory box 3: Sensitivity analysis versus scenario analysis

This section of the RIT–T application guidelines explains how sensitivity analysis can assist in selecting reasonable scenarios to use when performing scenario analysis. As such, it is beneficial to distinguish these concepts.

Sensitivity analysis entails varying one or multiple inputs to test how robust the output of an analysis or model is to its input assumptions. For example, we suggest that if the results of the analysis in one reasonable scenario appear to be sensitive to a particular input (say, forecast electricity demand), this provides a strong basis to explore reasonable scenarios that incorporate different levels of that input more holistically. For example, this might include adopting a range of scenarios where there is particularly high or low load growth.

It is worth noting that we do not recommend limiting the use of sensitivity analysis to selecting reasonable scenarios. After identifying the preferred option, the RIT–T proponent should illustrate 'boundary values' for important input assumptions (such as the discount rate and VCR) at which the preferred option changes. The RIT–T proponent can then discuss the plausibility of that value and evaluate the risk of that credible option.

Scenario analysis focuses on describing different sets of states of the world that reflect common values of particular parameters that are relevant to the investment decision. For example, a reasonable scenario will reflect a common set of values for the rate of demand growth, fuel costs, technology costs and environmental target(s).

Under the RIT–T, the use of scenario analysis to assess a credible option entails:

- developing/describing different scenarios based on a range of parameters, which the RIT–T refers to as 'reasonable scenarios'; and then
- exploring how different projects (credible options) produce different outcomes (states of the world) under a range of different reasonable scenarios.

Through this, RIT–T proponents gain a comprehensive understanding of what states of the world could arise with and without a credible option in place under different sets of external circumstances. For a given credible option, a RIT–T proponent then probabilistically weights the outcomes (the states of the world under that option relative to the base case) across the different reasonable scenarios to derive that option's expected net market benefit.

To elaborate on the above guidance, sensitivity analysis can guide RIT–T proponents to explore reasonable scenarios where changes in variables are material. This is where material changes are those that would affect the ranking of credible options, and where relevant, the sign (positive or negative) of net economic benefits. This entails undertaking the following steps:

1. For each variable or parameter forming part of a reasonable scenario, take the most probable value or values that also provide an internally consistent or plausible scenario. Combining these probable values will generate one or more reasonable scenario, as a 'central reasonable scenario'. Under the central reasonable scenario, the net economic benefits of each credible option can be determined by comparing the state of the world **with** the credible option in place to the base case.
2. Undertake sensitivity analysis on those parameters or values that could reasonably change the ranking or sign (where the investment is not motivated by reliability corrective action) of the net economic benefits of any of the credible options, determined under a central reasonable scenario. Then, the net economic benefits of a credible option are calculated and compared under:
 - o a central reasonable scenario; and
 - o a reasonable scenario based on the same central reasonable scenario but with a change to one of the parameters or values in that central reasonable scenario (referred to as a 'modified central reasonable scenario').
3. Adopt additional reasonable scenarios that reflect variations in that parameter/variable where a change to a parameter/variable in a central reasonable scenario yields a change to the ranking or sign²⁸ of the net economic benefits of any of the credible options.

Example 12 provides a simple stylised example to assist RIT–T proponents in applying this approach.

Example 12: Stylised example on selecting reasonable scenarios

Consider where the RIT–T proponent is assessing two credible options. Assume that the most likely ISP scenario comprises of a:

- medium base forecast electricity demand;
- discount rate of 8 per cent;
- medium capital, operating and ancillary services costs for existing, committed, anticipated and modelled projects; and
- realistic bidding based on a Nash Equilibrium approach.

The RIT–T proponent uses this ISP scenario as its central reasonable scenario and calculates the net economic benefit of the two credible options under this scenario.

The RIT–T proponent then applies sensitivity analysis to each of the key variables in the central reasonable scenario. This could involve the RIT–T proponent calculating the net

²⁸ That is, whether net economic benefits are positive or negative. This sign is less relevant when the preferred option can have a negative net economic benefit (e.g. reliability corrective action).

economic benefit of each credible option under a modified central reasonable scenario that varies one of the variables in the central reasonable scenario—such as the level of forecast base electricity demand—while holding the other variables constant.

In some cases, the ranking, or ranking/sign (whichever relevant) of credible options' net economic benefits calculated under, for example, a demand modified central reasonable scenario might differ significantly from that calculated under the associated central reasonable scenario. In such cases, the RIT–T proponent should include an additional set of reasonable scenarios that reflect varying levels of forecast electricity demand. The RIT–T proponent should then apply the same approach to the other elements of the central reasonable scenario.

In addition to the stylised example above, example 13 and example 14 provide two worked examples showing how RIT–T proponents could apply this approach in practice.

Example 13: Demand sensitivity

This example shows how a RIT–T proponent could undertake a sensitivity analysis of forecast demand.

Assume there are two credible options:

- Augment a transmission line between Region A and Region B at a present value cost of \$60 million (augmentation option).
- Establish a local generator in Region B (generation option).

Region A has more plentiful generation capacity and lower generation costs than Region B. Over the period of the analysis under its central reasonable scenario, the RIT–T proponent:

- forecasts that energy and peak demand in Region A will grow by 2 per cent;
- forecasts that energy and peak demand in Region B is will grow by 6 per cent; and
- assumes a discount rate of 7.5 per cent.

The major modelled projects in the state of the world with the augmentation option are the development of:

- a 200 MW plant in Region A in year 5 of the analysis; and
- a 600 MW plant in Region B in year 8 of the analysis.

In the base case, the major modelled projects are the development of:

- a 200 MW plant in Region A in year 10 of the analysis; and
- a 600 MW plant in Region B in year 2 of the analysis.

The market benefits of the augmentation option in the central reasonable scenario include the following:

- Decreased dispatch costs—cheaper generation in Region A displaces more expensive generation in Region B.

- Increased capital costs—the 200 MW plant in Region A is brought forward by 5 years (from year 10 to year 5).
- Decreased capital costs—the 600 MW plant in Region B is delayed by 6 years (from year 2 to year 8).

Assume the present value market benefit of the augmentation option is calculated to be \$75 million. The present value net economic benefit under these assumptions is \$75 million – \$60 million = \$15 million.

Assume that the same process is carried out for the generation option, which yields a present value net economic benefit of \$10 million.

A sensitivity analysis is now run on the assumption regarding growth in energy and peak demand in Region B.

Under this modified central reasonable scenario, growth in energy and peak demand in Region B will be 10 per cent over the period of the analysis instead of 6 per cent.

Under these demand growth assumptions, the major modelled projects in the state of the world **with** the augmentation option are the development of a:

- 300 MW plant in Region A in year 4 of the analysis; and
- 900 MW plant in Region B in year 9 of the analysis.

In the **base case**, a:

- 200 MW plant is developed in Region A in year 10 of the analysis; and
- 900 MW plant is developed in Region B in year 1 of the analysis.

The present value of the market benefit of the augmentation option under these assumptions includes the following:

- Decreased dispatch cost: cheaper generation in Region A displaces more expensive generation in Region B.
- Increased capital costs: the plant in Region A is larger (300 MW instead of 200 MW) and is brought forward by 6 years (from year 10 to year 4).
- Decreased capital costs: the 900 MW in Region B is delayed by 8 years (from year 1 to year 9).

Due to the change in the type and timing of the modelled projects under the revised demand growth assumption, assume that the present value market benefit of the augmentation option is \$85 million. The present value net economic benefit under these assumptions is \$85 million – \$60 million = \$25 million.

Assume that the same process carried out for the generation option in the modified central reasonable scenario yields a present value net economic benefit of \$20 million.

The analysis shows that, in the event that growth in energy and peak demand in Region B is higher than forecast, both credible options will have a higher net economic benefit than forecast. However, since the ranking of net economic benefits between the two credible

options has not changed, it may not be necessary for the RIT–T proponent to develop additional reasonable scenarios with varying levels of forecast demand in its assessment of the credible options.

Example 14: Lower generation capital cost sensitivity

The following example builds on example 13 to show how a RIT–T proponent could undertake a sensitivity analysis of generation capital costs. The credible options are the same as in example 13.

Assume that under the central reasonable scenario:

- growth in energy and peak demand is the same as initially assumed—2 per cent in Region A and 6 per cent in Region B; and
- generation capital costs are ‘medium’.

As in example 13, these assumptions result in the following outcomes for the augmentation option:

- A 200 MW plant being developed in Region A in year 5 of the analysis in the state of the world with the augmentation option, and in year 10 of the analysis in the base case.
- 600 MW plant being developed in Region B in year 8 of the analysis in the state of the world with the augmentation option, and in year 2 of the analysis in the base case.

As per example 13, the present value net economic benefit of the augmentation option is \$15 million. The present value net economic benefit of the generation option is \$10 million.

A sensitivity analysis is now run on the assumption regarding generation capital costs. The new modified central reasonable scenario assumes generation capital costs are ‘low’. Under this assumption the major modelled projects in the state of the world with the augmentation option are the development of:

- A 300 MW plant in Region A in year 3 of the analysis.
- A 700 MW plant in Region B in year 7 of the analysis.

In the base case:

- the same 300 MW plant is developed in Region A in year 8 of the analysis; and
- the same 700 MW plant is developed in Region B in year 1 of the analysis.

Due to the change in the type, timing and costs of the modelled projects, assume the present value market benefit of the augmentation option is now \$70 million. The present value net economic benefit under these assumptions is \$70 million – \$60 million = \$10 million.

Assume that the same process carried out for the generation option, which now yields a present value net economic benefit of \$20 million.

The sensitivity analysis shows that where generation capital costs are lower than forecast, the credible options will have different levels of net economic benefit than forecast. In addition, the ranking of net economic benefits between the two credible options has changed. Therefore, it may be necessary for the RIT–T proponent to develop additional reasonable scenarios with varying levels of generation capital costs in its assessment of the credible options.

3.8.3 Reasonable scenarios and computational effort

The number of reasonable scenarios and credible options used in a particular RIT–T assessment will have a major influence on the extent of modelling and analysis that the RIT–T proponent must undertake. This is valuable to consider given NER clause 5.15A.2(b)(2) requires RIT–T proponents to apply the RIT–T instrument to a level of analysis which is proportionate to the scale and likely impact of each credible option.

As an example, assume that a RIT–T proponent is assessing a \$50 million network option to increase network transfer capability to accommodate expected load growth:

- against one alternative credible option;
- using a single discount rate;
- based on a single set of capital, operating and ancillary services costs for existing, committed, anticipated and modelled projects;
- based on two alternative demand forecasts; and
- using both competitive bidding and a ‘realistic’ bidding approach.
- This analysis would necessitate the development of:
 - four reasonable scenarios—encompassing two different demand levels (high and low) and two different bidding approaches (competitive and realistic); and
 - 12 states of the world—encompassing one set of reasonable scenarios for each of the two credible options and the base case.

It will often, but not always, be necessary for a RIT–T proponent to model a separate market development path for each state of the world. For example, it would be appropriate to model how plant expansion paths change with different levels of demand and with or without different credible options. However, there may be some parameters for which it would be infeasible or unnecessary to model separate plant expansion paths as those parameters were varied. Such parameters could include discount rates and bidding behaviour. For example, it may be unnecessary to develop separate market expansion paths under different bidding assumptions, as it may be infeasible to determine how bidding behaviour affects the pattern of plant development.

In the present case, only six market development modelling paths may be required. That is, there might be a different path for the high and low demand reasonable scenarios, for each the two credible options plus the base case: $2 \times (2 + 1) = 6$. Table 1 illustrates this.

Table 1: Modelling and analysis required under the RIT–T

Reasonable scenario	Credible option	Market development path	State of the world
1: High demand, competitive bidding	Base case	1	1
1: High demand, competitive bidding	Option 1	2	2
1: High demand, competitive bidding	Option 2	3	3
2: High demand, strategic bidding	Base case	1	4
2: High demand, strategic bidding	Option 1	2	5
2: High demand, strategic bidding	Option 2	3	6
3: Low demand, competitive bidding	Base case	4	7
3: Low demand, competitive bidding	Option 1	5	8
3: Low demand, competitive bidding	Option 2	6	9
4: Low demand, strategic bidding	Base case	4	10
4: Low demand, strategic bidding	Option 1	5	11
4: Low demand, strategic bidding	Option 2	6	12

If we varied the input assumptions further, the number of reasonable scenarios, market development paths and required states of the world in applying the RIT–T analysis would multiply.

3.8.4 High impact, low probability events

A RIT–T can capture the economic impacts of HILP events using scenario analysis, which entails following these RIT–T application guidelines in:

- exploring reasonable scenarios where relevant HILP events occur. For guidance on selecting reasonable scenarios, see section 3.8.1;
- costing the impact of that HILP event occurring. In costing this event, we would expect the RIT–T proponent to include market benefits related to changes in load shedding. In valuing these market benefits, the RIT–T proponent should use a VCR that is consistent with our guidance in section 3.4.2. For example, if and where applicable, the RIT–T proponent might find it is suitable to apply a VCR associated with widespread and long duration outages; and

- weighting the economic impact of the event by a reasonable estimate of its probability of occurring. For more information on weighting reasonable scenarios, see sections 3.8.3 and 3.9.

A RIT–T proponent can also use sensitivity testing to explore the robustness of different credible options to risks, including HILP events.

When exploring the economic impacts of HILP events, RIT–T proponents should:

- explore the viability and effectiveness of non-network options in managing or responding to the effects of HILP events;
- recognise the different factors influencing the impact of certain HILP events. For instance, RIT–T proponents should have regard to AEMO’s role in determining new ‘protected events’ when considering the impact of HILP events; and avoid skewing the results. This can be achieved by assuming that:
 - o the HILP event occurred in the context of reasonable BAU actions; and
 - o the industry responded responsibly and efficiently to the HILP event.

3.9 Uncertainty and risk

The future will be uncertain when RIT–T proponents apply the RIT–T. Therefore, the expected costs and market benefits of a credible option (and therefore the net economic benefit) should also be uncertain. This uncertainty may have a material impact on the selection of the preferred option. The following sections provide information and guidance on how a RIT–T proponent can respond to uncertainty when applying the RIT–T.

The **range of reasonable scenarios** will primarily reflect where there is material uncertainty over the future market supply and demand conditions and characteristics, as well as where this affects the expected market benefits or costs of a credible option. Those reasonable scenarios should reflect the range of potential outcomes. Associated with each reasonable scenario is a probability corresponding to the likelihood of that scenario occurring. RIT–T proponents then probability-weight market benefits across a range of reasonable scenarios.

3.9.1 Uncertainty regarding market benefits

The market benefit of a credible option is the probability-weighted sum of its market benefits across all reasonable scenarios. The methodology for assigning probabilities to each reasonable scenario will depend on the methodology for defining the reasonable scenario. Where there is uncertainty about future demand, two different methodologies are possible:

- Under the first approach, choosing a range of equally spaced values for future demand, and probability weightings for each of these values. Extreme values of future demand will receive a lower probability than values closer to the mean.
- Under the second approach, the RIT–T proponent will then rank different values for future demand, and divide these values into groups (such as quartiles or deciles). It will then select a representative value for demand from each group. The probability assigned

to each representative value is the same (such as 25 per cent for quartiles, 10 per cent for deciles). Under this approach, the probability of each demand value arising is

constant, but the chosen representative demand values are likely to be grouped closer together for values of demand closer to the mean.

While either approach is acceptable, the methodology for assigning probabilities to each reasonable scenario must be consistent with the methodology for choosing the reasonable scenarios themselves. Where a RIT–T proponent has no evidence or rationale for assigning a higher probability for one reasonable scenario over another, it may weight all reasonable scenarios equally.

Moreover, where the RIT–T proponent uses the most recent ISP scenarios as its reasonable scenarios, it must adopt the probability weightings that AEMO used in the most recent ISP.²⁹ Where the RIT–T proponent only uses some of the ISP scenarios, the probability weightings that AEMO assigns to those scenarios should inform the probability weightings that the RIT–T proponent applies. Example 16 demonstrates how a RIT–T proponent might do this.

Example 15: Probability weighting when using a sub-set of the ISP scenarios

Assume the ISP scenarios (and probability weightings) are Scenario 1 (10%), Scenario 2 (40%), Scenario 3 (20%), Scenario 4 (20%), Scenario 5 (10%).

Assume that Scenario 5 is based around the early retirement of generators in Region A, which only has a material impact on the benefits of projects that run through Region A.

Assume the RIT–T proponent is seeking to address an identified need that involves an intraregional issue in Region B, and therefore finds that excluding Scenario 5 would have an immaterial impact on its cost benefit analysis whilst reducing its computational burden. As such, the RIT–T proponent has a demonstrable reason to exclude Scenario 5.

In absence of AEMO indicating what the probability weightings would be in absence of Scenario 5, the RIT–T proponent might use its discretion to re-weight the scenarios to maintain the same relative probabilities as set out in the ISP. To do this, the RIT–T proponent would re-weight each of the remaining scenarios by dividing the probability weightings by 0.9 (1.0 – 0.1).

Alternatively, the RIT–T proponent might have particular information regarding the conditional likelihood of each ISP scenario occurring. For instance, if Scenario 5 is a variation of the most likely scenario (Scenario 2), but with early retirement, it could be preferable to re-weight Scenario 2 to 50% and maintain the probabilities for Scenario 1, Scenario 3 and Scenario 4 that were in the ISP.

