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24 November 2011

Claire Rozyn
Australian Energy Market Commission
PO Box A2449
South Sydney NSW 1235

Dear Ms Rozyn

ERC0131—AER submission to the distribution network planning and expansion rule change proposal

Please find attached the AER's submission the distribution network planning and expansion rule change proposal.

If you have any queries raised on the issues raised in this submission, please contact Kate Murphy on (02) 6243 1086.

Yours sincerely



Tom Leuner
General Manager
Wholesale Markets



MCE rule change proposal—Distribution network planning and expansion framework

AER submission on AEMC consultation paper

24 November 2011

1 Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) consultation paper on the proposed distribution network planning and expansion framework.

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 proposed 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
- grant exemptions or variations to DNSP's annual planning reporting requirements
- audit DNSP's planning and decision making for certain investments 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 broadly supports the proposed reforms. This submission comments on the proposed rule changes regarding:

- DNSP's annual planning and reporting requirements
- the RIT-D project assessment process and dispute resolution process.

The submission also responds to some of the issues raised in the AEMC's consultation paper.

The proposed rule will impose new obligations on DNSPs. It is important that those obligations be clear so that the DNSPs are able to establish processes and procedures to ensure on going compliance with any new requirement. The AER will be responsible for monitoring compliance and undertaking investigations where obligations may have been breached. We suggest that the AEMC thoroughly review the drafting of the proposed rule. Any ambiguity in rule drafting will present difficulties for DNSPs in complying with obligations under the rules and for the AER in enforcing these obligations.

2 Annual planning and reporting requirements

Annual planning process

The MCE has proposed that DNSPs will carry out an annual planning process covering a minimum forward planning period of five years. The planning process will apply to all distribution network assets and activities that have a material impact on the distribution network. DNSPs will be required to use reasonable endeavours to engage with non-network proponents and consider non-network alternatives. They will also be required to establish and implement a Demand Side Engagement Strategy.

The AER broadly supports the proposed movement towards a nationally-consistent approach to network planning. The MCE's proposed approach is a positive development and the proposed annual planning process appears to provide a reasonable framework for distribution network planning.

The proposed framework could be improved further if it provided a uniform start date across jurisdictions for the annual planning period and the publication of the distribution annual planning report (DAPR). A uniform start date may promote improved transparency and consistency in industry practices. It would also more effectively facilitate joint planning across jurisdictions (for example between the Powercor and Essential Energy networks) and between transmission and distribution networks.

If the AEMC considers that each jurisdiction should determine its own start date, then the Electricity Rules should at a minimum specify a default start date. This is necessary to ensure that the proposed provisions are workable in the event that a jurisdiction does not specify a date.

Distribution annual planning report

The MCE also proposes that DNSPs publish a DAPR each year. The proposed DAPR will include detailed information on the DNSP's forecasting, details of system limitations and proposed network investments, characteristics of the network and a summary of any joint planning activities. The MCE has also proposed that the AER would be able to grant exemptions or variations to the national annual reporting requirements where a DNSP is able to demonstrate that due to its operational or network characteristics, the costs of preparing the data would manifestly exceed any benefits that may be obtained from reporting the data.

The AER supports a national framework for reporting (including the proposed DAPR). The information proposed to be included in the DAPR should provide a valuable resource to market participants and the publication of the DAPR may improve the transparency and accountability of DNSP decision making. The information contained in the DAPR may provide:

- other network service providers, customers, market participants and interested parties with an improved understanding of the likely future development of the network

- a valuable resource for the AER in undertaking reviews of DNSP's revenue proposals as well as its other regulatory and enforcement roles
- potential demand side providers with information which may assist them to develop non-network solutions, and
- important information to customers to assist in determining on optimal locations for connection to the network.

Demand forecasting is the critical first step in the network planning process. Improved information disclosure around forecasting processes will enhance opportunities for better comparisons of differing methodologies across jurisdictions. It may also provide a platform for the future development of a common approach to forecasting in each jurisdiction, which could be developed through AEMO's National Energy Forecasting Project.

Given disclosure of network planning data and methodologies has the potential to provide benefits to a broad range of other market participants and interested parties, the AER considers that it would be unlikely that the proposal to allow exemptions/variations would provide a net benefit. The information proposed to be included in the DAPR is core network planning information that in the most part should already be considered by DNSPs when undertaking their current planning activities. Requiring disclosure of this information should not provide an unwarranted additional cost or regulatory burden on DNSPs.

The AER has also considered an alternative where the Electricity Rules could allow exemptions/variations for only some of the proposed information. However this approach is also not supported as all the information proposed to be included in the DAPR is important for a variety of purposes and is necessary to provide a comprehensive overview of the DNSP's approach to forward planning.

