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9 August 2012

Claire Rozyn
Australian Energy Market Commission
PO Box A2449
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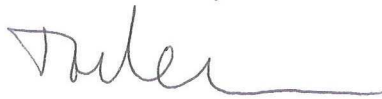
Dear Ms Rozyn

ERC0131 – AER submission to the AEMC distribution network planning and expansion draft rule determination and draft rule

Please find attached the AER's submission to the AEMC's draft rule determination and draft rule on the distribution network planning and expansion rule change proposal.

If you have any queries raised in this submission, please contact George Huang on (02) 9230 3856.

Yours sincerely



Tom Leuner
General Manager
Wholesale Markets



MCE rule change proposal – Distribution network planning and expansion framework

AER submission on AEMC draft rule and draft rule determination

August 2012

1 Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) draft rule and draft rule determination for the distribution network planning and expansion framework rule change request.

Among its roles, the AER is the economic regulator of electricity distribution services in the National Electricity Market. The AER has also been responsible for developing the regulatory test and new regulatory investment test for transmission (RIT-T). These responsibilities leave the AER well placed to comment on the design of distribution network service providers' (DNSPs) planning processes and the regulatory investment test for distribution (RIT-D).

The draft rule outlines significant roles for the AER. It is proposed that the AER:

- develop the RIT-D and the regulatory investment test for distribution application guidelines (the application guidelines)
- be responsible for considering disputes on the application of the RIT-D and
- undertake a periodic review of the appropriateness of certain RIT-D cost thresholds.

These responsibilities mean that the AER has a particular interest in this rule change.

The AER comments on the AEMC's draft rule and draft rule determination relate primarily to the RIT-D and dispute resolution processes.

2 RIT-D and dispute resolution process

Regulatory investment test for distribution

As noted in its previous submission, the AER is broadly supportive of the proposed introduction of a new RIT-D project assessment process for distribution assessments. The RIT-D is a key feature of the framework for network planning and investment. The RIT-D is designed to promote competitive neutrality in the assessment of alternative options, economic efficiency and transparency in DNSP decision making.

The AER is broadly supportive of the draft RIT-D rules. The draft determination and rule have addressed many of the concerns raised by the AER in its previous submission. In particular the AER notes that it is supportive of the draft rule:

- amending the proposed rule by only requiring that the RIT-D to be based on a cost-benefit analysis of each credible option. This removes the requirement in the proposed rule that each credible option be compared against the case where no option is implemented. This approach removes a level of unnecessary analysis for reliability driven projects and provides greater flexibility in writing the RIT-D to account for differences between reliability and non-reliability driven projects.
- amending the proposed rule so that only the AER can introduce new classes of market benefits. This addresses AER concerns that the proposed rule would lead to an ad hoc inconsistent approach to market benefits across DNSPs given the definition of market benefits could be subject to quite divergent views.
- introducing a framework where RIT-D proponents are required to reapply the RIT-D where there is a material change in circumstances meaning the identified preferred option may no longer be the preferred option.

As noted in its previous submission, the AER's preference is for the Electricity Rules to set high level principles regarding the coverage of the RIT-D, with further details on the nature of the test and the class of costs and benefits to be set out in the RIT-D. This is still the AER's preference. However, the AER recognises the draft RIT-D rule introduces a more robust economic framework for assessment of network and non-network investment options.

Nonetheless, the AER has comments on the draft RIT-D rules under the following four headings:

- Discretionary quantification of market benefits
- Ensuring the RIT-D procedures promote competitive neutrality
- Re-application of the RIT-D
- Transitional RIT-D arrangements

Discretionary quantification of market benefits

Clause 5.17.1(d) of the draft rule provides that a RIT-D proponent may, in a RIT-D assessment, quantify classes of market benefits which are material or would alter the selection of the preferred option.

The AER is concerned with the level of discretion given to RIT-D proponents on deciding whether market benefits should be considered during a RIT-D assessment. This may result in an inconsistent consideration of market benefits over time and between DNSPs as the RIT-D proponent is not required to assess material market benefits. This would be a violation of one of the key RIT-D principles that the RIT-D be capable of being applied in a predictable, consistent and predictable manner. Further in some circumstances where material market benefits are not considered, the preferred option may not be the option with the highest net economic benefit. Thus, if this level of discretion remained, RIT-D proponents potentially may be able to game the RIT-D to ensure their favoured option is the preferred option.

To address these issues, the AER suggests that the draft rule be amended to require RIT-D proponents to quantify classes of market benefits in a RIT-D assessment which are material or would alter the selection of the preferred option.

Ensuring the RIT-D procedures promote competitive neutrality

Clause 5.17.4 of the draft rule outlines the procedures for RIT-D proponents to follow when undertaking a RIT-D assessment. In particular, proponents must determine whether a non-network option is a potential credible option at the start of a RIT-D assessment process. If a non-network option is a potential credible option, then the RIT-D proponent must as a first step, consult on non-network options in accordance with subclauses 5.17.4(b)-(h). If a non-network option is not a potential credible option, then the RIT-D proponent does not need to consult and may proceed directly to the draft project assessment report.