Example 16 demonstrates the method for calculating market benefits across a probability weighted range of reasonable scenarios.

²⁹ AER, *RIT–T*, August 2020, subparagraph 7(b).

Example 16: Calculating the expected market benefit

A RIT–T proponent is considering three credible options across four reasonable scenarios. The three credible options are a: network option, generation option, and demand-side option. The four reasonable scenarios are:

- High capital costs; High demand (Scenario 1);
- High capital costs; Low demand (Scenario 2);
- Low capital costs; High demand (Scenario 3); and
- Low capital costs; Low demand (Scenario 4).

The following probabilities of occurrence are assigned to each of the above reasonable scenarios:

- Scenario 1 = 10 per cent;
- Scenario 2 = 25 per cent;
- Scenario 3 = 45 per cent; and
- Scenario 4 = 20 per cent.

Table 2 presents a ranking of these three credible options across each of the four reasonable scenarios according to market benefit relative to a base case.

Table 2: Ranking credible options across reasonable scenarios (\$m)

Credible option	Market benefit, scenario 1	Market benefit, scenario 2	Market benefit, scenario 3	Market benefit, scenario 4
Network option	22	5	45	13
Generation option	25	16	40	20
Demand-side option	16	8	6	2

Calculating the (probability-weighted) market benefit across the range of reasonable scenarios requires one more step than the analysis for generating the results in table 2. For each credible option, the market benefit under each reasonable scenario must be weighted by that reasonable scenario’s probability of occurrence. This generates one market benefit estimate for each credible option, as outlined in table 3 below.

Table 3: Calculating expected market benefit (\$m)

Credible option	Market benefit × weight, S1	Market benefit × weight, S2	Market benefit × weight, S3	Market benefit × weight, S4	Probability weighted market benefit
Network option	22 × 10%	5 × 25%	45 × 45%	13 × 20%	26.3
Generation option	25 × 10%	16 × 25%	40 × 45%	20 × 20%	28.5
Demand-side option	16 × 10%	8 × 25%	6 × 45%	2 × 20%	6.7

3.9.2 Uncertainty regarding costs

Where there is a material degree of uncertainty in the costs of a credible option, the RIT–T instrument requires the RIT–T proponent to calculate the expected cost of the option under a range of different reasonable cost assumptions. The cost of the credible option is the probability weighted present value of the direct costs of the credible option under the different cost assumptions.³⁰

For the avoidance of doubt, the term ‘cost assumptions’ is distinct from the term reasonable scenarios used elsewhere in the RIT–T instrument and these RIT–T application guidelines.

The direct costs of a credible option may vary for reasons other than the nature of the relevant reasonable scenario. For example, the direct costs of a credible option may be uncertain because they depend on variables such as exchange rates, the price of copper or the price of thermal coal. Similarly, whether a reasonable scenario reflects high or low demand growth is unlikely to affect the costs of a credible option. This is why a RIT–T proponent must separately undertake a weighted averaging of the direct costs of a credible option as well as the market benefits of a credible option.

Example 17: Calculating the expected cost

The following example continues from example 16. For each of the three credible options, the RIT–T proponent also considered three cost assumptions (‘Low’, ‘Medium’ and ‘High’).

The three cost assumptions and associated probabilities of occurrence for each credible option were:

- Network option:
 - Low (low steel prices; favourable exchange rate) = 15 per cent.
 - Medium (medium steel prices; average exchange rate) = 55 per cent.
 - High (high steel prices; unfavourable exchange rate) = 30 per cent.

³⁰ AER, RIT–T, August 2020, paragraph 6.

- Generation option:
 - Low (low steel prices; low labour costs) = 10 per cent.
 - Medium (medium steel prices; medium labour costs) = 50 per cent.
 - High (high steel prices; high labour costs) = 40 per cent.
- Demand-side option:
 - Low (low implementation and maintenance costs) = 30 per cent.
 - Medium (medium implementation and maintenance costs) = 50 per cent.
 - High (high implementation and maintenance costs) = 20 per cent.

As table 4 outlines, the RIT–T proponent can calculate an expected cost for each credible option by taking a weighted-average across cost assumptions.

Table 4: Calculating expected cost (\$m)

Credible option	Low cost scenario	Medium cost scenario	High cost scenario	Expected cost
Network option	22.5	25	32.5	26.9
Generation option	23	27	29	27.4
Demand-side option	5	6	7	5.9

For completeness, drawing on the probability weighted market benefits derived in example 16, the net economic benefits and ranking of these three options are in table 5 below.

Table 5: Calculating expected net economic benefits (\$m)

Credible option	Probability weighted market benefit	Expected cost	Expected net economic benefit	Ranking
Network option	26.3	26.9	-0.6	3
Generation option	28.5	27.4	1.1	1
Demand-side option	6.7	5.9	0.8	2

3.9.3 Option value

The RIT–T instrument requires RIT–T proponents to consider option value as a class of potential market benefit.³¹ Option value is a benefit resulting from retaining flexibility where certain actions are irreversible (sunk), and new information may later arise on the payoff from taking a certain action.

It is important for RIT–T proponents to consider option value because many network investment decisions are partially- or fully-irreversible. In some cases, past decisions are reversible at an increased cost. For example, a RIT–T proponent might purchase land for a substation where land is inexpensive. If it later determines that more land is required but the surrounding areas are fully developed, expanding the substation might remain feasible but significantly costlier.

A RIT–T proponent might expect that information will later become available that affects the net market benefit of a partially- or fully-irreversible action it is deciding to carry out. In such circumstances, there should be value in retaining some flexibility to respond to that new information when it emerges. For example, if demand for a transmission line is uncertain but might increase, the RIT–T proponent might wish to retain the flexibility to expand the capacity of the transmission line at a relatively low cost in the future. If demand for a transmission line is uncertain but might decrease, the RIT–T proponent may prefer to implement a temporary (perhaps a non-network) solution to congestion problems and defer a major sunk investment until the demand for the transmission line is clear.

Capturing option value when applying a RIT–T

Where the future is uncertain, the RIT–T proponent may consider investment options that retain some flexibility and allow it to respond to any new information that arises. For example, where there is material uncertainty about future demand growth, the set of credible options could include an option that allows the RIT–T proponent to make a smaller network investment now, but retain flexibility to upgrade the line at a reduced cost later.

RIT–T proponents can make investment decisions that capture these benefits of retaining flexibility, or 'account for option value' by performing scenario analysis consistently with these RIT–T application guidelines, thereby valuing how the net benefits of different credible options vary under different scenarios. In identifying credible options, RIT–T proponents should be considering credible options where the decision maker is able to change its action in response to new information. Where this type of credible option is available (that is, an option that has flexibility built into it), we can see the RIT–T as allowing for two stages: (1) whether to commit to an option with built-in flexibility, and (2) whether to partially- or completely-reverse the earlier decision.

Decision rules and visual aids can assist the RIT–T proponent to value the option it can exercise in stage (2) above. As noted in section 3.2.3, the RIT–T proponent can formulate credible options incorporating a decision rule or policy regarding how it will respond to certain changes in variables. Visual aids such as 'tree' diagrams can often represent such

³¹ AER, *RIT–T*, August 2020, Subparagraph 11(j) and as required under NER clause 5.15A.2(b)(4)(ix).

rules or policies (see figure 11). Example 35 in appendix A provides a worked example of how RIT–T proponents can capture option value through using such visual aids and decision rules.

For clarity, the RIT–T instrument allows RIT–T proponents to capture option value beyond what they have otherwise captured by probabilistically weighting credible options over reasonable scenarios, as long as it is not double-counted.³²

3.9.4 Contingency allowances

Contingency allowances are often included in cost estimates to allow a RIT-T proponent to take into account uncertainty in the costs of a credible option. If a material contingency allowance is included in a cost estimate for a credible option, the RIT-T proponent must explain:³³

- the reasons and basis for the contingency allowance, including the particular costs that the contingency allowance may relate to
- how the level or quantum of the contingency allowance was determined
- the methodologies and processes in place to minimise the likelihood of spending the contingency allowance. [ENA suggests this sentence is deleted – see submission]

3.10 Selecting the preferred option

Under the RIT–T, the preferred option is the credible option that maximises the net economic benefit across the market, compared to all other credible options. The net economic benefit of a credible option is simply the market benefit less the costs of the credible option.

The preferred option may have a net economic cost where an identified need is for reliability corrective action, providing inertia network services under NER clause 5.20B.4, or providing system strength services under NER clause 5.20C.3.

³² Specifically, the RIT–T provides that market benefit includes the present value of 'any additional option value (meaning any option value that has not already been included in other classes of market benefits) gained or foregone from implementing the credible option with respect to the likely future investment needs of the market'. See AER, *RIT–T*, August 2020, subparagraph 11(i).

³³ NER, cl. 5.16.2(c)(8).

Example 18: Calculating expected net market benefit

This example builds on example 16 and example 17. Combining the information in table 4 and table 5 allows calculation of a single net economic benefit estimate for each credible option. The net economic benefit of each of the credible options considered in example 16 and example 17 above is outlined in table 6 below.

Table 6: Calculating expected net market benefit (\$m)

Credible option	Market benefits	Costs	Net economic benefit	Ranking
Network option	11.3	11.9	-0.6	3
Generation option	13.5	12.4	1.1	1
Demand-side option	0.9	0.5	0.4	2

The preferred option in this example is the generation option.

3.11 Externalities

Under the RIT–T, externalities are economic impacts that accrue to parties other than those who produce, consume and transport electricity in the market (see NER clause 5.15A.2(b)(9)). As such, externalities are not included in either the costs or market benefits of a credible option and are therefore not included in the determination of net economic benefit.

As virtually all individuals and businesses located in the geographic NEM consume electricity, we recognise that NER clause 5.15A.2(b)(9) may be read as only trivially limiting the scope of costs or benefits to consider under the RIT–T. However, we consider that interpretation would conflict with the intention of clause 5.15A.2(b)(9). Rather, we interpret the qualifier ‘consumers of electricity’ in NER clause 5.15A.2(b)(9) as referring to costs or benefits incurred or obtained, respectively, by parties in their capacity as consumers of electricity. Thus, RIT–T proponents should exclude costs or benefits that arise but are incidental to parties’ electricity consumption from its analysis.

Example 19 provides examples of negative and positive externalities below.

Example 19: Externalities

Negative externality

Assume a credible option is a local gas-fired peaking generator, planned for development in close proximity to an existing hotel. The RIT–T proponent expects the development of the generator will reduce the nearby hotel’s annual earnings (due to a loss of visual amenity). The present value of this loss is \$15 million.

In this example, the \$15 million cost borne by the hotel’s proprietor is a negative externality.

While the development of the gas-fired peaking generator drives this cost, the generator’s developer will not incur the cost. It is therefore not part of the credible option’s costs.

Positive externality

Assume a credible option entails developing a large-scale wind farm located near a small town. The RIT–T proponent expects the development of the wind farm will increase the annual earnings of the town’s restaurant during the duration of the wind farm’s construction, due to a large number of construction workers temporarily residing in the town. The present value of these increased earnings is \$1 million.

In this example, the \$1 million benefit to the restaurant’s proprietor is a positive externality. The development of the wind farm drives this benefit. However, this is not realised by the wind farm’s developer or any other NEM party in their capacity as consumers of electricity. Therefore, this benefit is not part of the market benefits of the credible option.

Externalities and external funding contributions

Our guidance that RIT–T proponents must exclude externalities from their RIT–T applications has a bearing on how RIT–T proponents should treat external project funding for a credible option differently depending on whether it has or will be provided by:

- a Registered Participant under the NER or any other party in their capacity as a consumer, producer or transporter of electricity in the market (a Participant)³⁴; or
- any other party (Other Party).

As example 20 illustrates, funds that move between Participants count as a wealth transfer and should not affect the calculation of the final net economic benefit under the RIT–T. This wealth transfer occurs because the benefit gained by the Participant receiving the external funds (that is, the reduction in the required outlay by the RIT–T proponent in providing the

³⁴ For clarity, by including parties in their capacity as producers and/or transporters of electricity, this definition captures entities such as distributed energy resources suppliers and energy service companies, that may wish to support (and implicitly, discourage) particular credible options from which they benefit in a RIT–T. Such an entity could provide this support directly as a proponent of a non-network option, or indirectly via subsidies to end-use consumers to encourage take-up of non-network options.

credible option) is directly offset by the cost (or negative market benefit) incurred by the other Participant providing the external funds.

As example 21 illustrates, funds from an Other Party to a Participant should increase the net economic benefit of the option. This occurs because the benefit gained by the Participant receiving the external funds (that is, the reduction in the required outlay by the RIT–T proponent in providing the credible option) is not offset by the cost incurred (or negative net market benefit) by the Other Party in providing the external funds. This is because the costs and benefits to the Other Party are outside the scope of RIT–T cost benefit analysis, which is limited to producers, consumers and transporters of electricity in the market. As such, these external funds increase the final net economic benefit calculated under a RIT–T application.

While funds from an Other Party to a Participant in connection with a credible option increase the net economic benefit of that option, the RIT–T proponent should report the expected net economic benefit of different credible options in absence of such funds, as well as after receiving these funds. Doing this will increase the transparency of the RIT–T application, allowing stakeholders to understand what is driving the results of the cost benefit analysis.

Example 20: Funding from a Participant

A large generator in a region wishes to support the development of a new regulated interconnector from its local region to an adjacent region. The interconnector will facilitate increased electricity exports at times of high wholesale spot prices in the adjacent region when the existing interconnector is often constrained. Assume the following:

- The RIT–T proponent estimates that the present value of construction cost and lifetime operating and maintenance costs of the interconnector are \$120 million.
- The RIT–T proponent estimates that the present value of the market benefits of the interconnector are \$110 million.
- The generator wishes to provide \$10 million to the proponent of the interconnector, being the jurisdictional TNSP in that generator's region because the present value of its expected benefit from the interconnector is \$15 million. As such, the generator's decision to contribute \$10 million was a rational decision that would allow the project to go ahead so that it is \$5 million better off.

As the generator is a Participant and a party who produces electricity in the market, the generator's \$10 million contribution to the proponent TNSP does not increase the net benefits of the interconnector option for the purposes of a RIT–T assessment. The generator's \$10 million contribution is treated as a voluntary wealth transfer between producers and consumers of electricity. The contribution is therefore ignored in the calculation of market benefits and has no impact on the net economic benefit of the project.

Moreover, if the generator's contribution of \$10 million of its expected benefit was a market benefit (say, it allows the generator to sell a greater amount of electricity into the spot market), then this contribution should already be included in the \$110 million expected benefit. If that market benefit was not entirely captured in the \$110 million (for reasons such as oversight or immateriality), the generator's proposal to provide the \$10 million contribution would be a reasonable basis for the RIT–T proponent to further explore whether it has included relevant and material market benefits in the RIT–T analysis.

Example 21: Funding from an Other party

A jurisdictional government wishes to support the development of a new regulated interconnector from its local region to an adjacent region to facilitate increased production and/or consumption of electricity in its region. The construction cost of the interconnector is \$100 million and the present value of its lifetime operating and maintenance costs is \$20 million.

The government wishes to contribute \$10 million to the proponent of the interconnector, being the jurisdictional TNSP in the government's region.

As the government is not a Registered Participant and is not making the contribution in its capacity as a producer, consumer or transporter of electricity in the market, the government's \$10 million contribution to the proponent TNSP reduces the cost of the interconnector option for the purposes of a RIT–T assessment. That is, the cost of the interconnector option for RIT–T purposes becomes \$110 million. The government's \$10 million contribution is effectively treated as a reduction in costs borne by those who consume, produce and transport electricity in the market in relation to the interconnector option.

3.12 Suitable modelling periods

The duration of modelling periods should take into account the size, complexity and expected life of the relevant credible option to provide a reasonable indication of the market benefits and costs of the credible option. This means that by the end of the modelling period, the network is in a 'similar state' in relation to needing to meet a similar identified need to where it is at the time of the investment.

It is difficult to provide definitive guidance on how to implement this principle. However, it is unlikely that a period of less than 5 years would adequately reflect the market benefits of any credible option. In the case of very long-lived and high-cost investments, it may be necessary to adopt a modelling period of 20 years or more.

Moreover, RIT–T proponents should also include any relevant and material terminal values into their discounted cash flow analysis, where appropriate – that is, where the expected economic life is longer than the modelling period. Terminal values represent a credible option's expected costs and benefits over the remaining years of its economic life after the modelling period. It is best practice for RIT–T proponents to explain and justify the assumptions underpinning terminal value calculations.

4 Stakeholder engagement process in applying the RIT-T

This part of the RIT-T application guidelines summarises the process that the RIT-T proponent must follow when applying the RIT-T. NER clause 5.16.4 establishes a three-stage process for RIT-T projects that are not actionable ISP projects, as summarised in figure 1. This includes consulting on a:

- consultation report;
- project assessment draft report (draft report); and □ conclusions report.

Figure 1: RIT-T assessment and consultation process



* Cost threshold at the time of drafting. Under clause 5.15.3 of the NER, we must review RIT-T cost thresholds every three years for changes in input costs. In addition to the cost threshold, other requirements to skip publishing the draft report include:

no material market benefit, the TNSP has identified its preferred option in the consultation report, and submissions on the consultation report did not identify any additional credible options which could deliver a market benefit.