3 RIT-D and dispute resolution process

Regulatory investment test for distribution

The AER welcomes the proposed introduction of a new RIT-D project assessment process for distribution investments. The RIT-D should provide a more robust economic framework for the effective assessment of alternative projects including non-network solutions. This is a critical aspect of the framework for network planning and investment that provides transparency around DNSP's decisions regarding particular network (or non-network) investments.

The AER broadly supports the amalgamation of the limbs of the regulatory test and the creation of a single cost-benefit assessment framework specifically developed for distribution investments. While the AER supports a new RIT-D framework to replace the regulatory test, it has a number of comments on:

- the RIT-D 'principles', including the level of prescription in these principles

- the RIT-D design parameters, including the scope of investments subject to the RIT-D, and
- the proposal for the AER review of the treatment of non-network alternatives.

The RIT-D principles

The MCE’s proposed rule amalgamates the reliability and market benefits limbs of the current regulatory test and establishes a single cost-benefit assessment framework for all proposed investments. The MCE has proposed that DNSPs would be required to quantify all costs, but would have discretion as to whether to quantify market benefits.

The MCE’s proposed rule includes ‘principles’ that the AER must comply with when developing and publishing the RIT-D. The principles prescribe a significant amount of detail on the matters that must be set out in the RIT-D, including the nature of the test and the classes of costs and benefits. While there are some differences, the general approach to prescribing principles adopted in the proposed rule is very similar to that adopted for the provisions in the Electricity Rules regarding the RIT-T.

Level of detail in RIT-D specifications

In previous submissions to the AEMC, the AER has outlined problems associated with adopting an overly prescriptive approach for the Electricity Rule requirements for the RIT-T. These concerns are also relevant to the RIT-D. In particular, a highly prescriptive approach to setting out the principles that should underpin the RIT-D:

- creates significant issues if there are problems with the drafting of these principles
- may not provide sufficient flexibility to allow the RIT-D to respond to unforeseen market developments as any changes would generally require amendment to both the Electricity Rules and then subsequent amendment to the RIT-D, and
- will also lead to considerable overlap in the material covered in the Electricity Rules and the AER’s RIT-D and application guidelines.

The AER’s experience in developing the RIT-T has confirmed some of the difficulties associated with a highly prescriptive approach. For example in developing the RIT-T some stakeholders raised concerns around the requirement in the Electricity Rules that the RIT-T “must be based on a cost-benefit analysis that includes an assessment of reasonable scenarios... if each credible option were implemented *compared to a situation where no option is implemented* [emphasis added]”. In effect this clause requires TNSPs to develop a ‘do nothing’ option as a base case scenario even where the identified need is for reliability corrective action and a ‘do nothing’ option was not feasible. The AER and other stakeholders did not identify this issue during the rule change process and the AER was unable to respond to it during the development of the RIT-T due to the drafting in the Electricity Rules.

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. However, the AER appreciates that the AEMC may consider that heavily prescribed principles for the RIT-D are appropriate in order to promote

consistency with the framework that was established in transmission. Given this, the AER has conducted a very high level review of the proposed principles and has identified a number of areas where the drafting could be revisited. These are detailed below.

Comments regarding specific principles in the proposed rule

The base case

Clause 5.6.5CA (c)(1) requires that the RIT-D must require a comparison of reasonable scenarios if each credible option were implemented “compared to a situation where no option was implemented”. The implication of this provision is that a DNSP must develop a base case scenario where no option is implemented to calculate the absolute value of the net economic benefit arising under each scenario.

The AER notes that it is necessary to require this type of analysis for a project that is not driven by reliability corrective action (because the option with the highest net economic benefit may be to ‘do nothing’). However, for projects driven by reliability corrective action, this approach may require a level of analysis which is unnecessary given that the ‘do nothing’ option is not feasible. In these circumstances it is arguable that the relative ranking of the options is more important than the absolute values of the net economic benefits for each option.

The AER appreciates that any amendment to 5.6.5CA to address this issue will likely introduce a slightly different framework for projects driven by reliability corrective action compared to other projects. However, on balance, the AER considers that further thought should be given to whether it should be necessary to develop a ‘do nothing’ scenario in circumstances where reliability requirements mean that doing nothing is not plausible.

Additional classes of market benefits

Clauses 5.6.5CA(c)(4)(viii) and 5.6.5CA(c)(6)(iv) state that the RIT-D must require a DNSP to consider “any other market benefits that are determined to be relevant by the DNSP” (in addition to the classes of benefit and cost provided in the Electricity Rules). The drafting of this clause differs from the drafting in the RIT-T, without any sound reason.