The AER is supportive of RIT-D procedures giving greater focus to the consideration of non-network options as this promotes competitive neutrality between network and non-network options. However, the AER considers that, as currently drafted, the screening process for non-network options may not ensure an adequate assessment of non-network options. The RIT-D proponent does not need to consult prior to making a determination about whether to consider non-network options.

The AER notes that the DNSP demand side engagement obligations in clauses 5.13.(e)-(j) of the draft rule. These obligations require the DNSP to develop a strategy to engage non-network providers and considering non-network options and establish a demand side engagement register to notify non-network providers of developments relating to distribution network planning and expansion. The AER understands this is designed to ensure a RIT-D proponent can assess the viability of non-network options at the start of a RIT-D assessment process without consultation.

However the AER is concerned that this may not ensure a RIT-D proponent has the necessary prior engagement with non-network service providers to ensure they have the necessary information to make an assessment of whether a non-network (either by itself or in combination with network investment) is a potential credible option. In particular, the demand side engagement obligations do not require the DNSP to provide the technical characteristics of the identified need prior to the RIT-D assessment. Thus, non-network service providers are not guaranteed they will have the information necessary to develop or propose non-network solutions or engage meaningfully with DNSPs. This means DNSPs may not have the information needed to accurately assess the potential for non-network solutions at the start of the RIT-D assessment process without consultation.

The AER proposes that the rules could require that if a RIT-D proponent comes to the conclusion that a non-network option is not a potential credible option, then in addition to publishing their finding they must notify all non-network service providers on its register of its conclusion and allow one month for stakeholders to make a submission on the conclusion. The RIT-D proponent would be required to

provide, as part of this consultation, information about the technical characteristics of the need and its basis for concluding why a non-network solution is not a potential credible option. If the consultation finds that a non-network option may be a potential credible option, then the RIT-D proponent must publish a non-network options report and follow the associated consultation process.

The AER is also concerned that the RIT-D procedures encourage RIT-D proponents to only look at pure non-network or network options and not options which combines both non-network and network investment. The initial screen for non-network options does not ask RIT-D proponents to consider whether a non-network option can form part of a combined non-network and network solution. While in practice a RIT-D proponent may consider a combined non-network and network solution, the rule should be clarified to state that during the initial screen for non-network options the RIT-D proponent should look at whether a non-network option is a potential credible option or can form part of a potential credible option. A non-network options report should have to be published where it is found a non-network option can form part of a potential credible option.

Exemptions from the RIT-D

Clause 5.17.5(s) of the draft rule provides that where the preferred option is less than \$20 million the RIT-D proponent may discharge its obligation publish the final project assessment report separately and include the report as part of its annual planning report. The AER considers this threshold may be too high as distribution projects above \$10 million tend to be major projects and should be the subject of its own final report. Thus, the more appropriate threshold for clause 5.17.5(s) is \$10 million. The AER considers this is unlikely to impose an onerous regulatory burden on RIT-D proponents as it not likely to capture a large number of discrete projects.

Re-application of the RIT-D

As stated above, the AER is supportive of the AEMC's inclusion of the draft rule requiring DNSPs to re-apply the RIT-D where there is a material change in circumstances. The AER considers it is best practice for DNSPs to reapply the RIT-D where there is a material change in circumstances. However, the AER considers the rule as drafted may not deal well with the circumstances where the material change is a change in the demand forecast which delays the identified need arising. In that case, it may not be appropriate to reapply the RIT-D immediately.

In those circumstances the AER considers the appropriate action would be for the DNSP to wait until the identified need is projected to arise again and then apply the RIT-D at that stage. Thus, the AER considers the draft rule should be amended to include that where the material change in circumstances is a delay in the identified need arising then the RIT-D proponent should wait until the identified need arises again before reapplying the RIT-D. The delayed application of the RIT-D would ensure that the new RIT-D assessment would consider any new credible options (i.e. new non-network options) which have arisen since the RIT-D was first applied.

Whilst outside the scope of this review, the AER considers that a similar reapplication provision should also be introduced for the RIT-T.

Dispute Resolution processes

The AER is supportive of the dispute resolution procedures in the draft rules. In particular the AER notes that the AEMC has taken on board its proposal in the previous submission to clarify the interested party definition and remove the provisions in the proposed rule for the AER to grant an exemption to the dispute resolution process.

AER determination that a non-reliability driven projects complies with the RIT-D

Clause 5.6.6AA of the National Electricity Rules provides that for non-reliability driven RIT-T projects the AER may, on written request by a TNSP, make a determination as to whether the preferred option set out in project assessments conclusions report satisfies the RIT-T. In the draft determination, the AEMC has asked stakeholder input on introducing an equivalent provision for the RIT-D. The AER did not support the introduction of clause 5.6.6AA when it was introduced as part of the RIT-T rule change and considered it should be removed.¹ The AER would not support the introduction of an equivalent provision for the RIT-D. However in principle there is no reason why this provision should only apply to the RIT-T and not the RIT-D.

¹ AER, *Submission to AEMC National Electricity Amendment (Regulatory Investment Test for Investment) draft rule determination*, 15 May 2009, p.9.



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