4.1 Consumer and non-network engagement

The NEO requires network businesses to operate their networks in the long-term interests of electricity consumers. Accordingly, network businesses should engage with their consumers so they can provide services that align with their long term interests. While the NER are not prescriptive on consumer engagement, it is best practice for the RIT-T proponent to describe in each of the three RIT-T reports how they have:

- engaged with consumers, as well as other stakeholders; and
- sought to address any relevant concerns identified as a result of that engagement.

Taking a best practice approach to consumer and non-network engagement should help RIT–T proponents to:

- identify the preferred option, by allowing a broad spectrum of credible options to be considered and by providing additional scrutiny to the analysis to ensure it is robust; and
- apply the RIT–T in a way that is credible, which reduces the scope for misunderstandings and disputes, and increases the AER's ability to fast-track further regulatory assessments on expenditure related to that project.

In general, to better understand the views of consumers and other stakeholders when applying a RIT–T, proponents may wish to do the following:

- Undertake early engagement with consumers, non-network businesses and other key stakeholders. Early engagement with stakeholders on an investment proposal can occur before a RIT–T application has formally commenced, particularly through consultation on the RIT–T proponent's annual planning reports. Proactive early engagement will likely involve doing more than just fulfilling the minimum RIT–T consultation requirements in NER clause 5.16.4. However, such initiatives might minimise the effort required during the RIT–T application process. For example, early engagement might equip prospective non-network proponents to propose more suitable or effective credible options. Early consultation can also support RIT–T proponents in commencing their analysis with a well-framed identified need. Achieving this can facilitate a faster, smoother and less controversial RIT–T process, reducing the scope for disputes.
- Focus on providing transparent, user-friendly data to stakeholders. We respect the need for network businesses to protect commercially sensitive information, but note that the effectiveness with which other credible options may be proposed for a RIT–T application is maximised when stakeholders have access to all of the relevant information to appropriately contextualise an investment proposal.
- Make efforts to understand broader consumer views, recognising that the consumers who do not actively participate in consultation with network businesses can be those most affected by investment decisions. As an example, for large RIT–T projects, such efforts might include convening a consumer reference group.
- Recognise that making submissions during the RIT–T application process takes considerable time and effort on the part of consumers. We encourage RIT–T proponents to give adequate weight to the suggestions made and perspectives offered by consumers in their submissions. We also encourage RIT–T proponents to be aware of demands placed on stakeholders when there are multiple consultation processes on foot. For instance, strategies such as early engagement or being flexible to consider suggestions made outside written submissions might prove beneficial.

Our 'consumer engagement guideline for network service providers' states our expectations of how network businesses should engage with their consumers—that is, their 'end users'.³⁵ We encourage best practice consumer engagement in line with these guidelines in general,

³⁵ For these guidelines, see AER, *Better Regulation, Consumer Engagement Guideline for Network Service Providers*, 2013.

as well as when applying a RIT–T and in other aspects of network planning, such as when providing information in annual planning reports.

4.2 Project specification consultation report

The RIT–T proponent must prepare a consultation report setting out certain information about the proposed transmission investment. A RIT–T proponent is not required to make the consultation report separately available if it includes the consultation report as part of its annual planning report.

Information required for consultation report

The consultation report must set out:

- the identified need for the investment;
- assumptions used in identifying the identified need. Where reliability corrective action is required, the RIT–T proponent must include reasons why this action is necessary;
- the technical characteristics of the identified need that a non-network option would be required to deliver, such as the size of load reduction or additional supply, location and operating profile;
- a description of all credible options that the RIT–T proponent considers would address the identified need; and
- for each credible option identified, information about:
 - the technical characteristics of the credible option;
 - whether the credible option is likely to have a material inter-regional impact;
 - the classes of market benefits that the RIT–T proponent considers are unlikely to be material and reasons why they are unlikely to be material;
 - the estimated construction timetable and commissioning date; and
 - to the extent practicable, the total indicative capital and maintenance costs.

In describing an identified need for reliability corrective action, it is often useful for a RIT–T proponent to specify:

- the maximum demand in MW and energy MWhs at risk. This should include expectations regarding the timing of any expected breach of a reliability standard and by how much;
- specific details on the planning criteria applied (for example specific clause and section references to the legislation or other regulatory instruments that apply); and

- in an ‘n–x’ reliability assessment³⁶, any assumptions the RIT–T proponent has made in developing ‘x’ (including for example information regarding generator and interconnector availability).

It will also be beneficial for the consultation report to include additional information to assist non-network proponents in proposing alternative credible options. Where relevant, this information could include:

how any proposed augmentation credible option links to asset refurbishment or replacement plans on the transmission network; and

- information regarding future generation and demand assumptions.

Consultation process

The RIT–T proponent must make the consultation report available to all registered participants, AEMO and interested parties.³⁷ Below is a summary of the important stages in the consultation process:

- Within five business days of finalising the consultation report, the RIT–T proponent must provide a summary of the report to AEMO. AEMO will publish the summary on its website within three business days of receiving the summary.
- Upon request, the RIT–T proponent must make their consultation report available to an interested party within three business days.
- While not required in the NER, we consider it best practice for the RIT–T proponent to publish its consultation report (possibly alongside the summary of the report) and the closing date and requirements for submissions on its website.
- The RIT–T proponent must seek submissions from registered participants, AEMO and interested parties on the credible options presented and the issues addressed in the consultation report.
- The period for submissions must be at least 12 weeks from the date AEMO publishes the summary on its website.

4.3 Project assessment draft report

If the RIT–T proponent decides to proceed with the proposed transmission investment, it must prepare a draft report within:

- 12 months after the consultation period on the consultation report³⁸; or

³⁶ That is, an assessment towards meeting a deterministic reliability standard where the network is able to withstand, at all times, an unexpected failure or outage of ‘x’ number of system components.

³⁷ Registered participant and interested party are defined in chapter 10 of the NER.

³⁸ NER cl. 5.16.4(g) states that the consultation period on the consultation report must be no less than 12 weeks from when AEMO publishes the summary of the consultation report on its website.

- a longer period agreed to by the AER in writing.

NER clause 5.16.4(m) allows the RIT–T proponent to include its draft report as part of its annual planning report. However, it must publish its annual planning report within 12 months after the consultation period on the consultation report (unless the AER agrees to a longer period).

Information required for the draft report

The draft report must include the following information:

- a description of each credible option assessed;
- a summary of, and commentary on, the submissions received;
- a quantification of the costs (including a breakdown of the operating and capital expenditure) and classes of material market benefits for each credible option;
- where relevant, the reasons for why a class of market benefit is not material;
- a detailed description of the method used to quantify each class of material market benefit and cost;
- what (if any) market benefit class is estimated to arise outside the RIT–T proponent's region and a quantification of the value of such benefits (in aggregate across all regions);
- the results of the net present value analysis for each credible option and accompanying explanatory statements regarding the results; and
- the proposed preferred option and details on its technical characteristics, estimated construction timetable and commissioning date and a statement and analysis that the preferred option satisfies the RIT–T.

Where the RIT–T proponent has undertaken market modelling, the draft report should also describe any assumptions made in this modelling. If the RIT–T proponent based its market modelling on the most recent ISP, it could simply make this statement. Otherwise, the RIT–T proponent might demonstrate why it varied, omitted or added to any modelling assumptions that form the most recent IASR, or explain how it simplified the modelling adopted in the most recent ISP.

While not explicitly required under the NER, we consider it best practice to publish the following documentation along with the draft report:

- Relevant documents that show detailed modelling, inputs and assumptions used for the RIT–T assessment. The RIT–T proponent should undertake best endeavours to address potential confidentiality concerns that might prevent it from making data or modelling information available. For example, the RIT–T proponent could explore whether it can aggregate, anonymise or redact that information, or share it with requesting parties on a confidential basis.

- Submissions received in response to the consultation report, unless marked confidential. In the case of confidential submissions, the RIT–T proponent should explore with the submitting party whether it can make a redacted or non-confidential version public.

Consultation process

The RIT–T proponent must make the draft report available to registered participants, AEMO and interested parties. Below is a summary of the important stages in the draft report process:

- Within five business days of finalising the draft report, the RIT–T proponent must provide a summary of the report to AEMO. AEMO will publish the summary on its website within three business days.
- Upon request, the RIT–T proponent must make its draft report available to an interested party within three business days.

While not required in the NER, it is best practice for the RIT–T proponent to also publish its draft report (or the summary of the report) and the closing date and requirements for submissions on its website.

- The RIT–T proponent must seek submissions from registered participants, AEMO and interested parties on the preferred option presented and the issues addressed in the draft report.
- The period for submissions must be at least six weeks from the date AEMO publishes the summary on its website.
- An interested party, a registered participant or AEMO (each known as a relevant party) may request a meeting with the RIT–T proponent within four weeks of the end of the consultation period. However, the RIT–T proponent is only required to hold a meeting if at least two relevant parties request a meeting. The RIT–T proponent may meet with a relevant party if, after considering all submissions, it considers that the meeting is necessary.

Exemption from preparing a draft report

Under clause 5.16.4(z1) of the NER, RIT–T proponents are exempt from providing a draft report if all of the following conditions are met:

- the estimated capital cost of the preferred option is less than \$43 million (we must review this threshold every three years)³⁹;
- the RIT–T proponent has identified in its consultation report its preferred option, its reasons for that option and noted that it will be exempt from publishing the draft report for its preferred option;

³⁹ This cost threshold became \$43 million on 1 January 2019, which we will therefore update on 1 January 2022. See AER, *Final determination: Cost thresholds review*, November 2018.

- the RIT–T proponent considers that the preferred option and any other credible options do not have a material market benefit (other than benefits associated with changes in voluntary load curtailment and involuntary load shedding); and
- the RIT–T proponent forms the view that submissions on the consultation report did not identify additional credible options that could deliver a material market benefit.

4.4 Project assessment conclusions report

As soon as practicable after the consultation period for the draft report, the RIT–T proponent must make available its conclusions report to all registered participants, AEMO and interested parties.⁴⁰ NER 5.16.4(t) requires the RIT–T proponent publish the conclusions report, which requires making the conclusions report available to registered participants electronically.⁴⁶

Where the RIT–T proponent is exempt from preparing a draft report, it must make the conclusions report available within 12 months of publishing the consultation report.

The RIT–T proponent is not required to make the conclusions report separately available if it includes the conclusions report as part of its annual planning report.

Information required for project assessment conclusions report

The conclusions report must set out:

- the matters required in the draft report (see section 4.3); and
- a summary of, and the RIT–T proponent's response to, submissions received from interested parties regarding the draft report. If the RIT–T proponent is exempt from preparing a draft report, the conclusions report must address any issues raised during its consultation on the consultation report.

Where the RIT–T proponent has undertaken market modelling, the draft report should also describe any assumptions made and inputs used in this modelling. If the RIT–T proponent based its market modelling on the most recent ISP, it could simply make this statement. Otherwise, the RIT–T proponent might demonstrate why it varied, omitted or added to any modelling assumptions or inputs that form the most recent IASR, or explain how it simplified the modelling adopted in the most recent ISP. While not explicitly required under the NER, it is best practice to publish the following documentation along with the conclusions report:

- Relevant documents that show detailed modelling, inputs and assumptions used for the RIT–T assessment. The RIT–T proponent should undertake best endeavours to address potential confidentiality concerns that might prevent it from making data or modelling information available. For example, the RIT–T proponent could explore whether it can

⁴⁰ Registered participant interested party and AEMO are defined in chapter 10 of the NER.

⁴⁶ See the definition of publish/publication in chapter 10 of the NER.

aggregate, anonymise or redact that information, or share it with requesting parties on a confidential basis.

- Submissions received in response to the consultation report and the draft report, unless marked confidential. In case of confidential submissions, the RIT–T proponent might explore with the submitting party whether it can make a redacted or non-confidential version public.

Publishing the conclusions report

Below is a summary of the stages for publishing and making the conclusions report available to registered participants, AEMO and interested parties:

- Within five business days of finalising the conclusions report, the RIT–T proponent must provide a summary of the report to AEMO. AEMO will publish the summary on its website within three business days.
- Upon request, the RIT–T proponent must make its conclusions report available to an interested party within three business days.
- The RIT–T proponent must publish the conclusions report by making it available to registered participants electronically.

While not required in the NER, it is best practice for the RIT–T proponent to also publish the conclusions report on its website as well as the date that this report was published. The RIT– T proponent may also note on its website that a process exists for resolving RIT–T disputes and the timeframes for lodging a dispute notice with the AER.

4.5 Reapplication of and reopening triggers for the RIT-T

Clause 5.16.4(z3) of the NER sets out that if a material change in circumstances has occurred, the RIT-T proponent must notify us of that and the actions it proposes to take as a result. The RIT-T proponent must also provide us with any information necessary to support the actions it proposes to take. Within 40 days, we must determine the actions the RIT-T proponent is to take. When making this determination, we must have regard to:

- : the credible options (other than the preferred option) identified in the conclusions report
- : the material change in circumstances identified by the RIT-T proponent
- : whether a failure to promptly undertake the RIT-T project is likely to materially affect the reliability and secure operating state of the transmission network, or a significant part of that network
- : whether the RIT-T proponent has had regard to:
 - o whether, in the RIT-T proponent's reasonable opinion, reapplying the **regulatory investment test for transmission to the** RIT-T project is justified in the circumstances
 - o the costs and delay that may result from the actions the RIT-T proponent proposes to take as a result of the material change in circumstances
 - o the costs and delay that may result from the reapplication (in whole or in part) of the regulatory investment test for transmission to the RIT-T project.

Clause 5.16.4(z4) of the NER provides that a material change in circumstances may include, but is not limited to:

- : a change in the key assumptions **(such as assumptions concerning demand forecasts, major policies, or plant closures)** used in identifying the identified need described in the project assessment conclusions report; or **[Note: ENA suggests examples in brackets are deleted as they are not referenced in Clause 5.16.4(z4)]**
- : for a **RIT-T project where the estimated capital cost of the preferred option is in excess of \$100 million (as varied in accordance with a cost threshold determination)** and **where** AEMO is not the sole RIT-T proponent, one or more RIT reopening triggers applying to the project have been triggered, or
- : a change in circumstances which, in the reasonable opinion of the RIT-T proponent, means that the preferred option identified in the project assessment conclusions report may no longer be the preferred option.

~~Clause 5.16.4(z3) of the NER sets out that if a material change in circumstances means that, in the reasonable opinion of the RIT-T proponent, the preferred option identified in the conclusions report is no longer the preferred option, the RIT-T proponent must re-apply the RIT-T to the RIT-T project.~~

~~NER clause 5.16.4(z4) clarifies that a material change in circumstances may include, but is not limited to, a change in the key assumptions (such as assumptions concerning demand forecasts, major policies, plant closures, etc.) used in identifying:~~

- ~~the identified need described in the conclusions report; or~~ ~~the credible options assessed in the conclusions report.~~

Since RIT–T proponents should be applying the inputs, assumptions and scenarios from the most recent IASR (see section 0), if changes to key inputs, assumptions or scenarios trigger an ISP update, the RIT–T proponent should actively consider whether there has been a change in circumstances that materially affects its RIT–T project.

~~We can make a determination to exclude RIT–T proponents from this clause, where appropriate. In making this determination, NER clause 5.16.4(z5) specifies that we must have regard to:~~

- ~~• the credible options (other than the preferred option) identified in the conclusions report;~~
- ~~• the change in circumstances identified by the RIT–T proponent; and~~
- ~~• whether a failure to promptly undertake the RIT–T project is likely to materially affect the reliability and secure operating state of the transmission network, or a significant part of that network.~~

~~We expect that situations requiring a re-application of the RIT–T under NER clause 5.16.4(z3) will be exceptional. Similarly, circumstances where we make a determination to exclude RIT–T proponents from this clause are also likely to be exceptional. For this reason, we will consider these situations on a case-by-case basis on whether such a determination would be appropriate.~~

4.5.1 RIT reopening triggers

A RIT reopening trigger is defined in Chapter 10 of the NER as meaning:

... the events, factors, or circumstances which, if they occur or eventuate would mean that the preferred option for a RIT-D project contemplated by clause 5.17.4(j)(13) or RIT-T project contemplated by clause 5.16.4(k)(10) or clause 5.16A.4(d)(9) may no longer be the preferred option, and may include a change in the key assumptions used in identifying or ranking the credible options for that project.

In addition to complying with the definition of a RIT reopening trigger, **for a credible where the estimated capital cost of the preferred option that exceeds \$100 million (as varied in accordance with a cost threshold determination)** and where AEMO is not the sole RIT-T proponent, a RIT-T proponent must propose one or more relevant RIT reopening triggers. These RIT reopening triggers must be tailored to the specific circumstances of the project in question.