The RIT-T requires a TNSP to consider additional classes of market benefit or cost that:

- the AER has specified in the RIT-T, and
- other benefits or costs that are determined to be relevant by the TNSP and agreed to by the AER in writing.

During the development of the Electricity Rules for the RIT-T, the AER argued that it was not appropriate for TNSPs to propose additional classes of market benefits and costs that were not already specified in the Electricity Rules or the RIT-T itself. The AER is also of this view in relation to the RIT-D. The ability to consider additional classes of market benefit or cost that are not in the Electricity Rules or the RIT-D may lead to an inconsistent approach to the development of the RIT-D, in particular given that defining ‘market benefit’ could be subject to quite divergent views.

A preferable approach is to permit the AER to set out additional classes of market benefit or cost in the RIT-D and then limit the addition of any further classes of market benefits. This approach would provide for a much more strategic and complete approach to developing the RIT-D than permitting DNSPs to consider additional classes of benefit on an ad hoc basis. However, if the AEMC considers that it is appropriate for DNSPs to consider classes of market benefit that are not set out in the Electricity Rules or RIT-D, then the Electricity Rules should require a DNSP to obtain prior written agreement from the AER to consider additional benefits.

Classes of costs that must be considered

Clause 5.6.5CA states that a DNSP must quantify all classes of costs unless it can provide reasons why a particular class of cost is not expected to apply to a credible option. A similar provision does not apply under the equivalent RIT-T provisions. It is not clear why this clause is beneficial or necessary. It is very difficult to imagine circumstances in which construction costs, operating and maintenance costs and costs associated with complying with regulatory requirements would not apply to a particular credible option. DNSPs also have experience in quantifying these classes of cost as they are broadly the same as those that currently apply under the reliability limb of the existing regulatory test.

Timeframe for publishing the RIT-D

The proposed rule does not yet include a date for the publication of the RIT-D and application guidelines. If the AEMC accepts the MCE's proposed rule, 12 months following the commencement of the rule is an appropriate period for the AER to develop and publish the RIT-D. This is consistent with the approach adopted in the RIT-T rule.

RIT-D design parameters

Scope of investments subject to the RIT-D

The MCE has proposed that DNSPs will undertake the RIT-D when a distribution system limitation exists and the most expensive option is expected to cost \$5 million or more. The RIT-D will also not apply to urgent and unforeseen investments, negotiated services, replacements, refurbishments or connection services.

The AER supports the proposed \$5 million threshold as it provides consistency with the RIT-T provisions and is sufficiently high that it will not create a significant RIT-D assessment burden on DNSPs.

The AER also supports the inclusion of the obligation in clause 5.6.5CB(e) that a DNSP must not treat different parts of an integrated solution to an identified need as distinct and separate options for the purpose of determining whether the RIT-D applies to those parts. This provision addresses concerns that DNSPs may be able to divide distribution programs into smaller projects to avoid triggering a RIT-D assessment process.

However the AER considers that it may also be appropriate to include further boundaries around the requirements to undertake RIT-D assessments. In particular further thought should be given to whether a DNSP should reapply the RIT-D where:

- a significant period of time has elapsed (for example several years) since the completion of the original assessment
- significant new information (such as a revised demand forecast) has emerged since the completion of the original assessment (but before construction) which indicates that the need for the investment has changed
- the estimated costs associated with the project has significantly increased since completing the original assessment due to, for example town planning or environmental approval considerations.

In these circumstances the original RIT-D assessment may not be able to be relied upon as identifying the most efficient investment option and it would be reasonable and prudent to require a DNSP to reapply the RIT-D.

This approach would not be consistent with the current approach in transmission. However, the AER considers that subsequent amendments to the transmission arrangements may be warranted.

Exemptions from the RIT-D

The MCE has proposed that the urgent and unforeseen projects would not be subject to a RIT-D.

While the proposed rule exempts urgent and unforeseen projects from being subject to the RIT-D, this exemption only applies to reliability driven investments where:

- the investment must be operational within six months
- the event causing the identified need was not reasonably foreseeable and was beyond the reasonable control of the DNSP, and
- failure to address the identified need is likely to materially adversely affect the reliability and security of the network.

This is similar to the approach taken for urgent and unforeseen transmission investments.

It would be very rare for a distribution network project that is greater than \$5 million to be urgent or unforeseen. Given this, the AER supports the proposed limitations on this exemption as it ensures that DNSPs cannot exclude projects from analysis under the RIT-D due to errors or deficiencies in the DNSP's own network planning arrangements. The proposed limitations also restrict any gaming opportunities for a DNSP to delay project planning and avoid the RIT-D assessment process.

