

17 April 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Dr Tamblyn

RE: Review of National Framework for Electricity Distribution Network Planning and Expansion (AEMC Reference EPR0015)

Please find attached the AER's submission on the AEMC's scoping and issues paper for the review of the framework for electricity distribution network planning and expansion.

Please contact me if you have any questions in relation to the matters raised in our submission.

Yours sincerely



Michelle Groves
Chief Executive Officer



AER Submission

**Review of National Framework for Electricity Distribution
Network Planning and Expansion**

Response to AEMC scoping and issues paper

17 April 2009

1. Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the Australian Energy Market Commission's (AEMC) scoping and issues paper for its review of the national framework for electricity distribution network planning and expansion.

Among its roles, the AER is the economic regulator of electricity distribution services in the National Electricity Market (NEM). The AER has also been responsible for the development of the regulatory test and it is proposed that the AER develop the new regulatory investment test for transmission (RIT-T). These responsibilities leave the AER well placed to comment on two of the most important considerations for this review – the design of the distribution network service providers' (DNSPs) planning processes and the design of the regulatory investment test for distribution (RIT-D).

The Ministerial Council on Energy's (MCE) terms of reference for this review require the AEMC to consider three main elements of a national distribution framework:

- A requirement on DNSPs to undertake an annual planning process. This planning process includes a requirement on DNSPs to produce an annual planning report.
- A requirement for DNSPs to undertake a project assessment and consultation process when considering network expansions and augmentations, subject to appropriate thresholds
- A dispute resolution process to provide a mechanism for market participants to question DNSPs' decision making

Section 2 of the submission provides views on each of these three issues, commenting on appropriate scope of annual planning reports, features of the RIT-D and the RIT-D dispute resolution process. In many areas, the AER supports an approach for distribution that is consistent to that being developed in transmission.

Section 3 of the submission provides responses to the specific questions raised in the scoping and issues paper.

The AER believes that this review has the potential to improve the transparency of DNSPs' annual planning and the assessment of individual projects. This improved transparency can help support the efficient development of the distribution network. At the outset, however, it should be noted that improved transparency surrounding DNSP planning is only one element of an overall approach to ensure that DNSPs make planning decisions that are not weighted against non-network options. For example, improved transparency of DNSP planning does not provide additional economic incentives for distributors to consider non-network options.

There are, however, other reviews with the potential to consider distribution network planning issues more broadly. As noted in the scoping and issues paper, the review of demand side participation in the NEM is assessing whether there are any barriers to non-network projects within the current arrangements for distribution network planning.

2. Key issues

2.1 Planning reports

The MCE terms of reference note that as part of the national distribution framework, each DNSP will be required to conduct an annual planning process in which DNSPs produce a five year forward planning report. The report will be published annually and made publicly available.

This requirement is an important development. There is currently no requirement in the National Electricity Rules for DNSPs to publish annual planning reports, and the jurisdictional reporting requirements vary significantly from state to state. A requirement on DNSPs to produce annual planning reports has the potential to bring more transparency to distribution planning, while a standardisation of planning requirements should ensure greater consistency of distribution reporting.

A key issue in developing planning requirements concerns the content that should be required in these annual planning reports. The scoping and issues paper notes that specific content requirements of the planning report could include:

- credible scenarios of demand for next five years
- forecast of distribution network constraints and other distribution network problems
- potential solutions to network constraints including results of case-by-case project assessments and public consultations where applicable
- information on projects which were not subject to the project assessment process that have been scheduled or are proposed
- outcomes of the transmission network service provider (TNSP) and DNSP joint planning
- forecast of distribution network capacity including load forecasts and transmission interface provisions including the extent of surplus capacity at different points in the distribution network
- other factors such as adequacy of transmission interchange capacity, general network capacity and summer and winter peak capacity.

The AER supports the inclusion of all this information in annual planning reports.

Another key issue concerns the level of detail that should be required in annual planning reports. Annual planning reporting requirements of TNSPs are outlined in clause 5.6.2A of the National Electricity Rules. This provides a useful framework to consider the level

of detail that should be specified in the Rules concerning annual planning reporting requirements for DNSPs.¹

Clause 5.6.2A provides some detail on how information should be provided in the TNSP's annual planning reports. For example, rather than merely requiring identification of potential solutions to network constraints, the clause requires the name of the project and when it is proposed to become operational; the reason for the constraint (including load forecasts and assumptions used); the proposed solution; the total cost of the solution; and other network and non-network options considered.