The principles that we consider should guide the development of a RIT reopening trigger are:

- identifying the key inputs and assumptions used in RIT modelling, and the events, factors and changes in circumstances that may alter those key inputs and assumptions
- identifying an event, factor or circumstance that would have a real, rather than a potential or a possible, likelihood on affecting the key inputs and assumptions and may eliminate

net benefits of the preferred option and/or alters the ranking of credible options

- [being objective and capable of being verified](#)
- [where possible, quantify boundary values of key inputs and assumptions, for example the cost limit of a project before the net benefits of the project becomes negative.](#)

[Worked examples of RIT reopening triggers and proposed actions that a RIT-T proponent may take in response to a material change in circumstances is set out in **Appendix B**.](#)

4.5.14.5.2 Cancellation of the RIT-T

~~NER clause 5.16.4(z3) describes when a RIT-T proponent must re-apply a RIT-T. This must occur if a material change in circumstances means that, in the reasonable opinion of the RIT-T proponent, the preferred option identified in the conclusions report is no longer the preferred option.~~

~~However, it is also [reasonable-possible](#) that a material change in circumstances may lead to the identified need no longer existing, even mid-way through the RIT-T application process. This may lead the RIT-T proponent to cancel its RIT-T assessment before completing the RIT-T process. For example, the RIT-T proponent may publish a consultation report, only for its customers to later advise that, due to a material change in circumstances, the identified need no longer exists.~~

While not explicitly required under the NER, in circumstances mentioned above, we expect that the RIT-T proponent would clearly set out the reasons that led to the cancellation of the particular RIT-T assessment. It is also a best industry practice to keep stakeholders informed as soon as the RIT-T proponent becomes aware of the material change of circumstances around the identified need.

5 Dispute resolution

Clause 5.16B of the NER sets out a dispute resolution process for disputing the conclusions that a RIT–T proponent has made in its conclusions report. This part of the RIT–T application guidelines summarises the process that the disputing party, RIT–T proponent and AER must follow during a RIT–T dispute resolution process.⁴¹ It provides information on who may dispute a RIT–T assessment, what matters can be disputed, how to lodge a dispute, and the process that we, the RIT–T proponent and disputing parties must follow in resolving a dispute.

We are responsible for resolving all disputes relating to certain conclusions in the conclusions report. Eligible parties may apply to us for a finding on the disputed conclusion.

5.1 Who can make a RIT–T dispute

In the NER and these RIT–T application guidelines, a 'disputing party' refers to a person or party disputing a conclusion in the conclusions report. Only the following parties can lodge a dispute:⁴²

- Registered Participants;
- Australian Energy Market Commission (AEMC);
- Connection Applicants;
- Intending Participants;
- AEMO; and
- interested parties.

In the context of RIT–T disputes, an interested party is:⁴⁹

...a person including an end user or its representative who, in the AER's opinion, has the potential to suffer a material and adverse National Electricity Market impact from the investment identified as the preferred option...

For the purpose of this clause, material and adverse NEM impacts include impacts on:

- a network operator or other stakeholders such as aggregators or energy service companies in the NEM that:
 - o constrain the network operator's ability to fulfil functions mandated under the NER; or

⁴¹ For completeness, as the National Transmission Planner, AEMO acts as RIT–T proponent in Victoria. Since the NER permit AEMO to raise a RIT–T dispute, it can also be a disputing party.

⁴² For definitions of these eligible dispute parties, see chapter 10 of the NER and/or the glossary in appendix B. ⁴⁹ NER, cl. 5.15.1.

- o undermine the stakeholder's ability to perform its operations to the extent that it can no longer operate or perform a particular function. This may result from physical obstruction or a substantial reduction in profitability; or
- an electricity consumer, in their role as a consumer of electricity that reduce the quality or reliability of their electricity supply below what is required under the NER or reduce the sum of consumer and producer surplus.

A stakeholder cannot be an interested party for the purposes of NER clause 5.15.1 if its potential to suffer material and adverse impact relates to an externality rather than a NEM impact (see section 3.11 for a discussion on externalities). Given this, material and adverse NEM impacts do not relate to personal detriment or personal property rights.

The following examples demonstrate impacts relating to personal detriment and property rights to provide guidance on how we would apply NER clause 5.15.1.

Example 22: Material and adverse impacts

Impacts relating to personal detriment

A RIT–T proponent has identified a non-network option as its credible option. Part of this program will entail procuring network support services from back-up diesel generators. The RIT–T proponent expects this will defer its need for network augmentation and reduce the costs of electricity to end-users overall.

The RIT–T proponent also expects that some of its consumers will claim that the preferred option would cause detriment by increasing health-related costs due to the diesel generators increasing air pollution.

The negative impacts of this program on some consumers would constitute an impact relating to personal detriment. Therefore, we would not consider these consumers as interested parties on this basis.

Impacts relating to personal property rights

A RIT–T proponent has identified a network option as its credible option. Under this option, the RIT–T proponent will build poles and wires. This network infrastructure will run through several different properties. Some of the property owners consider that this action will devalue their property.

This would constitute an impact relating to personal property rights. Therefore, we would not consider these property owners as interested parties.

5.2 What can be disputed

The disputing party can only dispute conclusions that a RIT–T proponent made in the conclusions report regarding:

- the application of the RIT–T;
- the basis on which the RIT–T proponent classified the preferred option as being for reliability corrective action; or
- the RIT–T proponent's assessment about whether the preferred option will have a material inter-network impact in accordance with any criteria for a material inter-network impact that is in force at the time of preparing the conclusions report.

A dispute may not be raised about any issues outlined in the conclusions report which:

- are treated as externalities by the RIT–T; or
- relate to an individual's personal detriment or property rights.

For further guidance and examples on the matters that the RIT–T treats as externalities, see section 3.11.

5.3 Lodging a dispute and information required

Within 30 days of the RIT–T proponent publishing the conclusions report, the disputing party must:

- give notice of the dispute in writing setting out the grounds for the dispute to us; and □ at the same time, provide a copy of the dispute notice to the relevant RIT–T proponent.

The dispute notice should include the following information:

- the disputing party's name, a contact officer, address, email and telephone number;
- the ground/s for the dispute;
- any submissions the disputing party made regarding the consultation report, the draft report and conclusions report (if applicable);
- the RIT–T proponent's reply to any submissions made by the disputing party regarding the conclusions report (if applicable);
- details of any meetings held by the RIT–T proponent with the interested party (if applicable); and
- the details of any other known parties involved in the matter.

5.4 Procedure for a dispute

The AER, RIT–T proponents and disputing parties all have different obligations under clause 5.16B of the NER to ensure the timely resolution of disputes. Figure 2 summarises the process for resolving RIT–T disputes.

Timeframe for resolving disputes

We must either reject the dispute or make and publish a determination:

- within 40 days of receiving the dispute notice, or
- within a period of up to an additional 60 days where we notify interested parties that the additional time is required to make a determination because of the complexity or difficulty of the issues involved.

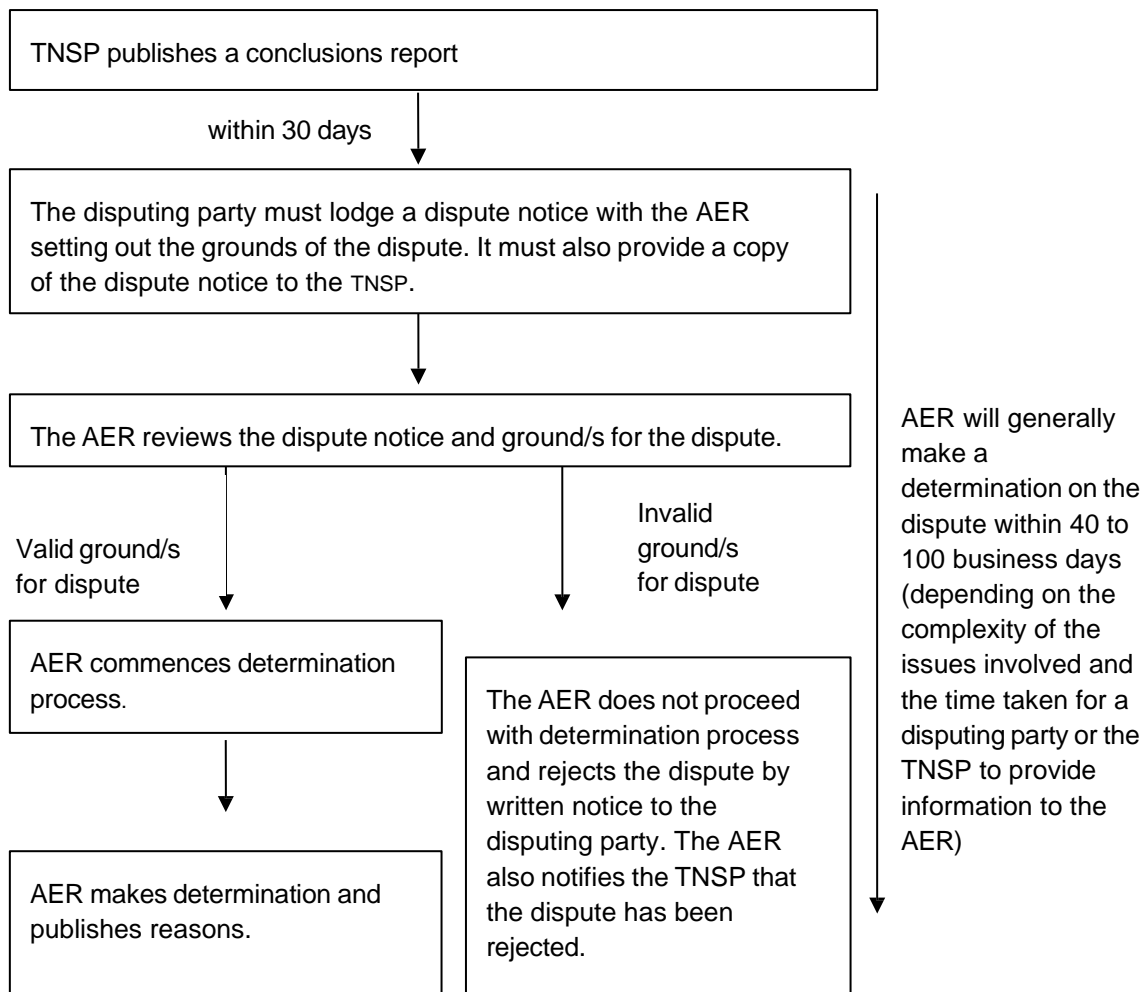
Extension of timeframe – request for additional information

We may also extend the time for making our determination if we have requested further information regarding a dispute from the disputing party or the RIT–T proponent, provided:

- we make the request for the additional information at least seven business days prior to the expiry of the period for making our determination; and
- the RIT–T proponent or disputing party provides the additional information within 14 business days of receipt of the request.

Under these circumstances, we may extend the time for making our determination by the time it takes the disputing party or RIT–T proponent to provide our requested information.

Figure 2: Dispute resolution process



AER determination

After considering the dispute notice and any other relevant information, we must either reject the dispute or make and publish a determination.

If we reject the dispute, we must:

- reject the dispute by written notice to the disputing party if we consider the grounds for the dispute are misconceived or lacking in substance; and
- notify the RIT–T proponent that the dispute has been rejected.

If we do not reject the dispute, we must make and publish a determination:

- stating that, based on the grounds of the dispute, the RIT–T proponent will not need to amend its conclusions report; or
- directing the RIT–T proponent to amend the matters set out in its conclusions report.

Scope of AER determination

We may only determine that the RIT–T proponent must amend the matters set out in the conclusions report if the RIT–T proponent has:

- incorrectly applied the RIT–T;
- erroneously classified the preferred option as being for reliability corrective action;
- incorrectly assessed whether the preferred option will have a material inter-network impact; or
- made a manifest error in performing calculations in applying the RIT–T.

Material and advice the AER may consider

We may engage an expert to provide advice. Given the level of technical and engineering detail involved in RIT–T assessments, such experts may include engineers, economists or experts in the electricity industry. We will likely require an engineering consultant to advise us on the engineering/planning aspects where the identified need is for reliability corrective action. Given the complex economic modelling and analysis required, we may also require an economic consultant to assist in resolving disputes regarding the quantification of market benefits.

On the material we may consider in making a determination on the dispute, we:

- must only take into account information/analysis that the RIT–T proponent could reasonably be expected to have considered/undertaken at the time it applied the RIT–T; and
- may disregard any matter raised by the disputing party or the RIT–T proponent that is misconceived or lacking in substance.

The following material is likely to be relevant to our consideration:

- the dispute notice;
- the consultation report, the draft report and conclusions report (as applicable);
- AEMO's most recent ISP and IASR;
- any expert advice or reports on the proposed asset;
- relevant transmission annual planning reports and other relevant planning publications;
- relevant planning criteria, reliability requirements or jurisdictional licensing requirements; and
- relevant regulatory decisions relating to the proposed asset.

Requests for further information

Under clause 5.16B(f)(3) of the NER, we may also request further information from the disputing party and RIT–T proponent. The disputing party or the RIT–T proponent must provide any additional information we request as soon as reasonably practicable.

A request for further information will be in writing and the notice will explain that:

- the request is being made under clause 5.16B(f)(3) of the NER;
- the timeframe within which the RIT–T proponent or disputing party should provide the information (generally 14 business days); and
- under NER clause 5.16B(i), the clock has stopped for when we must make a determination.

While the NER expressly provide for us to request information from the RIT–T proponent or the disputing party, we are not prohibited from requesting information from a party that is external to a dispute. We may ask third parties to provide information voluntarily. We can also issue a notice under section 28 of the National Electricity Law (as discussed below).

Depending on the nature of the information from external parties, and the anticipated use to which the information will be put, we may allow the applicant and/or disputing party an opportunity to comment on the information.

Section 28 notice

Under section 28 of the National Electricity Law, we may issue a compulsory information gathering notice to require a person to provide information or produce documents that we require for the performance or exercise of our functions and powers. The RIT–T dispute resolution process is one of our functions.

A section 28 notice can require the person providing the information or producing documents within the time specified in the notice. We determine the timeframe within which information must be provided on a case by case basis. In the case of a RIT–T dispute, the notice will likely require that the information be provided within 14 business days.

Section 28(3) provides that a person must comply with a section 28 notice unless the person has a reasonable excuse. Under section 28(4) a person must not, in purported compliance with a relevant notice, provide information that the person knows is false or misleading in a material particular.

A breach of section 28 carries a penalty of up to \$2,000 (in the case of a natural person) or \$10,000 (in the case of a body corporate).

Publishing a determination on the RIT–T dispute

We must publish our determination and reasons. We will publish this determination on our website, along with the dispute notice and all submissions (except those that are confidential).

For information regarding our use and disclosure of information, see the current version of the ACCC/AER Information Policy, which is available on our website.⁴³

Compliance with AER determination

A determination will generally take effect on the date that we make it, and will specify a reasonable timeframe for the RIT–T proponent to comply with our directions to amend its conclusions report.

5.5 Requesting an AER determination on the RIT–T application

Under NER clause 6A.8.1, revenue determinations can include contingent projects. The expenditure expected for such projects does not form part of the revenue allowance. However, we can later adjust the revenue allowance under NER clause 6A.8.2, if certain conditions (trigger events) occur during the regulatory period. In practice, trigger events can include a determination from us that the proposed investment satisfies the RIT–T (a 'preferred option determination'). These determinations will not be under NER clause 5.16.6, which was removed from the NER in the ESB rule change regarding the actionable ISP framework, which commenced on 1 July 2020.

Given this practice, this section provides guidance to inform RIT–T proponents on how:

- we will likely approach preferred option determinations; and
- they can work effectively with us when requesting a preferred option determination.

Requesting a preferred option determination

Our preference is that a request for a preferred option determination will be:

- in writing to support our decision making process;
- include any information or reports that may be relevant to our determination. This will facilitate a timely decision making process and reduce or avoid the need for information requests; and
- lodged after the expiry of the 30 day period for disputing a conclusions report, or after any RIT–T dispute has been resolved. A TNSP may lodge a request before the 30 day period. However, if a disputing party raises a valid RIT–T dispute, we will pause our assessment until the dispute resolution process is resolved.

Making a preferred option determination

⁴³ AER, ACCC and AER Information Policy: collection and disclosure of information, <https://www.aer.gov.au/node/6280>, accessed 25 June 2018.

We will endeavour to make any preferred option determination as quickly as practicable. The complexity of the project and the quality of information provided to us will determine the time required to undertake the assessment. However, we expect to complete any assessment within 120 business days of receiving the request (excluding any time required for dispute resolution or for the TNSP to respond to information requests).

We will publish the determination, along with our reasoning and any relevant nonconfidential material on our website.

Material we may consider

In making a preferred option determination, we:

- must use the findings and recommendations in the conclusions report;
- may request further information from the RIT–T proponent; and
- may have regard to any other matter we consider relevant. Other likely relevant information includes expert advice or reports on the proposed asset, any relevant planning publications and regulatory decisions relating to the proposed asset.

We may also engage an expert to provide advice. Such experts may include technical advisers, economists or experts in the electricity industry.

5.6 Costs determinations

Clause 5.15.4(a) of the NER provides that where we engage a consultant to assist in making a RIT–T dispute determination, we may make a costs determination. Costs determinations are limited to consultancy costs. Relevantly, NER clause 5.15.4 states:

(b) Where a costs determination is made, the *AER* may:

(1) render the RIT–T proponent or the RIT–D proponent (as the case may be) an invoice for the costs; or

(2) determine that the costs should:

(i) be shared by all the parties to the dispute, whether in the same proportion or differing proportions; or

(ii) be borne by a party or parties to the dispute other than the RIT–T proponent or the RIT–D proponent whether in the same proportion or differing proportions; and

(iii) the *AER* may render invoices accordingly.

(c) If an invoice is rendered under subparagraph (b)(2)(iii), the *AER* must specify a time period for the payment of the invoice that is no later than 30 *business days* from the date the *AER* makes a determination under paragraph (a).