AER review and enforcement functions

The major challenge currently presented to the AER in monitoring and enforcing compliance with the network planning provisions of the Electricity Rules is the lack of enforcement tools available to the AER. Currently none of the requirements regarding the need to undertake a RIT-T and the associated consultation requirements are listed as civil penalty provisions

under the National Electricity Regulations. The implication of this is that the only formal action the AER can take in relation to a suspected breach of these provisions is to seek an order from the Federal Court.

It is unclear whether it is intended that the distribution network planning provisions will be civil penalty provisions. While addressing this issue is beyond the scope of the AEMC's role in assessing a rule change proposal, the AER considers that the effectiveness of the improved network planning framework may be further improved if the obligations were classified as civil penalty provisions.

The MCE has proposed that the AER should:

- be able to review a DNSP's policies or procedures to determine if non-network alternatives have been duly considered
- conduct audits to determine if non-network alternatives have been duly considered for projects exempt from the RIT-D assessment process, and
- publish a report each year detailing the results of any audits undertaken in the previous twelve months.

The AER supports the drafting of the first of these two requirements as they provide the AER with the option (but not an obligation) to undertake these tasks. This approach is preferable as the AER may find after several audits that there are no specific ongoing issues with regard to distribution network planning that require annual review. In these circumstances it is not clear what ongoing benefit will be derived from continuing to prioritise compliance and enforcement activity in this area.

The AER considers that the same principle should apply to the publication of reports detailing any audits undertaken. The current drafting *requires* the AER to publish these reports annually. It is not clear why this obligation is necessary. As the enforcement body for the national electricity market, the AER publishes quarterly compliance reports and investigation reports to provide information on its enforcement and compliance activity.¹

Dispute resolution process

The MCE has proposed a RIT-D dispute resolution process which is broadly similar to that applying to transmission investments under the RIT-T. The process permits registered participants, the AEMC, connecting applicants, intending participants, AEMO, interested parties and non-network providers to lodge a dispute with the AER regarding a DNSP's RIT-D assessment.

While the AER supports an effective dispute resolution process applying to a DNSP's RIT-D assessments, it has some concerns regarding the scope of the parties who could raise a dispute and the proposed power to allow the AER to grant exemptions from the dispute resolution process.

¹ The AER's approach to enforcement and compliance is outlined in the *Compliance and enforcement statement of approach*, December 2010 (available on the AER's website www.aer.gov.au)

Parties who can raise a dispute

The AER broadly supports the classes of parties that can raise a dispute, but has some concerns with the definition of ‘interested parties’ in the Electricity Rules. Interested parties are defined (for the purpose of RIT-T and RIT-D disputes) as:

a person including an end user or its *representative* who, in the AER’s opinion, has, or identifies itself to the AER as having the potential to suffer a material and adverse market impact from the proposed *transmission investment* or *distribution investment* (as the case may be) that is the *preferred option* identified in the *project assessment conclusions report* or the *final projects assessment report* (as the case may be).

The AER considers there are aspects of this definition which are not clear. Firstly, the reference to a person that *identifies itself has having* the potential to suffer an impact does not make it clear whether:

- that by merely identifying themselves, a person is an interested party for the purposes of this definition, or
- a person is an interested party for the purposes of this definition is solely a matter for the AER’s opinion.

Secondly, ‘market’ is not italicised in the definition and it is therefore unclear whether the material and adverse market impact experienced by the interested party must arise in the national electricity market or in the market for some other good or service (such as the market for rental properties or tourism services).

The AER considers that the drafting of this definition should be revised. One possible alternative definition could be:

a person including an end user or its *representative* who, in the AER’s opinion has the potential to suffer a material and adverse *market* impact from the proposed *transmission investment* or *distribution investment* (as the case may be) that is the *preferred option* identified in the *project assessment conclusions report* or the *final projects assessment report* (as the case may be).

This revised definition would remove some of the ambiguity associated with the current drafting and apply to both RIT-T and RIT-D disputes.

Exemptions from the dispute resolution process

The AER considers that the proposal to allow the AER to grant exemptions from the dispute resolution process is unnecessary and unlikely to improve the proposed dispute resolution process. There are likely to be two circumstances where the AER may consider it appropriate to grant an exemption to the dispute resolution process:

- the dispute was based on matters unrelated to the RIT-D assessment or was vexatious, or
- the time involved in conducting the dispute resolution process would lead to an unacceptable threat to system security and reliability.

Both of these issues are already adequately dealt with in other provisions in the proposed rules:

- urgent and unforeseen investments will be exempt from the RIT-D assessment process and would therefore not be captured under the proposed dispute resolution process, and
- the AER will have the power to dismiss disputes which are misconceived or lacking in substance.

Given these provisions, it is difficult to identify what additional benefit would be gained from allowing the AER to grant exemptions from the dispute resolution process.