The AER supports a similar level of detail being required in the DNSP's annual planning reports. Specifying in some detail the information that is required in annual planning reports improves transparency surrounding the planning process. This specification should also promote greater consistency of information provided in annual planning reports, thereby minimising the administrative costs for participants that operate in multiple jurisdictions.

The scoping and issues paper queries whether the planning process should include an assessment of the accuracy of past planning. For example, it notes that DNSPs could be required to evaluate the robustness of past planning processes by setting out historical performance data and providing explanations for any differences, and report on their compliance with planning requirements.

The AER supports including this type of reporting as part of the national framework. This reporting, which is already being carried out in some jurisdictions, increases confidence of market participants in planning processes conducted by distribution companies.

The AER believes that further transparency would be provided by requiring DNSPs to engage in preliminary consultation prior to finalising the annual planning reports. Similar to the approach proposed for the National Transmission Network Development Plan (NTNDP), DNSPs could provide details on proposed planning inputs, current annual planning reports and the proposed work plan for stakeholder comment. The AEMC has argued that this consultation creates transparency and enhances the confidence stakeholders will have in the NTNDP.² Similar benefits would appear to be created by requiring preliminary consultation by DNSPs on their annual planning reports.

2.2 Project assessment and consultation

The MCE terms of reference note that as part of the national distribution planning framework, there will be an individual project assessment and consultation process, subject to certain thresholds. This process will be outlined in the RIT-D. The RIT-D is designed to ensure that DNSPs conduct a robust economic assessment of alternative projects including non-network solutions. The MCE views transparency of decision making and analysis as an important feature of the RIT-D framework.

¹ It should also be noted that clause 5.6.2A requires TNSPs to report on similar factors to those highlighted by the AEMC as potential features of a DNSP annual reporting regime.

² AEMC 2008, *National Transmission Planning Arrangements – Final Report to MCE*, 30 June 2008, p.24.

There appear to be three main issues that arise in the design of the RIT-D:

- the threshold for applying individual project assessments under the RIT-D
- factors that should be considered in a request for proposal (RFP) process
- the form of the RIT-D assessment test .

The threshold for applying individual project assessments under the RIT-D

In transmission, the proposed RIT-T rule change requires TNSPs to undertake a RIT-T assessment for all projects above \$5 million. The NERA/ACG report for the MCE suggested that distribution projects requiring an estimated capital expenditure of more than \$2 million be required to issue a request for proposals from potential providers of non-network solutions.

The AER favours retaining consistency with the approach in transmission and believes that RIT-D assessments should therefore be conducted on projects valued at over \$5 million. The AER feels that the \$2 million cut off outlined in the NERA/ACG report is quite low and would create a significant RIT-D assessment burden on DNSPs. The AER notes, however, that RIT-D thresholds will be subject to periodic review. If it is not currently possible to rigorously analyse different thresholds, as suggested by NERA/ACG, a subsequent review would provide an opportunity to assess the appropriateness of the threshold chosen.

The AEMC also notes the risk that distribution programs are potentially able to being broken up into smaller projects to avoid triggering the RIT-D assessment process. To avoid this situation, the AEMC could give thought to clarifying that the RIT-D assessment also applies to both a project with a value in excess of \$5 million and a program with a value of over \$5 million, where a program is defined as a series of small related projects with a value of over \$5 million.

Project specification process

In transmission, all projects subject to a RIT-T assessment will be required to undertake a project specification process. The purpose of this project consultation stage is to help ensure that all potential options, including non-network options, are identified and considered.

The AER notes that there is no similar project specification requirement specified in the NER for DNSPs. The AER believes that a requirement for DNSPs to undertake a similar project specification process is an important issue that needs to be progressed in this review. As noted in the scoping and issues paper, a formal project specification process is an important means of ensuring that the RIT-D assessment is conducted in a transparent manner.

In terms of the threshold for conducting the project specification process, the AER considers that all projects required to undertake a RIT-D assessment (that is projects

with a value of more than \$5 million) should also go through the project specification process.

The AER notes that a project specification consultation process is proposed as part of the RIT-T draft rule changes. In transmission it is proposed that the TNSP must prepare a project specification report including:

- a description of the identified need, such as a need to meet relevant reliability requirements
- technical characteristics of the identified need that a non-network option would be required to deliver such as size of load reduction or additional supply
- detailed description of all possible credible options that address the identified need
- for each possible option, detailed information such as technical characteristics, classes of market benefit that could be material, estimated construction timetable, and total indicative costs (to the extent practicable).

A TNSP must seek submissions on the options and issues included in the report, with the consultation period not to be less than 12 weeks.