If we make a costs determination, we will provide an invoice to the appropriate party. The invoice will break down the costs involved. Consistent with the requirements of the NER, payment of the invoice will be required no later than 30 business days from the date of our RIT–T dispute determination or a determination that a preferred option satisfies the RIT–T.

In making a cost determination, we have the discretion to determine the proportion of costs that each party should bear. Where we consider it appropriate for parties to share the costs, we will take into account the circumstances and nature of the dispute to make this decision.

A Guidance and worked examples on classes of market benefits

Clause 5.16.2(c)(6) of the NER requires we provide guidance and worked examples on acceptable methodologies for valuing the market benefits of a credible option. This appendix provides this guidance and worked examples on the following classes of market benefits:

- variable operating costs (specifically, changes in fuel consumption arising through different patterns of generation dispatch) (A.1);
- voluntary load curtailment (A.2);
- involuntary load shedding (A.3);
- costs to other parties (A.4);
- timing of transmission investment (A.5);
- network losses (A.6);
- ancillary services costs (A.7);
- competition benefits (A.8); and
- option value (A.9).

A.1 Variable operating costs

A credible option may lead to a decrease, increase, or no material net change in the variable operating costs of supplying electricity to load. Variable operating costs include fuel consumption, ongoing legal and regulatory compliance costs and variable maintenance costs. For simplicity, this example focuses on fuel costs.

First, a credible option may lead to a decrease in the cost of fuel consumed to supply electricity to load. For example, a credible option may:

- lead to a direct reduction in generation dispatch (typical for a demand-side reduction option); or
- facilitate the substitution of high-fuel cost plant with low-fuel cost plant (typical for a network option).

Either of these would constitute a positive contribution to the market benefits of the credible option.

Example 23: Decrease in fuel costs

Load is 200 MW. Local gas-fired generation has a fuel cost of \$30/MWh and capacity of 100 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 200 MW.

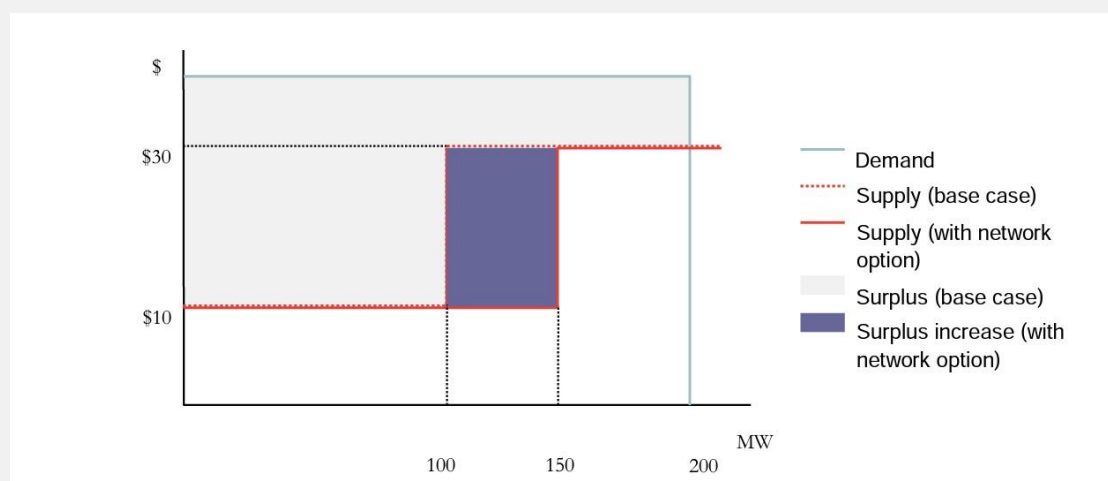
The capacity of the network between the remote generator and the load is limited to 100 MW, whereas the capacity of the network between the local generator and the load is effectively unlimited.

The credible option is to augment the network between the remote generator and the load by 50 MW. This would reduce the fuel costs used in dispatch:

- from: \$4,000 per hour ($100 \text{ MW} \times \$10 + 100 \text{ MW} \times \30);
- to: \$3,000 per hour ($150 \text{ MW} \times \$10 + 50 \text{ MW} \times \30).

Assuming the same conditions over all 8,760 hours in a full year, the total fuel cost saving would be $8,760 \times \$1,000 = \$8,760,000$ per annum. This would make a positive contribution to the market benefit of the network option.

Figure 3: Decrease in fuel costs



Alternatively, a credible option may lead to an increase in the cost of fuel consumed to supply electricity to load. This may occur if, for example, the credible option is a local generator dispatched in a manner that reduces unserved energy. However, the increase in fuel costs would constitute a negative contribution to the market benefit of the credible option.

Example 24: Increase in fuel costs

Load is 200 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 200 MW. The capacity of the network between the remote generator and the load is limited to 150 MW.

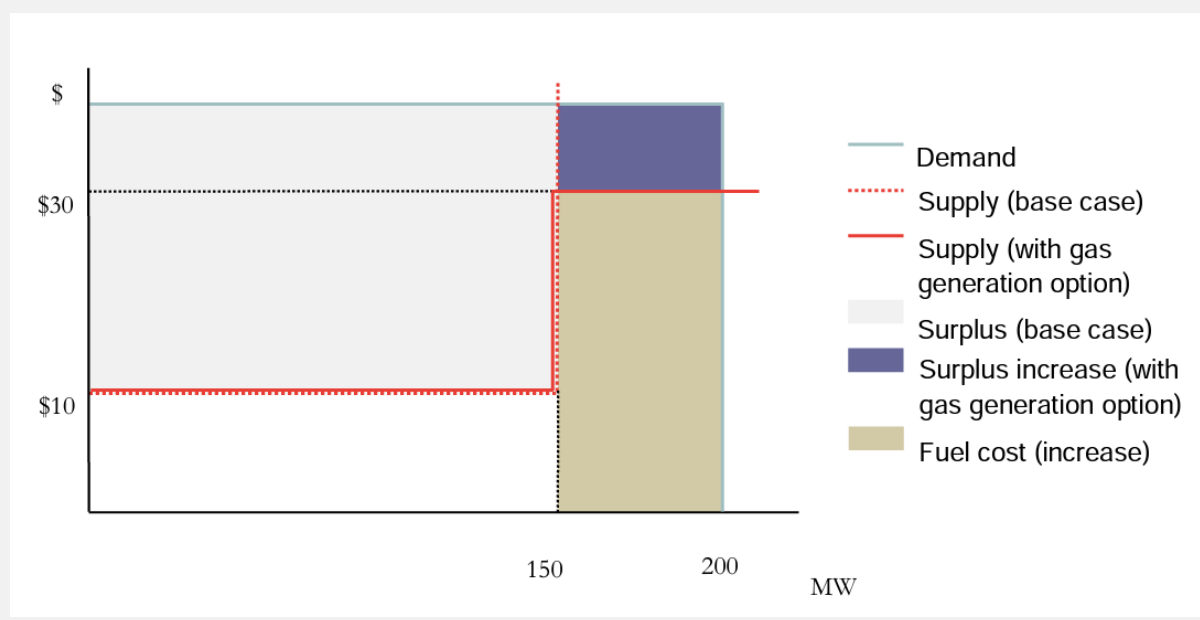
The credible option is to build a 75 MW local gas-fired generator with a fuel cost of \$30/MWh. This would increase the fuel costs used in dispatch:

- from: $150 \text{ MW} * \$10 = \$1,500$ per hour;
- to: $150 \text{ MW} * \$10 + 50 \text{ MW} * \$30 = \$3,000$ per hour.

In doing so, the credible option would reduce unserved energy by 50 MW.

Assuming the same conditions over all 8,760 hours in a full year, the total fuel cost increase would be $8,760 * (\$3,000 - \$1,500) = \$13,140,000$ per annum. This would make a negative contribution to the market benefits of the local generation option.

Figure 4: Increase in fuel costs



Finally, a credible option may have no material net impact on the cost of fuel consumed to supply electricity to load. For example, a network augmentation may both:

- facilitate the substitution of high-fuel cost plant by low-fuel cost plant (which reduces the cost of fuel consumed to supply electricity to load); and
- lead to a reduction in unserved energy (which increases the cost of fuel consumed to supply electricity to load).

Example 25: No change in fuel costs

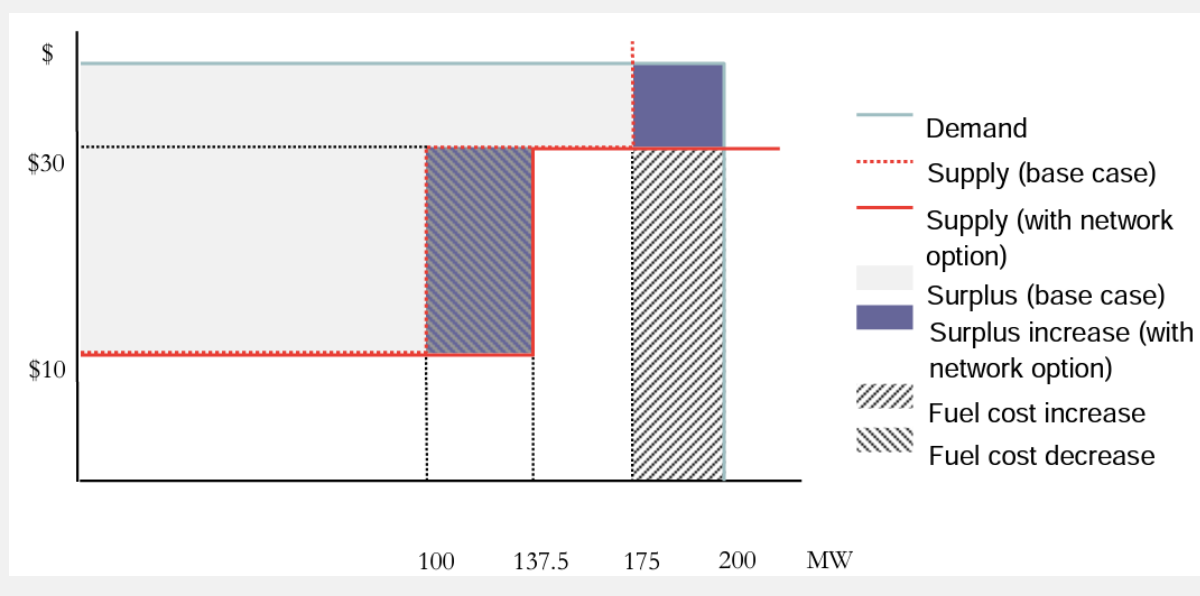
Load is 200 MW. Local gas-fired generation has a fuel cost of \$30/MWh and capacity of 75 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 200 MW. The capacity of the network between the remote generator and the load is limited to 100 MW.

The credible option is to augment the network between the remote generator and the load by 37.5 MW. This would have the following effect on the fuel costs used in dispatch:

- from: $100 \text{ MW} \times \$10 + 75 \text{ MW} \times \$30 = \$3,250$ per hour;
- to: $137.5 \text{ MW} \times \$10 + 62.5 \text{ MW} \times \$30 = \$3,250$ per hour.

The credible option in this case has reduced unserved energy by 25 MW (increasing fuel costs) while simultaneously displacing 12.5 MW of expensive local generation with cheap remote generation (decreasing fuel costs).

Figure 5: No change in fuel costs



A.2 Voluntary load curtailment

A credible option may lead to a reduction in voluntary load curtailment. For example, a network option may facilitate substituting high-fuel cost plant with low-fuel cost plant. In doing so, this option might reduce the spot price of electricity, consequently reducing voluntary load curtailment. This reduction in voluntary load curtailment can be valued as a market benefit by multiplying:

- the quantity (in MWh) of voluntary load curtailment not undertaken due to the credible option; by
- consumers' willingness to pay (in \$/MWh) for the electricity that is not voluntarily curtailed due to the credible option.

This positive contribution to the market benefit of the credible option will be partly offset by a negative contribution to market benefit due to the costs of providing the additional electricity that is not voluntarily curtailed as a result of the credible option (see also the discussion of fuel consumption above).

Example 26: Decreased voluntary load curtailment

Load is 200 MW. Local gas-fired generation has a fuel cost of \$30/MWh and capacity of 100 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 250 MW.

The capacity of the network between the remote generator and the load is limited to 150 MW, whereas the capacity of the network between the local generator and the load is effectively unlimited.

Voluntary load curtailment at a spot price of \$30/MWh is 40 MW, and is 0 MW at a spot price of \$10/MWh is 0 MW.

The credible option is to augment the network between the remote generator and the load by 50 MW. In the base case:

- Demand = Load – voluntary load curtailment = 200 MW – 40 MW = 160 MW.
- The remote generator is dispatched to 150 MW and the local generator is dispatched to 10 MW.
- Spot price = \$30/MWh (set by the local generator).
- Value of fuel consumed = 150 MW*\$10 + 10 MW*\$30 = \$1,800 per hour.
- Value of voluntary load curtailment = 40 MW*\$30/MWh = \$1,200 per hour.

In the state of the world with the credible option:

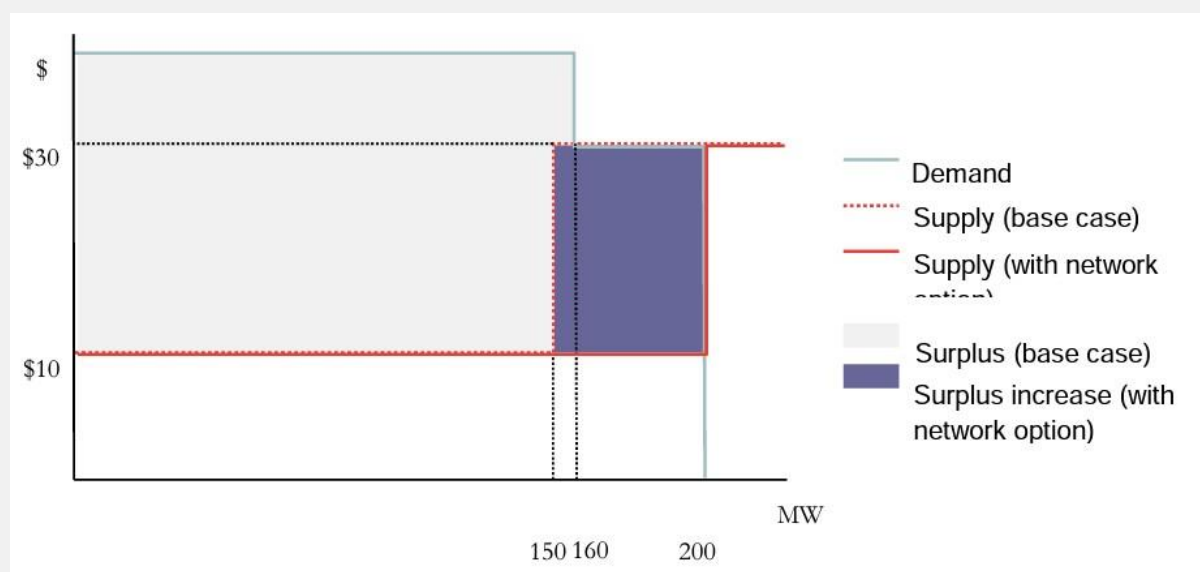
- Demand = Load – voluntary load curtailment = 200 MW – 40 MW = 160 MW.
- The remote generator is dispatched to 150 MW and the local generator is dispatched to 10 MW.
- Spot price = \$30/MWh (set by the local generator).
- Value of fuel consumed = 200 MW*\$10 + 0 MW*\$30 = \$2,000 per hour.

Value of voluntary load curtailment = 0 MW*\$10/MWh = \$0 per hour

Thus, the contribution to the market benefit of the credible option from a reduction in voluntary load curtailment is \$1,200 – \$0 = \$1,200 per hour. This would be partly offset by the cost of increased fuel consumption of \$2,000 – \$1,800 = \$200 per hour. The net impact on the market benefit of the credible option is \$1,000 per hour.

Assuming the same conditions prevail for 100 hours in a year, the annual market benefit due to decreased voluntary load curtailment and the corresponding increased fuel consumption is 100*\$1,000 = \$100,000 per annum

Figure 6: Decreased voluntary load curtailment



Alternatively, a credible option (namely, a demand-side reduction option) may lead to an increase in voluntary load curtailment. This would make a negative contribution to the market benefits of the credible option, derived from:

- the quantity (in MWh) of voluntary load curtailment undertaken due to the credible option; multiplied by
- consumers' willingness to pay (in \$/MWh) for the electricity that is voluntarily curtailed due to the credible option.

However, this negative contribution to the market benefits of the demand-side option should be **more than offset** by a positive contribution to market benefit caused by reduced involuntary load shedding that would otherwise occur (see example 27 below).

The RIT–T proponent could then derive the net contribution to the market benefits of the demand-side option from the difference between:

- the value of unserved energy to consumers generally; and
- the value of that energy to those consumers who have voluntarily agreed to consume less as a result of the demand-side option.

For example, assume a demand-side option lead to voluntary load curtailment of 10 MWh of electricity valued by consumers at \$30/MWh. If this 10 MWh of electricity displaced the same amount of involuntary load shedding at \$30,000/MWh, this would yield a positive contribution to market benefits of $(\$30,000 - \$30) \times 10 = \$299,700$.

A.3 Involuntary load shedding

A credible option may reduce involuntary load shedding if it is:

- a local generation option that supplies electricity;
- a demand-side reduction option that leads to voluntary load curtailment and thereby reduces demand for electricity; or
- a network option that enables electricity to be transported from a location where it is relatively plentiful to a location where it is relatively scarce when involuntary load shedding would otherwise occur.

This reduction in involuntary load shedding can be valued as a market benefit by multiplying:

- the quantity (in MWh) of involuntary load shedding not required due to the credible option; by
- a reasonable forecast of the value of electricity to consumers (in \$/MWh) not shed due to the credible option (see section 3.4.2 on VCR).

This positive contribution to market benefits would be partially offset by a negative contribution from providing the credible option. For example, a local generation option may reduce involuntary load shedding but will increase the use of fuel to supply electricity.

It is worth noting that a credible option may also lead to involuntary load curtailment in some circumstances. For instance, a credible option might require outages of existing network infrastructure during construction. As above, we would expect this negative contribution would be largely offset by larger positive contributions, such as reduced involuntary load curtailment post-construction.

Example 27: Decreased involuntary load shedding

Assume load is 201 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 250MW. The capacity of the network between the remote generator and the load is limited to 200 MW. Customers' value of involuntarily curtailed energy is \$30,000/MWh.

The credible option is to build a 25 MW local gas-fired generator with a fuel cost of \$100/MWh. In the **base case**:

- Demand outstrips supply by $201 \text{ MW} - 200 \text{ MW} = 1 \text{ MW}$.
- The value customers place on involuntarily curtailed energy is \$30,000/MWh.
- Value of fuel consumed = $200 \text{ MW} * \$10 = \$2,000$ per hour.
- Value of involuntarily curtailed load = $1 \text{ MW} * \$30,000 = \$30,000$ per hour

In the state of the world **with the credible option**:

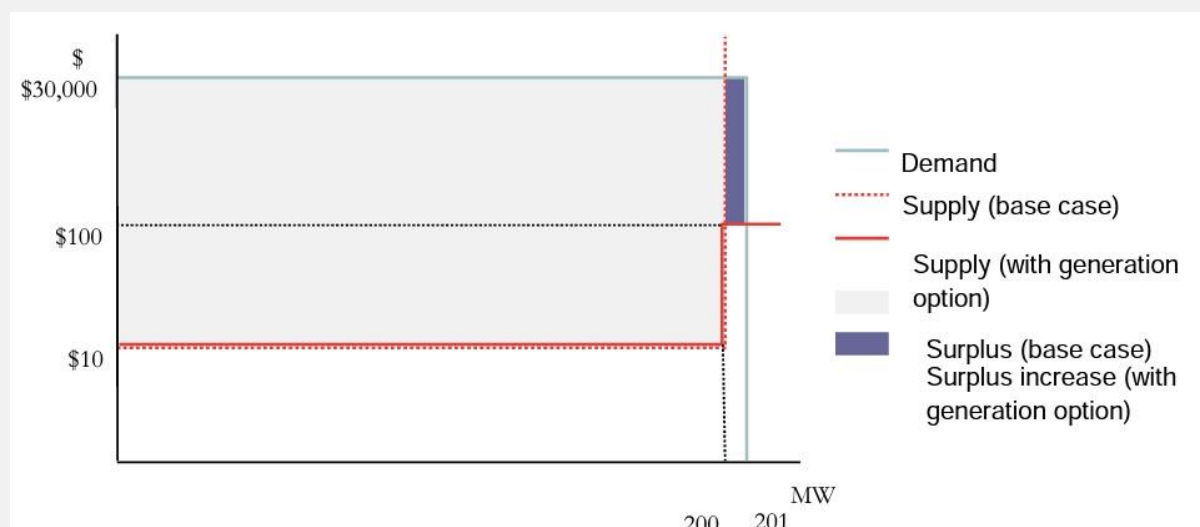
- Output of remote generator = 200 MW, output of local generator = 1 MW.
- The local gas-fired generator has a fuel cost of \$100/MWh.

- Value of fuel consumed = $200 \text{ MW} \times \$10 + 1 \text{ MW} \times \$100 = \$2,100$ per hour.
- Demand = supply and hence there is no load shedding.

The contribution to the market benefits of the credible option from reduced involuntary load shedding is $\$30,000 - \$0 = \$30,000$. This would be partly offset by the cost of increased fuel consumption needed to generate electricity, which is $\$2,100 - \$2,000 = \$100$ per hour.

The net contribution to the market benefits of the credible option (in terms of decreased involuntary load shedding and increased fuel consumption) is thus $\$29,900$ per hour. Assuming the same conditions over 10 hours in a year, the total contribution to the market benefits of the credible option is $10 \times \$29,900 = \$299,000$ per annum.

Figure 7: Decreased involuntary load shedding



As noted above, a demand-side option may have a negative contribution to the market benefit from increasing voluntary load curtailment, whilst simultaneously having a positive contribution from decreasing involuntary load shedding. However, the net effect on the market benefit would almost always be positive, as electricity will usually be worth more to those who are involuntarily curtailed than to those who are voluntarily curtailed.

Example 28: Increased voluntary and decreased involuntary load curtailment

Assume load is 201 MW. Remote coal-fired generation has a fuel cost of $\$10/\text{MWh}$ and capacity of 250 MW. The capacity of the network between the remote generator and the load is limited to 200 MW. In the event demand outstrips supply, load is involuntarily curtailed (load shedding) where customers value this energy at $\$30,000/\text{MWh}$.

The credible option is a demand side option where commercial customers agree with a retailer to reduce power demand by 1 MW when requested by the retailer. This will occur when the retailer expects that the spot price would exceed $\$1,000/\text{MWh}$ in the absence of load curtailment. The $\$1,000/\text{MWh}$ price reflects the retailer's view of its commercial customers' underlying willingness to pay for electricity.

In the **base case**:

- Demand outstrips supply by $201 \text{ MW} - 200 \text{ MW} = 1 \text{ MW}$.
- Price is set at the value customers place on involuntarily curtailed load ($\$30,000/\text{MWh}$) and 1 MW of load is involuntarily curtailed to ensure demand = supply.
- Value of voluntary load curtailment = $0 \text{ MW} * \$1,000 = \0 per hour.
- Value of involuntary load curtailment = $1 \text{ MW} * \$30,000 = \$30,000$ per hour.

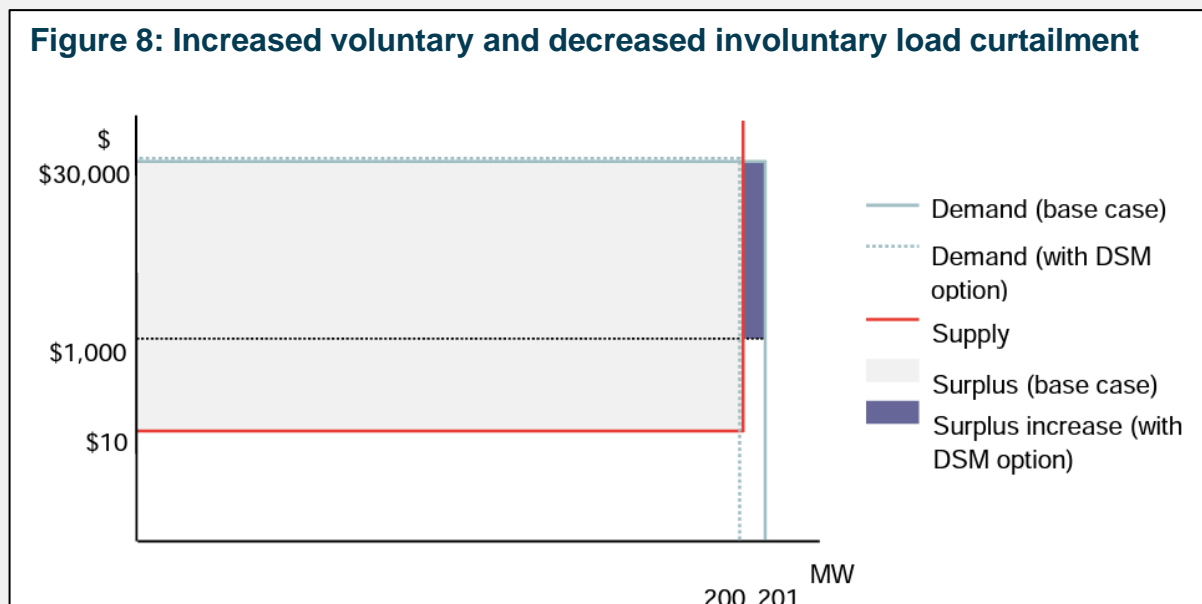
In the state of the world **with** the credible option:

- Demand = load – voluntary load curtailment = $201 \text{ MW} - 1 \text{ MW} = 200 \text{ MW}$.
- The remote generator sets the price at $\$10/\text{MWh}$.
- Voluntary load curtailment under the credible option at a price of $\$10/\text{MWh}$ is 1 MW.
- Demand = supply and there is no load shedding.
- Value of voluntary load curtailment = $1 \text{ MW} * \$1,000 = \$1,000$ per hour.

The market benefit of the credible option arising from the demand side option is the:

- benefit of decreased involuntary load curtailment = $\$30,000 - \$0 = \$30,000$; less
- benefit of increased voluntary load curtailment = $\$1,000 - \$0 = \$1,000$.

The combined contribution to the market benefits of the credible option (in terms of increased voluntary and decreased involuntary load curtailment) is thus $\$29,000$ per hour.



Assuming the same conditions over 10 hours in a year, the total contribution to the market benefits of the credible option would be $10 * \$29,000 = \$290,000$ per annum.

A.4 Costs to other parties

This class of costs captures the impact of a credible option on the plant expansion path of the market. To the extent that a credible option leads to a delay in the commissioning of a new plant (which reduces the present value of the resource costs incurred to meet demand), or to other reductions to other parties' costs, this represents a positive market benefit of the option. The reverse is also the case.

Example 29: Delaying plant commissioning

The credible option is the development of a 1,000 MW interconnection. The development of this interconnection will delay the need for a 450 MW mid-merit gas plant by 3 years. Without the interconnection, the gas plant would be developed immediately ($t = 0$). With the interconnection, the gas plant would be developed in three years ($t = 3$). The mid-merit gas plant has a total capital cost of \$500 million. The discount rate is 7 per cent.

Based on the above assumptions, the positive contribution to the market benefits of the interconnection option due to the delayed commissioning of the mid-merit gas plant (in terms of delaying capital costs only) can be calculated as follows:

- The present value of the mid-merit gas plant's capital costs in the base case:

$$PV = \frac{\$500m}{(1.07)^0} = \$500m$$

; less

- The present value of the mid-merit gas plant's capital costs with the credible option:

$$PV = \frac{\$500m}{(1.07)^3} = \$408m$$

The positive contribution to the market benefits of the credible option due to the delayed commissioning of the mid-merit gas plant is $500 - 408 = \$92$ million.

Example 30: Delaying and accelerating plant commissioning

The following example builds on example 29. In addition to delaying the need for a mid-merit gas plant, the credible option also leads to the bringing forward of a 450 MW baseload plant in the exporting region. In the base case, the mid-merit gas plant would be developed immediately ($t = 0$), while the baseload plant would be developed in three years ($t = 3$). With the credible option, the mid-merit gas plant would be developed in three years ($t = 3$) while the baseload plant would be developed in two years ($t = 2$). The baseload plant has a capital cost of \$600 million.

Based on the above assumptions, the negative contribution to the market benefits of the credible option due to the accelerated commissioning of the baseload plant (in terms of bringing forward capital costs only) is calculated as follows:

- The present value of the baseload plant's capital costs with the credible option:

$$PV = \frac{\$600m}{(1.07)^2} = \$524m$$

; less

- The present value of the baseload plant's capital costs in the base case:

$$PV = \frac{\$600m}{(1.07)^3} = \$490m$$

The negative contribution to the market benefits of the credible option due to the bringing forward of the commissioning of the baseload plant is $524 - 490 = \$34$ million.

The combined contribution to the market benefits of the credible option due to:

- the delaying of the mid-merit gas plant and
- the bringing-forward of the baseload plant is $92 - 34 = \$58$ million.

A.5 Timing of transmission investment

A credible option may change the timing (or the configuration) of other investments to be made by (or for) the RIT–T proponent in the future.⁴⁴

Market benefits from changes in the timing of expenditure should not refer to expenditure on transmission investments that have the same identified need as the set of credible options under consideration. RIT–T proponents derive the market benefits of all credible options by comparison against a common base case without any credible option in place.⁴⁵ As such, a RIT–T proponent should view any transmission investments directed towards the same identified need as a (or part of a) competing credible option. The RIT–T proponent will therefore exclude these competing options from the base case.

Therefore, the RIT–T proponent should only account for changes in the timing of transmission investments that address different identified needs to those that the credible option addresses. It is not clear whether or how many investments this category could or would include.

A.6 Network losses

A credible option may lead to a net increase or decrease in network losses. An increase in network losses makes a negative contribution to the market benefits of a credible option, while a decrease in network losses makes a positive contribution to the market benefits of a credible option.

⁴⁴ Under the NER and the RIT–T, a credible option is an option (or group of options) that, among other things, addresses an identified need.

⁴⁵ Although, the base case state of the world will vary across the relevant reasonable scenario under consideration. For a discussion on developing states of the world and reasonable scenarios, see section 3.5.

Example 31: Decreased network losses

Assume load is 500 MW. Remote coal-fired generation has a fuel cost of \$10/MWh and capacity of 750 MW. The capacity of the network link between the remote coal-fired generator and the load is limited to 600 MW.

The credible option is the augmentation of the network link between the remote coal-fired generator and the load. The augmentation will involve upgrading the transmission link from a 220 kV to a 400 kV line. The RIT-T proponent expects this augmentation will reduce transmission losses from 10 per cent to 5 per cent when operating at 500 MW.

In the base case:

- The remote coal-fired generator sets the price at \$10/MWh.
- Total losses = $\$10 \times 0.1 \times 500 \text{ MW} = \500 per hour.

In the state of the world with the credible option:

- The remote coal-fired generator sets the price at \$10/MWh.
- Total losses = $\$10 \times 0.05 \times 500 \text{ MW} = \250 per hour.

Assuming the same conditions over 8,760 hours per year, the contribution of decreased network losses to the market benefit of the credible option is $(\$500 - \$250) \times 8,760 = \$2,190,000$ per year.

A.7 Ancillary services costs

A credible option may lead to a net increase or decrease in ancillary services costs. An increase in ancillary services costs makes a negative contribution to the market benefits of a credible option, while a decrease in ancillary services costs makes a positive contribution to the market benefits of a credible option.

Example 32: Increased ancillary services costs

Assume load is 300 MW and is flat for all hours of the year. Average network control ancillary services costs across the year are \$0.35/MWh.

The credible option is the development of a network element to help stabilise voltage. The RIT-T proponent expects this will reduce average network control ancillary services costs to \$0.20/MWh.

Total ancillary services costs are, in the:

- Base case, $\$0.35 \times 8,760 \times 300 \text{ MW} = \$919,800$ per year.
- State of the world with the credible option, $\$0.20 \times 8,760 \times 300 \text{ MW} = \$525,600$ per year.

Assuming load is flat at 300 MW for all hours of the year, the contribution of reduced ancillary services costs to the market benefits of the credible option is

$\$918,800 - \$525,600 = \$394,200$ per year.

In some circumstances, it may be appropriate to use methods other than market modelling to estimate the net increase or decrease in ancillary services costs. For example, assume a RIT–T proponent is considering an augmentation credible option that will provide reactive power in addition to meeting the identified need. In these circumstances, it may be appropriate for the RIT–T proponent to value the reduction in reactive power ancillary service requirements following the implementation of the credible option as the approximate annual cost of providing a capacitor bank.

Assume that a 50 MVar capacitor bank has an estimated annual cost of \$150,000. Under these assumptions, the potential benefit per trading interval of reduced ancillary service requirements provided by the credible option is \$0.17/MVar. A RIT–T proponent can use this benefit to estimate the overall expected decrease in reactive power ancillary service requirements due to the credible option. Whether this amount will be material depends on how much it expects the credible option will reduce annual reactive power ancillary service requirements.

Whether alternative methods, such as this, are appropriate will depend on the particular circumstances surrounding the RIT–T assessment.

A.8 Competition benefits

Clause 5.15A.2(b)(4)(viii) of the NER requires a RIT–T proponent to consider competition benefits as a class of potential market benefits that could be provided by a credible option.

The ACCC's previous 'Regulatory Test Decision' extensively discussed competition benefits (particularly appendices C, D and E by Dr Darryl Biggar).⁴⁶ Our guidance below draws on that decision's discussion on computing market benefits of a credible option that include competition benefits. A modelling process can capture competition benefits when this explicitly takes into account the likely impact of the credible option on the bidding behaviour of generators (and other market participants) who may have a degree of market power relative to the base case. A market participant has a degree of market power in a given dispatch interval if it can, by varying its bid or offer, alter the pricing, dispatch and flow outcomes in the market (including possibly inducing 'clamping') in that dispatch interval in a manner that is profitable for that firm.

The RIT–T requires a RIT–T proponent to apply competitive short-run marginal cost (SRMC) bidding and provides for approximates of 'realistic' bidding approaches to be used as a reasonable scenario. Where realistic bidding considers the effects of a credible option, the measured change in overall economic surplus will include competition benefits **by implication**.