The AER believes that a similar project specification consultation process should be adopted in distribution. This would help ensure that key inputs into the project assessment are subject to consultation, thereby improving the identification of alternative options.

Form of the RIT-D assessment test

The AEMC queries how the decision making test to determine the most economic option under the RIT-D should be structured. The AEMC notes that distribution augmentations tend to be needed for reliability reasons and are less likely to deliver wider market benefits. Hence a less elaborate regulatory test may be required for distribution than for transmission.

The AER notes that for transmission the recent RIT-T draft determination integrates the market benefits and reliability limbs of the regulatory test, but allows a negative net present value for reliability-driven investments. The AER believes that this approach should also be adopted for distribution. This approach accommodates reliability augmentations while establishing a robust cost-benefit analysis framework for investment decision making.

There may be a view that this approach requires a disproportionate level of analysis in determining market benefits for reliability-driven projects. However, draft Rule 5.6.5B(c)(5) allows for the analysis to consider only material market benefits. Therefore, as noted in the AEMC's RIT-T draft determination, if no options have market benefits and hence the project is solely driven by the need to meet reliability standards, the RIT-T would effectively be a least cost test analogous to the test applied under the reliability limb of the current regulatory test.

There is no need, therefore, to develop separate decision-making tests in transmission and distribution.

2.3 Dispute resolution

The MCE's terms of reference require that the national distribution framework include a dispute resolution process. The purpose of the dispute resolution process is to provide a mechanism for market participants to question DNSPs' decision making, and in so doing provide increased transparency surrounding DNSPs' decisions.

There appear to be two major issues surrounding the operation of the dispute resolution process.

The scope of issues subject to dispute resolution

The AER believes that the dispute resolution process should only apply to project assessments undertaken by DNSPs under the RIT-D.

The scoping and issues paper queries whether the dispute resolution process could also apply to DNSPs' forecasts of distribution network constraints in their annual planning reports. While this would aid transparency surrounding DNSPs' decision making, the AER believes that this would potentially open up a very broad range of issues for dispute. This may create a costly dispute resolution process with potential for investment delays.

Similar transparency benefits could be provided by requiring DNSPs to consult on their annual planning reports (as noted earlier in the submission). Such an approach would allow interested parties to query findings in annual planning reports, but do so in a less resource intensive manner than formal dispute resolution.

Operation of the dispute resolution process

The scoping and issues paper questions whether dispute resolution should entail a merits review or compliance review. The AEMC's RIT-T draft determination recommends that disputes relating to the RIT-T be conducted as a compliance review. The AER can see no reason why a different dispute resolution framework should be applied in distribution compared to transmission.

3. Responses to scoping and issues paper questions

Below are AER responses to specific questions set out in the scoping and issues paper.

Issue	Question for comment	AER Response
The Commission's approach to the Review	1. The proposed scope for the Review; 2. The Commission's proposed approach and assessment criteria for the Review; and 3. The interaction between transmission and distribution network planning.	The AER considers that scope of distribution services included in the national framework should be limited to standard control services.
Scope of the annual planning and reporting process	4. In addition to emerging constraints, what other types of potential problems of the distribution network should be included in annual planning reports? 5. How could the interaction between transmission and distribution planning be reflected in annual planning and reporting process? 6. Should the annual planning report including	DNSP annual reporting should include reporting on work carried out by DNSPs including reporting of

	reporting on work carried out by DNSPs including reporting of actual network performance information and historical data?	actual network performance information and historical data. DNSPs should be required to report on differences between plans and actual performance.
Type and level of detail of information to be provided in annual planning reports	<p>7. What factors need to be considered to ensure the level of detail of the information provided is useful and appropriate to stakeholders?</p> <p>8. For the areas that are to be reported on, what specific factors should be considered? For example for emerging constraints, how should emerging constraints be classified and how could they be consistently set out?</p> <p>9. Should a distinction be made between general information that is publicly available and more detailed information for embedded generators and demand side response proponents?</p>	<p>As highlighted in the body of the submission, DNSPs should be required to report on:</p> <ul style="list-style-type: none"> ▪ credible scenarios of demand for next five years ▪ forecast of distribution network constraints and other distribution network problems ▪ potential solutions to network constraints including results of case-by-case project assessments and public consultations where applicable ▪ information on projects which were not subject to the project assessment process that have been scheduled or are proposed ▪ outcomes of the TNSP and DNSP joint planning ▪ forecast of distribution network capacity including load forecasts and transmission interface provisions including the extent of surplus capacity at different points in the distribution network ▪ other factors such as adequacy of transmission interchange capacity, general network capacity and summer and winter peak capacity. <p>A similar level of detail should be required in the DNSPs' annual planning reports as the requirements on TNSP reporting outlined in clause 5.6.2A of the Rules.</p>

<p>Implementation of the annual planning and reporting process</p>	<p>10. Would the Australian Energy Market Operator’s website be the appropriate central location for the planning reports to be stored and published?</p> <p>11. What would be the appropriate timeframe for the publication of the DNSP annual planning report (noting the relationship between the timeframe for the publication of the TNSP annual planning report and the DNSP/TNSP joint planning requirements)?</p>	<p>AEMO’s website appears to be the appropriate location for planning reports to be stored and published.</p>
<p>Thresholds to trigger project assessment under RIT-D</p>	<p>12. What types of investments should be required to undertake the project assessment process?</p> <p>13. What are the appropriate thresholds to trigger the project assessment process?</p> <p>14. Should the thresholds be indexed in accordance with CPI or subject to a periodic review?</p>	<p>As is the case proposed for RIT-T assessments, all projects estimated to cost over \$5 million should be subject to the RIT-D.</p> <p>A reconfiguration that changes the capacity of the distribution network that exceeds this threshold should also be assessed under the RIT-D. If a project is a mixture of replacement and augmentation, a RIT-D assessment should be conducted if the project includes an augmentation element valued over \$5 million.</p> <p>As is the case for RIT-T assessments, RIT-D thresholds should be subject to a periodic review</p>

<p>Identifying and consulting on options during project assessments</p>	<p>15. What factors should be considered in a RFP process and how should this be specified in the NER compared to AER guidelines? Including:</p> <ul style="list-style-type: none"> ▪ what defines a credible option? ▪ what information is needed to enable market participants to raise alternatives? ▪ how long should the consultation take place? ▪ should an RFP process include elements to deal with the potential issue of DNSPs seeking assurance from non-network proponents for the performance of a non-network option? 	<p>The AER believes that a similar project specification consultation process to that proposed for transmission should be adopted in distribution. Major details of the transmission project specification process, including definition of a credible option and consultation timeframes, are proposed to be outlined in the NER. There appears to be no valid reason to adopt a different approach for the distribution project specification.</p>
<p>Identification & quantification of the costs and benefits of distribution projects</p>	<p>16. What is the appropriate list of costs and benefits associated with distribution projects, and should that list be mandated in the NER?</p> <p>17. How should the range of benefits to be quantified under the project</p>	<p>All the costs and benefits set out in the RIT-T should be included in the RIT-D. As these costs and benefits are to be mandated in the NER for transmission, there is no reason to adopt a different approach for distribution.</p> <p>Where the value of the project looks likely to exceed \$5 million, the range of benefits should be identified through the DNSP undertaking a project consultation specification process similar to that</p>

	<p>assessment process be determined?</p> <p>18. How can the project assessment process ensure that environmental benefits are appropriately treated and quantified?</p>	<p>which is proposed in transmission.</p> <p>The AEMC's proposed RIT-T rule change does not propose to include environmental benefits as a separate class of market benefit required in the RIT-T. Indeed, the AEMC's draft determination notes that at this stage, developments in the AEMC's climate change review would not require any amendments to the proposed RIT-T Rules. The AER cannot see why a different approach should be adopted in distribution.</p>
<p>Decision making criteria to determine most economic option</p>	<p>19. How should a net benefit test be designed for distribution investments assessments?</p> <p>20. Is there a need for a more specific decision making criterion compared to the existing regulatory test?</p>	<p>The decision making rule should be the same as that proposed for the RIT-T – the preferred option is the one that either maximises the present value of net economic benefits or minimises the net economic costs (in the case of a reliability augmentation)</p> <p>In terms of a more specific decision making criteria, the AER is supportive of using a cost benefit ratio rather than a simple NPV comparison. However, the AER considers that where different options generate the same cost-benefit ratio, it should be the option that provides the best cost-benefit ratio in the most reasonable scenarios.</p>
<p>Scope of issues subject to dispute resolution</p>	<p>21. Should the dispute resolution process only apply to project assessments undertaken by DNSPs under the regulatory test or should the dispute resolution process also apply to matters arising from DNSPs' annual planning processes?</p> <p>22. What is the appropriate scale of distribution</p>	<p>The dispute resolution process should only apply to project assessments undertaken by DNSPs under the RIT-D.</p> <p>Under the proposed rules for transmission, interested parties will be able to raise disputes in relation to application of the RIT-T assessment for new small and new large transmission assets. Therefore, projects</p>