⁴⁶ D Biggar, *Calculating competition benefits: a two town example*, Appendix D to ACCC, *Decision of the review of the regulatory test for network augmentations*, August 2004.

Computing a credible option's market benefits in a given reasonable scenario **will include** competition benefits where the modelling process calculates market benefits as the difference between the following present values of the overall economic surplus:

- arising with the credible option, with bidding behaviour reflecting any market power prevailing with that option in place; and
- in the base case, with bidding behaviour reflecting any market power in the base case.

We suggest two possible methodologies for identifying that component of market benefits attributable to competition benefits—the 'Biggar approach' and the 'Frontier approach'.

The Biggar approach (developed by Dr Darryl Biggar) requires a modelling process that allows the bidding behaviour to be 'held constant' while the underlying network is changed. This method involves finding the difference between the overall economic surplus arising in a network with the credible option:

- with the bidding behaviour of market participants reflecting any market power they have in a network with that option in place; and
- with the bidding behaviour of market participants reflecting any market power they have in the base case network.

The Frontier approach (developed by Frontier Economics) involves finding the difference between the change in overall economic surplus resulting from the credible option;

- assuming bidding reflected the prevailing degree of market power both before and after the augmentation; and
- assuming competitive bidding both before and after the augmentation.

We provide worked examples using both these approaches — see example 33 and example 34 below.

For clarity, both of these approaches involve the same methodology for calculating the overall market benefits of a credible option. The difference between the two approaches is in how to divide the overall market benefits of a credible option between competition benefits and other benefits (also referred to as 'efficiency benefits'). Both approaches have certain merits.⁴⁷ A RIT–T proponent can adopt either approach or another approach in calculating competition benefits, and the RIT–T reflects this intention. However, it is important that there is no double counting of a credible option's competition benefits.

The key requirement in calculating competition benefits is a robust approach to the methodology for determining 'realistic' bidding behaviour. We do not wish to prescribe the methodology for determining realistic bidding behaviour other than to suggest it should:

⁴⁷ Dr Biggar considered that his approach yielded a more intuitive economic interpretation to competition benefits than Frontier Economics' approach. However, he noted that Frontier Economics' approach meant that its measure of efficiency benefits was directly comparable to the definition of market benefits in previous applications under the old regulatory test.

- be based on a credible theory as to how participants are likely to behave in the wholesale spot market over the modelling period; and
- take into account the impacts of other participants' behaviour on the bidding behaviour of any given participant.

Example 33: Competition benefits (Biggar approach)

The following example draws on Biggar (2004).⁴⁸ For this example, assume:

- Load is 200 MW.
- There are three generators capable of serving this load: Coal-fired generation with a SRMC of \$10/MWh and 120 MW capacity.
 - Mid-merit gas-fired generation with a SRMC of \$50/MWh and 100 MW capacity.
 - Peaking oil-fired generation with a SRMC of \$100/MWh and 40 MW capacity.
 - The credible option entails developing an interconnector with a capacity of 140 MW to a competitive region that supplies electricity at a constant SRMC of \$12/MWh.
 - The coal-fired generator behaves strategically. That is, it maximises its short-run profit, given by: $\text{Quantity} \times (\text{Price} - \text{SRMC})$.
- The coal-fired generator, due to technical requirements, has a minimum generation level of 60 MW and must offer its capacity in increments of 10 MW.
- All other generators (including the power supplied through the interconnector) behave competitively. That is, they bid their full capacity into the market at SRMC.

In the **base case**:

- The three generators in the region make the following offers:
 - Coal-fired generation offers 90 MW at \$10/MWh.⁴⁹
 - Mid-merit gas-fired generation offers 100 MW at \$50/MWh.
 - Peaking oil-fired generation offers 40 MW at \$100/MWh.
- The peaking generator sets the market price at \$100/MWh.
- Total dispatch costs are $90 \times \$10 + 100 \times \$50 + 10 \times \$100 = \$6,900$ per hour.

In the state of the world **with** the credible option:

- The interconnector enables the supply of 140 MW of electricity at \$12/MWh.
- The generators in the region make the following offers:
 - Coal-fired generation offers 120 MW at \$10/MWh.⁵⁰

⁴⁸ D Biggar, *Calculating competition benefits: a two town example*, Appendix D to ACCC, *Decision of the review of the regulatory test for network augmentations*, August 2004, p. 99.

⁴⁹ This maximises the incumbent coal-fired generators short-run profit at $90 \times (100 - 10) = \$8,100$ per hour. Offering 100 MW yields $100 \times (50 - 10) = \$4,000$ per hour. Offering 80 MW yields $80 \times (100 - 10) = \$7,200$ per hour. Offering 60 MW (minimum offer) yields $60 \times (100 - 10) = \$5,400$ per hour.

⁵⁰ This maximises the incumbent coal-fired generators short-run profit at $120 \times (12 - 10) = \$240$ per hour. Offering 110 MW yields $110 \times (12 - 10) = \$220$ per hour. Offering 60 MW (minimum offer) yields $60 \times (12 - 10) = \$120$ per hour.

- Mid-merit gas-fired generation offers 100 MW at \$50/MWh.
- Peaking oil-fired generation offers 40 MW at \$100/MWh.
- The marginal generator in the adjacent region sets the market price through the interconnector at \$12/MWh.
- Total dispatch costs are $120 * \$10 + 80 * \$12 = \$2,160$ per hour.

The Biggar approach calculates the competition benefit of a credible option as the difference between the total dispatch cost in a state of the world:

- **with** the credible option and assuming participants bid strategically in a manner that reflects any market power they have in the presence of the credible option; and
- **with** the credible option but assuming that participants bid as they did in a state of the world **without** the credible option (that is, the base case).

Based on the above data, we can determine the following:

- The total dispatch cost in a state of the world with the credible option and assuming participants bid strategically is: $(120 * \$10 + 80 * \$12) = \$2,160$ per hour.
- The total dispatch cost in a state of the world **with** the credible option and assuming participants bid as they did in a state of the world **without** the credible option (that is, the base case) is: $(90 * \$10 + 110 * \$12) = \$2,220$ per hour.
- The competition benefit is thus: $\$2,220 - \$2,160 = \$60$ per hour.

The total benefit is $\$6,900 - \$2,160 = \$4,740$ per hour. This implies that the efficiency benefit is $\$4,740 - \$60 = \$4,680$.

The Biggar approach calculates the competition benefit of a credible option as the difference between the total dispatch cost in a state of the world:

- **with** the credible option and assuming participants bid strategically in a manner that reflects any market power they have in the presence of the credible option; and
- **with** the credible option but assuming that participants bid as they did in a state of the world **without** the credible option (that is, the base case).

Based on the above data, we can determine the following:

- The total dispatch cost in a state of the world with the credible option and assuming participants bid strategically is: $(120 * \$10 + 80 * \$12) = \$2,160$ per hour.
- The total dispatch cost in a state of the world **with** the credible option and assuming participants bid as they did in a state of the world **without** the credible option (that is, the base case) is: $(90 * \$10 + 110 * \$12) = \$2,220$ per hour.
- The competition benefit is thus: $\$2,220 - \$2,160 = \$60$ per hour.

The total benefit is $\$6,900 - \$2,160 = \$4,740$ per hour. This implies that the efficiency benefit is $\$4,740 - \$60 = \$4,680$.

Example 34: The Frontier approach to calculating competition benefits

The following example is based on the data used in example 33. The Frontier approach calculates the competition benefit of a credible option as the difference between the change in the total dispatch cost between states of the world with and without the credible option;

- assuming competitive bidding in both states of the world; and
- assuming strategic bidding in both states of the world.

Based on example 33:

- The change in the total dispatch cost between states of the world with and without the credible option, assuming competitive bidding in both states of the world is:
 $(120 * \$10 + 80 * \$50) - (120 * \$10 + 80 * \$12) = \$3,040$ per hour.
- The change in the total dispatch cost between a state of the world with and without the credible option, assuming strategic bidding in both states of the world is:
 $(90 * \$10 + 100 * \$50 + 10 * \$100) - (120 * \$10 + 80 * \$12) = \$4,740$ per hour.
- The competition benefit is thus: $\$4,740 - \$3,040 = \$1,700$ per hour.
- The total benefit is the change in total dispatch costs between states of the world with and without the credible option, assuming strategic bidding. From above, this is $\$4,740$. This is the same as under the Biggar approach.
- The total benefit and competition benefit imply an efficiency benefit of $\$4,740 - \$1,700 = \$3,040$. This is equivalent to the change in total dispatch costs between states of the world with and without the credible option, assuming competitive bidding in both states of the world

The RIT–T allows a RIT–T proponent to model the effect of ‘realistic’ generator bidding behaviour. Realistic bidding in this context could include disorderly bidding, where appropriate. Therefore, to the extent a credible option attenuates the incentives for a generator to engage in disorderly bidding, the calculation of that credible option’s market benefit could include the market benefit arising from more cost-reflective generator bidding. However, modelling disorderly bidding behaviour is difficult and most RIT–T assessments may not warrant this.

A.9 Option value

Clause 5.15A.2(b)(4)(ix) of the NER requires a RIT–T proponent to consider option value as a class of potential market benefits that could be provided by a credible option.

Option value refers to a benefit that results from retaining flexibility where certain actions are irreversible (sunk), and new information may arise in the future on the payoff from taking a certain action. Option value is likely to arise where there is uncertainty regarding future outcomes, the information that is available in the future is likely to change, and the credible options are sufficiently flexible to respond to that change. For example, option value might be realised through credible options that 'build-in' the option to:

- Expand at minimal cost in response to upside demand risk, such as by building in excess capacity. This action will likely have option value where there are economies of scale and there is a high probability that the high demand scenario will occur.
- An option to withdraw or reduce the scope in response to downside demand risk, such as by selecting smaller, scalable investments such as network support agreements. This action will likely have option value where investments are irreversible and there is a high probability that a low demand scenario will occur.

In our view, a RIT–T proponent should effectively capture option value as a class of market benefit if it performs scenario analysis in accordance with these RIT–T application guidelines, whilst also exploring credible options that involve staging decisions that result in option value. We note that, as long as it is not double-counted, the RIT–T allows RIT–T proponents to capture option value beyond what they have otherwise captured by probabilistically weighting credible options over reasonable scenarios.⁵¹

We provide more guidance on scenario analysis and option value in sections 3.2.3, 3.7, 3.8 and 3.9. We also provide the worked example below, which extends from example 16 and example 17 earlier on in these RIT–T application guidelines.

⁵¹ Specifically, RIT–T paragraph (11)(i) provides that market benefit includes the present value of “any additional option value (meaning any option value that has not already been included in other classes of market benefits) gained or foregone from implementing the credible option with respect to the likely future investment needs of the market”.

Example 35: Flexibility and option value

This example extends from example 16 and example 17. Example 16 described three credible options – a network option, a generation option and a demand-side option. It compared the merits of these options across four reasonable scenarios reflecting the potential combinations of future plant capital cost (high or low) and future demand growth (high or low). To simplify this example, assume that plant capital costs are certain to be low and the only uncertainty is demand growth, which may be high or low with equal probability (50% each).

Example 16 assumed that the size of each credible option was fixed and irreversible at the time of the investment decision. There was no scope to either expand or fully- or partially-reverse the option in the future once the RIT–T proponent knew whether actual demand growth was high or low. This example relaxes that restriction.

Example 16 implicitly incorporated two time periods:

- Present (T_P) — the time of the investment decision and commissioning date; and
- Future (T_F) — the time at which:
 - The identity of the true reasonable scenarios becomes apparent. That is, when it becomes known whether future demand growth is high or low); and
 - The time at which the market benefits of the credible option come to fruition.

Figure 9: Example 16 time periods

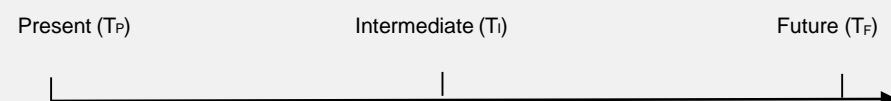


This example distinguishes between the times when the identity of the true reasonable scenarios becomes apparent from when the market benefits of the credible option come to fruition. Assume the RIT–T proponent can make a follow-up decision (after its initial investment decision) when it knows whether future demand will be high or low (T_I), but before the market benefits of any credible option arise (at T_F).

Therefore, this example incorporates three time periods:

- Present (T_P);
- Intermediate (T_I); and
- Future (T_F),

Figure 10: Revised time periods



The ability of the RIT–T proponent to make a follow-up investment decision at T_I when future demand growth is known but has not yet occurred opens up the possibility for it to:

- develop a small-scale initial option at T_P ; and
- if demand turns out to be high, expand or supplement that option at T_I in time to meet the higher demand at T_F .

In this way, the RIT–T proponent can more efficiently select its initial investment to reduce the risk of unnecessary (or insufficient) expenditure.

Given the opportunity to make a follow-up investment decision at T_I , the RIT–T proponent can undertake an option sufficient to cater for all future demand scenarios, including where there is high demand growth. Alternatively, the RIT–T proponent can undertake a smaller and cheaper option that it can expand if required. This smaller option would be sufficient if future demand growth turned out to be low. However, it would prove to be insufficient if demand growth turned out to be high, requiring a subsequent upgrade or supplementary investment.

To specify each credible option, the RIT–T proponent must specify (a) what action it will take in the short-term at T_P ; and (b) in the event that demand turns out to be high at T_I , what further action it will take in advance of T_F . This example assumes any supplementary investment would be a network option or upgrade.

Under these assumptions, the RIT–T proponent estimates the following six credible options:

- A full-scale network option that satisfies the high-growth scenario, as in example 16.
- A full-scale generation option that satisfies the high-growth scenario, as in example 16.
- A full-scale demand-side option that satisfies the high-growth scenario, as in example 16.
- A small-scale network option that satisfies the low-growth scenario and is upgradable to the level of the full-scale network option should demand turn out to be high. The RIT–T proponent assumes the following:
 - In the low-growth scenario, the benefits of the small-scale and full-scale network options are identical.
 - In the high-growth scenario, the benefits of the small-scale and full-scale network options are identical, because the RIT–T proponent upgrades the small-scale network option to the full-scale network option at T_I in time to meet the higher demand at T_F .
 - In the low-growth scenario, the costs of the small-scale network option are two-thirds of the costs of the full-scale network option, reflecting the loss of economies of scale involved in network development as well as the costs of building-in upgradeability to the small-scale network option.
 - The costs of initially developing the small-scale network option and subsequently upgrading to the full-scale network option at T_I are \$5 million greater than the costs of developing the full-scale network option from the outset

(at TP). This reflects the loss of economies of scale and duplication involved in developing a full-scale network option in two stages.

- A small-scale generation option coupled with the ability to undertake a small-scale network option later should demand growth turn out to be high. The RIT–T proponent assumes the following:
 - In the low-growth scenario, the benefits of the small-scale generation option and the full-scale generation option are identical.
 - In the high-growth scenario, the RIT–T proponent develops the small-scale network option at TI, in time to meet the higher demand at TF. The benefits of the small-scale generation option combined with the small-scale network option in the high-growth scenario equal the benefits of the small-scale generation option in the low-growth scenario plus half the benefits of the full-scale network option in the high-growth scenario. This reflects both the smaller size of the small-scale network option and that the (existing) small-scale generation would have otherwise provide some of those benefits.
 - The costs of the small-scale generation option are two-thirds the cost of full-scale generation option, reflecting the loss of economies of scale involved in generation development.
 - The costs of developing the small-scale network option at TI should demand growth turn out to be high are two-thirds the cost of the full-scale network option due to the loss of economies of scale.
- A small-scale demand-side option coupled with the ability to carry out a subsequent small-scale network option should demand turn out to be high. The RIT–T proponent assumes:
 - In the low-growth scenario, the benefits of the small-scale and full-scale demand side options are identical.
 - In the high-growth scenario, the RIT–T proponent will develop the small-scale network option at TI, in time to meet the higher demand at TF. The benefits of the small-scale demand-side option combined with the small-scale network option in the high-growth scenario are equal to the benefits of the small-scale demand-side option in the low-growth scenario plus half the benefits of the full-scale network option in the high-growth scenario. This reflects both the smaller size of the small-scale network option and that the (existing) small-scale demand-side option would have otherwise provided some of those benefits.
 - The costs of the small-scale demand-side option are two-thirds the cost of the full-scale demand-side option, reflecting the loss of economies of scale involved in arranging demand-side response.

- o The costs of developing the small-scale network option at TI should demand growth turn out to be high are two-thirds the cost of the full-scale network option due to the loss of economies of scale.

For each of these six credible options, there are two reasonable scenarios to consider—a low demand growth scenario and a high demand growth scenario, each potentially with its own market development path. As noted above, a probability of 50 per cent is attributed to each of the high and low demand growth scenarios.

The 'tree' diagram in figure 11 can represent the RIT–T proponent's choices when making an investment decision at TP without knowing how quickly demand will grow in the longer term. At TP, the RIT–T proponent can invest in a large option or a small option. The RIT–T proponent will know the rate of growth at TI, when it will make a supplementary investment if it initially invested in a small option and demand growth appears to be high. It will commission that supplementary investment so it can serve customers by the time the higher demand manifests at TF.

The tree diagram in figure 11 is a stylised representation of a subset of the choices commonly available to RIT–T proponents. The tree diagram and the analysis will become more complex the more times the RIT–T proponent receives information that it can act on by expanding, supplementing or winding back or down a project. This is because the analysis will need to be to capture all the potential option values.

In this example, the unweighted and weighted market benefits and costs of each of these credible options in each reasonable scenario are set out in table 7 below. In this case, the preferred option is option 4 – the small network option with the scope for upgrading to the large network option should demand growth turn out to be high.

Figure 11: Tree diagram for example 35

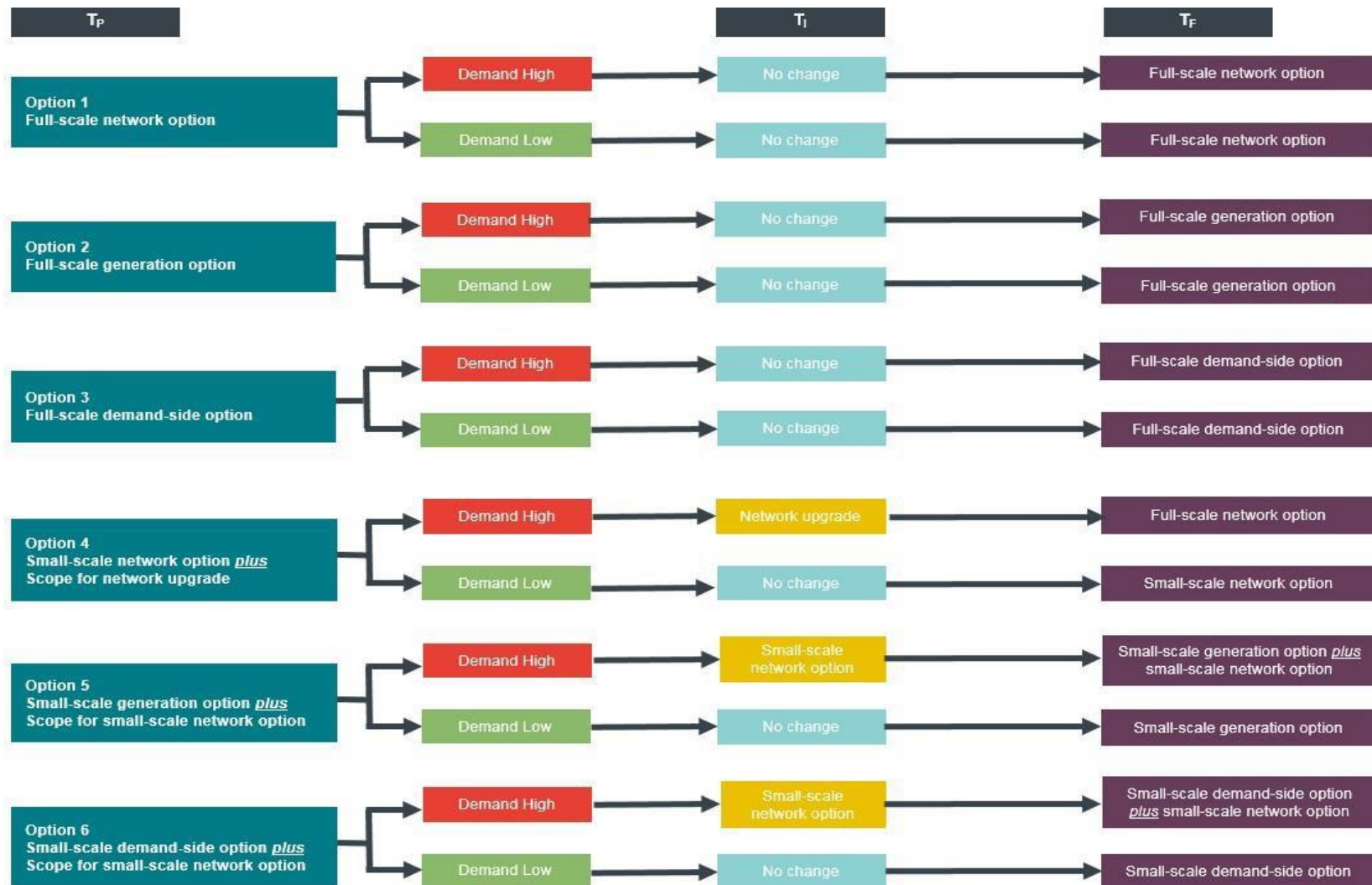


Table 7: Net economic benefit calculation for example 35

Option	Description	Market benefits high demand	Market benefits low demand	Weighted average market benefits	Costs high demand	Costs low demand	Weighted average costs	Net economic benefit	Rank
1	Full-scale network option	45	13	29	26.9	26.9	26.9	2.1	4
2	Full-scale generation option	40	20	30	27.4	27.4	27.4	2.6	3
3	Full-scale demand-side option	6	2	4	5.9	5.9	5.9	-1.9	6
4	Small-scale network option with scope for network upgrade	45	13	29	31.9	17.9	24.9	4.1	1
5	Small-scale generation option with scope for small-scale network option	42.5	20	31.3	36.2	18.3	27.2	4.0	2
6	Small-scale demand-side option with scope for small scale network option	24.5	2	13.3	21.9	3.9	12.9	0.4	5

B Guidance and worked examples on RIT reopening triggers and action taken in response

[Note: ENA has proposed some changes to these examples which are not captured here – see ENA submission.]

Clause 5.16.2(c)(10) of the NER requires we provide examples on RIT reopening triggers and actions that may be taken in response to a RIT reopening trigger being triggered.

This appendix provides examples of the following scenarios:

- increase in the cost of the preferred option (B.1)
- decrease in the cost of an alternative credible option (B.2)
- demand shock (B.3)
- change in government policy (B.4)
- act of God (B.5)
- technological change (B.6).

This appendix also provides examples of actions that may be taken in response to a RIT reopening trigger being triggered (B.7).

B.1 Increase in the cost of the preferred option

A RIT-T proponent has completed a RIT-T for an identified need and found the preferred option to be a new transmission line. Prior to the works being started, the proponent becomes aware that the cost to construct the line has significantly increased due to increases in the costs of copper and steel.

All else being equal, the significant increase in capital cost could change the ranking of credible options. For example, a different network option involving the augmentation of an existing transmission line could become more net beneficial (or have a lower net market cost) than the original preferred new line option. Alternatively, a third-party proposed non-network option (such as demand management) could become the preferred option to address the identified need.

Example 36: Potential reopening triggers in response to increase in the cost of the preferred option

In anticipation of these types of circumstances, the RIT-T proponent could develop option cost increase-related reopening triggers such as:

- Preferred option present value (PV) real cost increase of 10% or more (consistent with the boundary test analysis) compared to that applied in the relevant project assessment draft conclusions report
- Preferred option PV real cost increase of 25% or more of the estimated net market benefit of the option, as identified in the project assessment draft conclusions report

Preferred option PV real cost increase of 50% or more of the difference between the estimated net market benefit of the preferred option and the estimated net market benefit of the next-ranked credible option, as identified in the project assessment draft conclusions report.

B.2 Decrease in the cost of an alternative credible option

A RIT-T proponent has completed a RIT-T for an identified need and found the preferred option to be the augmentation of an existing transmission line. Prior to the works being started:

- the RIT-T proponent becomes aware that the cost to construct a different and more expensive network credible option (e.g. a new transmission line) has fallen significantly due to lower copper and steel prices
- A third-party proponent of a non-network credible option considered in the RIT-T notifies the TNSP proponent of the preferred option that the cost of the non-network option has fallen significantly since the PADR PACR was undertaken due to improvements in technology.

Example 37: Potential reopening triggers in response to decrease in the cost of an alternative credible option

In anticipation of these types of circumstances, the TNSP proponent could develop option cost decrease-related reopening triggers such as:

- Non-preferred network credible option PV real cost decrease of 25% or more compared to that applied in the relevant PADR PACR
- Non-preferred non-network credible option PV real cost decrease of 25% or more compared to that applied in the relevant PADR PACR; and
- Non-preferred non-network credible option PV real cost decrease of 50% or more of the difference between the estimated net market benefit of the preferred (network) option and the estimated net market benefit of the non-network credible option, as identified in the PADR PACR.

Note that where the original preferred option is a non-network option, cost-related reopening triggers will need to reflect both the attributes of the relevant preferred and non-preferred credible options, as well as the applicable incentives and information set(s) available to the relevant option proponent(s).

B.3 Demand shock

A RIT proponent has completed a RIT-T for an identified need, being the meeting of new demand in a particular greenfield area, and found the preferred option to be a new transmission line to the area. Subsequently, a large industrial business planning a new plant in the region faces delays and pushes back its planned expansion in the region by 24

months. This reduces the anticipated demand for electricity in the region in the short to medium term.

In this example, the demand shock is a reopening trigger. Assuming the cost of the preferred option is unchanged, the delay to the plant would tend to decrease both the market benefits and the net market benefit of the preferred option. The delay to the plant could also have implications for other related sources of demand in the region (such as new housing developments) and could provide a basis to reconsider the ranking of credible options and the timing of the preferred option. A demand shock may alternatively involve an unanticipated increase in demand due, for example, to a government decision to support an industrial plant in a particular region.

Example 38: Demand shock

In anticipation of these types of circumstances, the proponent could develop demand-related reopening triggers such as:

- Average forecast demand at the connection point(s) served by the preferred option for the next 10 years at least 5% lower or higher than that applied in the relevant **PADR PACR**: or
Average forecast demand growth or decline at the connection points served by the preferred option for the next 10 years at least 50% higher or lower (for example, 3% pa instead of 2% pa or 1% pa instead of 2% pa) than the rates applied in the relevant **PADR PACR**.

B.4 Change in government policy

A RIT proponent has completed a RIT-T for an identified need and found the preferred option to be a new 330 kV single-circuit transmission line. The federal government then announces a change in its climate change policy to bring forward the date by which Australia is to achieve 'net zero' emissions. The change in government policy is a reopening trigger due to its impact on the expected net benefits of the relevant credible options. All else being equal, the policy change could make a double-circuit or higher voltage (eg 500 kV) transmission line more net beneficial than the original preferred option.

Example 39: Change in government policy

In anticipation of these types of circumstances, the proponent could develop policy-related reopening triggers such as the introduction, removal or significant changes to a key applicable domestic or international law that was likely to lead to:

- the subsequent eventual meeting of a relevant option cost or demand trigger, and/or
a change in the potential cost, capacity or output of generation, storage or other sources of electricity supply in areas that a credible option considered in the **PADR PACR** was expected

B.5 Act of God

A RIT proponent has completed a RIT-T for an identified need and found the preferred option to be a new transmission line. Prior to the works being started, a global pandemic is declared, leading to government-mandated lockdowns and staff shortages in critical industries, in turn resulting in disruptions to international supply chains. As a result:

- household electricity demand rises slightly, but industrial and commercial electricity demand fall dramatically, leading to a substantial net overall reduction in demand and
- the costs of the preferred option and some other network and storage credible options (requiring imported capital equipment) considered in the RIT-T rise significantly; however
- the costs of some demand-side credible options fall due to the larger share of overall demand attributable to more price-responsive households.

This reopening trigger affects both demand and cost assumptions used in the modelling of credible options in the RIT-T. This could justify a full reapplication of the RIT-T to consider the identified need, the list of credible options and the preferred option (see below).

Example 40: Act of God

In anticipation of these types of circumstances, the RIT proponent could develop 'combination' reopening triggers that either incorporate tighter thresholds than individual component triggers, in cases where changes tend to work in the same direction of making a preferred option less net beneficial than another credible option.

For example, in addition to the above preferred option cost increase threshold of 10% (example 36 above) and demand reduction threshold of 5% (example 38 above), a combination trigger could incorporate a 5% increase in real costs coupled with a 2.5% reduction in average forecast demand over the next 10 years.

B.6 Technological change

A RIT proponent has completed a RIT-T for an identified need and found the preferred option to be a new transmission line. Prior to the works being started, the proponent becomes aware of a newly available technology that is likely to revolutionise energy storage in a way not reflected in the credible options considered in the original RIT-T assessment. This technological change is a reopening trigger due to its ability to make available promising new credible options not previously considered.

Example 41: Technological change

In anticipation of such possible events or changes, the proponent could include a general reopening trigger where it is notified of any event or circumstance likely to result in the timely availability of a new credible option that offers higher net market benefits than the preferred option across the range of reasonable scenarios considered in the original RIT-T. The new option should not be merely a reconfiguration or resizing of an already-considered credible option, but incorporate a major advancement or change in technology.

B.7 Actions that may be taken in response to a RIT reopening trigger being triggered

If a RIT reopening trigger has been triggered, a RIT proponent must inform us of the actions it proposes to take, and the timeframes in which it proposes to take such actions. The actions that a RIT proponent must include, at a minimum, are specified in clause 5.16.4(z4B) of the NER. Namely:

- (1) publishing a statement that the preferred option identified remains the preferred option, as well as any supporting information necessary to demonstrate that the preferred option identified remains the preferred option; or
- (2) publishing a statement that the preferred option is no longer the preferred option and identifying the new preferred option, as well as any supporting information necessary to demonstrate that the preferred option is no longer the preferred option and the reasons the new preferred option is the preferred option.

In addition to these minimum actions, examples of other actions a RIT proponent may wish to consider taking are set out in Example 42.

Example 42: Other actions to take in response to a RIT reopening trigger being triggered

A RIT proponent, prior to formally notifying us of a RIT reopening trigger being triggered which constitutes a material change in circumstances, may wish to consider taking the following possible actions:

- stakeholder consultation
- preparing a report of the process, including a summary of stakeholders' views and its own conclusions, and
- providing this report to us at the same time it notifies us of the material change in circumstances under clause 5.16.4(z3) of the NER

A RIT proponent, after formally notifying us of a RIT reopening trigger being triggered which constitutes a material change in circumstances, in addition to the statement it is required to publish under the NER, may also wish to consider taking the following actions:

- explaining how the ranking of credible options may have changed, as a result of taking actions including:
 - further stakeholder consultation proportionate to the likely impact of the RIT reopening trigger being triggered
 - preparing a report of the process, including a summary of stakeholders' views and its own conclusions, and
 - providing this report to us to inform our decision in whether to accept or reject the RIT proponent's proposed actions
- if the change in circumstances is complex (particularly where more than one key input or assumption is affected), reapplying the RIT-T.

C Glossary

Term	Definition
actionable ISP project	has the meaning in clause 5.10.2 of the NER.
anticipated project	has the meaning set out in paragraph 19 of the RIT-T.
application guidelines or guidelines	means the regulatory investment test for transmission application guidelines defined in the NER.
base case	has the meaning set out in the RIT-T. This is, where 'a situation in which no option is implemented by, on behalf of the <i>transmission network service provider</i> '.
committed project	has the meaning set out in paragraph 18 of the RIT-T.
connection applicant	has the meaning in chapter 10 of the NER. That is, a person who wants to establish or modify <i>connection</i> to a <i>transmission network</i> or <i>distribution network</i> and/or who wishes to receive <i>network services</i> and who makes a <i>connection enquiry</i> as described in NER clause 5.3.2.
cost	has the meaning set out in paragraph 2 of the RIT-T.
inertia network services	has the meaning in chapter 10 of the NER.
intending participant	has the meaning in chapter 10 of the NER. That is, a person who is registered by AEMO as an <i>Intending Participant</i> under Chapter 2.

interested party in respect to RIT–T disputes, this takes the meaning given in NER clause 5.15.1. That is, this means '...a person including an end user or its *representative* who, in the *AER's* opinion, has the potential to suffer a material and adverse *National Electricity Market* impact from the investment identified as the preferred option...'.

market benefit the term market benefit (not italicised) refers to the incremental benefit of a credible option (over the base case) in a given reasonable scenario. The term *market benefit* (italicised) has the meaning set out in paragraph 4 the RIT–T.

modelled project has the meaning set out in paragraph 20 of the RIT–T, where this is 'a hypothetical project derived from market development modelling in the presence of absence (as applicable) of the relevant *credible option* or *base case*'.

National Electricity Rules the rules as defined in the National Electricity Law.

net economic benefit has the meaning set out in paragraph 1 of the RIT–T. That is '*net economic benefit* equals the *market benefit* less *costs*'.

Other Party a party other than a Participant.

Participant a registered participant under the NER or any other party in their capacity as a consumer, producer or transporter of electricity in the market

reasonable scenarios has the meaning set out in paragraph 15 of the RIT–T.

RIT–T the regulatory investment test for transmission defined in the NER.

registered participant

has the meaning in chapter 10 of the NER. That is, a person who is registered by *AEMO* in any one or more of the categories listed in clauses 2.2 to 2.7 (in the case of a person who is registered by *AEMO* as a *Trader*, such a person is only a *Registered Participant* for the purposes referred to in clause 2.5A). However, as set out in clause 8.2.1(a1), for the purposes of some provisions of clause 8.2 only, *AEMO* and *Connection Applicants* who are not otherwise Registered Participants are also deemed to be *Registered Participants*

renewable energy zone

either the definition:

- In the NER, if the NER provides a definition.
- In the AEMC's coordination of generation and transmission investment review, if the AEMC provides a definition in this review but has not defined it in the NER.
- AEMO uses in connection with the ISP, if neither of the above apply.

state of the world

has the meaning set out in paragraph 17 of the RIT-T.

system strength services

has the meaning in chapter 10 of the NER.