	<p>projects that should be subject to the dispute resolution process? Should the threshold for the dispute resolution process be aligned with the threshold for the project assessment process?</p>	<p>with a value of in excess of \$5 million will be able to be disputed.</p> <p>It is similarly appropriate that all projects subject to the RIT-D should be subject to dispute resolution. As noted by the AEMC for transmission, creating a higher cost threshold for raising disputes would not reflect good regulatory practice.</p>
<p>Operation of the dispute resolution process</p>	<p>23. Who should be able to initiate the dispute resolution process?</p> <p>24. What process should be followed to resolve disputes and what should be the timing for this process? Should parties be required to undertake formal mediation process before the dispute is referred for a binding determination? What aspects of the proposed process for transmission should apply to distribution?</p> <p>25. Who should make binding determinations to resolve disputes? Is the AER the most appropriate body? If a mediation process is used, who should be the mediator for</p>	<p>In distribution, only registered participants are able to lodge a dispute while in transmission disputes can also be lodged by the AEMC, connection applicants, intending participants, NEMMCO and interested parties. The AER considers that this broader range of parties should also be able to lodge a dispute in distribution.</p> <p>The AER believes that the proposed dispute resolution process for transmission should form the basis for distribution dispute resolution. In particular, the grounds under which disputes can be raised in transmission and the process for conducting RIT-T disputes should also apply in distribution.</p> <p>The AER is the body responsible for RIT-T dispute resolution. There does not appear to be a strong reason for appointing a different body to hear RIT-D disputes.</p>

	<p>disputes?</p> <p>26. Should the appointed arbiter have the ability to reject disputes immediately if the grounds for the dispute are invalid, misconceived or lacking in substance?</p>	<p>As is the case in transmission, the arbiter should have the ability to reject disputes immediately if the grounds for the dispute are invalid, misconceived or lacking in substance</p>
<p>Outcome of the dispute resolution process</p>	<p>27. Should the dispute resolution process be restricted to reviewing the DNSP's compliance with the NER and requiring the DNSP to amend its analysis in its project assessments or annual planning report if it is found that it has not fully complied (i.e. compliance review)? Or, should the dispute resolution process provide for a review of the outcomes of the DNSP's project assessments or annual planning report and if it is found that the DNSP has not reached the best outcomes, direct the DNSP to implement the most suitable outcomes (i.e. merits review)?</p>	<p>Consistent with the approach adopted in transmission, the dispute resolution process should be restricted to reviewing the DNSP's compliance with the RIT-D</p>

<p>Relationship of the national framework with other issues</p>	<p>28. The appropriate balance of specification on the national framework between the NER and supporting guidelines.</p> <p>29. Should “urgent” investments be exempt from aspects of the national framework? If so, how should “urgent” be defined?</p> <p>30. What consequential amendments should be made to other arrangements to reflect the implementation of the national framework?</p>	<p>The current approach adopted in transmission should also be adopted for distribution. Principles on how the RIT-D should be applied would be set out in the NER; the RIT-D should be developed by the AER in accordance with these NER principles; and guidelines for the operation and application of the RIT-D would be published by the AER.</p> <p>The AEMC’s RIT-T draft determination proposes putting a large amount of RIT-T detail into the Rules. While the AER has previously raised concerns with the level of RIT-T detail that is proposed to be included in the Rules, there appears to be no reason for a different approach to be adopted to RIT-D prescription.</p> <p>In the National Transmission Planner review, the AER raised concerns that ‘urgent and unforeseen investment’ is exempted from the project consultation process. Similarly the AER is concerned about proposals to exempt ‘urgent’ distribution investments from project consultation.</p> <p>If the AEMC decides to exempt certain distribution investments from project consultation, similar safeguards to those outlined in the recent RIT-T draft determination need to be implemented for the RIT-D. Under the RIT-T proposals, the provision can only be accessed for ‘urgent and unforeseen’ investment, rather than just ‘urgent’ investment. The AER favours an ‘urgent and unforeseen’ investment test, because it would appear that an ‘urgent’ investment test would not preclude errors of planning or demand forecasting.</p> <p>“Urgent and unforeseen” should be defined in a similar manner to that outlined in the RIT-T draft determination. “Urgent and unforeseen” should be limited to circumstances where investment is required to be operational within 3 – 6 months; the event causing the need for the investment was not reasonably foreseeable and was beyond the reasonable control of the DNSP; a failure to address the need is likely to materially affect the reliability and secure operating of the distribution network; and the project is not a contingent project.</p>
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