



**AER Submission**

**National Transmission Planning Arrangements**

**Response to AEMC Draft Report**

**30 May 2008**

## Introduction

The Australian Energy Regulator (AER) welcomes the opportunity to respond to the AEMC's draft report on the implementation of new national transmission planning arrangements in the National Electricity Market (NEM).

The proposals outlined in the draft report have the potential to deliver significant improvements to the transmission planning framework in the NEM. The draft report proposes a detailed National Transmission Network Development Plan (NTNDP) with comprehensive coverage. It also proposes to provide the National Transmission Planner (NTP) with the discretion to make submissions to Transmission Network Service Provider (TNSP) consultations under the Regulatory Investment Test – Transmission (RIT) and to AER revenue reset consultations. The AER supports these initiatives and believes that they have the potential to provide for more efficient economic regulation of transmission businesses.

There are, however, a number of issues in the draft report which, if not addressed, could compromise the effectiveness of planning arrangements in the NEM. In particular, the specification of the NTP Advisory Committee in the National Electricity Law (NEL) and National Electricity Rules (NER) is unnecessary. Given that the Ministerial Council on Energy (MCE) has explicitly entrusted the planning role with the Australian Energy Market Operator (AEMO) board, it is preferable that AEMO be left to decide what committees it requires to perform its functions.

Further, there are also a number of aspects of the RIT proposals that could be improved. For example, the level of RIT prescription in the Rules creates significant regulatory overlap and is potentially confusing. Further, while it is not clear if the RIT or a separate framework should apply to distribution, the recommendation that the *Regulatory Test Version 3* continue to apply needs further consideration. Finally the proposal that the AER promulgate the RIT and associated guidelines by the end of the year is unworkable.

This submission provides more detailed comments on the major issues raised in the draft report. The submission addresses areas in the order covered in the draft report, namely:

- NTP functions and governance - the submission comments briefly on the functions of the NTP; and its governance and accountability arrangements.
- NTNDP – the submission comments on the scope of the NTNDP, scenarios and transmission development strategies and the relationship between the plan and TNSP Annual Planning Reports (APRs).
- RIT – the submission comments on RIT thresholds, RIT coverage, RIT exemptions, costs and benefits under the RIT, RIT prescription, development of the RIT and associated guidelines.
- revenue and pricing framework – the submission comments on the proposal to align each region's transmission and distribution regulatory resets.

## ***NTP objective, functions and governance***

### **Input into AER revenue reset processes**

The AEMC proposes a number of functions for the NTP that would greatly assist the AER in performing its regulatory responsibilities.

As the AEMC notes, the greatest assistance that the NTP can provide to the AER is the publication of a credible and comprehensive NTNDP. In this context, the AER agrees with the conclusions of the AEMC that the development of the NTNDP should serve to simplify RIT and regulatory reset processes. Whilst the longer term scenarios included in the NTNDP will be largely speculative, as the timeframe draws closer, the plans will become more defined and will have benefited from consideration in the planning processes of TNSPs and wider stakeholder consultation. As a result, by the time a project is proposed in the capital expenditure forecasts of a TNSP, it is expected that the economic justification case for allowing the capital expenditure may have already been made. This is an important development of the regulatory process. In addition, the AER notes that this directly supports the Council of Australian Governments (COAG) requirement that the new planning arrangements be no slower than those currently in place.

The transmission development strategies outlined in the NTNDP should then start to influence the planning and capital expenditure decisions of TNSPs. In so doing, the NTNDP will provide an important input into the AER's revenue regulation as a reference point in assessing TNSPs' forecasts of capital expenditure. As highlighted by the AEMC, the interaction between the planning in the NTNDP and shorter term planning of TNSPs will be formalised by requiring TNSPs to analyse the relationship between their revenue proposal and the development strategies contained in the most recent NTNDP, in particular where there are significant variances between the TNSP proposals and the NTNDP.

The AEMC also proposes that the NTP should have a discretionary ability to make submissions to AER revenue reset consultation processes. This proposal has the potential to greatly assist the AER in undertaking its regulatory roles. By providing independent and well informed views, the NTP would provide valuable input into the AER's regulatory assessment process. Indeed this function could significantly streamline the AER's regulatory role. For example, the AER would clearly take considerable comfort from a submission by the NTP noting consistency between projects outlined in the NTNDP and the TNSP's revenue reset application.

The AER also believes that the proposal whereby the AER can seek further advice or input from the NTP will also help the AER in its economic regulatory role. Having the ability to consult with an independent, well informed party has the potential to add greatly to the robustness of the regulatory process. Consistent with good regulatory practice, the AER supports the requirement for the publication of any information that is relied upon in making a revenue determination under chapter 6A of the NER.

However, as noted in our comments on the discussion paper, the AER considers that care must be taken to avoid prescribing a formal process into the NER which would curb useful information flows between the planner and the regulator.

## **Submissions to RIT processes**

Among the major functions of the NTP, the AEMC proposes that the NTP should have a discretionary role to make submissions on RIT consultation processes in relation to an augmentation (or relevant substitute to an augmentation) which impacts on National Transmission Flow Paths (NTFPs).

The AER fully supports this proposed role for the NTP and agrees with the AEMC that in performing this role the NTP has the potential to add significant value to the RIT process. As a highly informed, independent party, the NTP can be expected to provide well considered views on whether a TNSP's investment proposal is consistent with the efficient long term development of the network. This will help improve the accountability of the RIT consultation process, while not infringing on the responsibility of TNSPs for undertaking investment.

Given the substantial benefit that independent expert analysis can have on the RIT process, consideration should be given to strengthening this provision. Specifically, the NTP should be *required* to make submissions on augmentations that materially affect NTFPs.

## **NTP governance and accountability**

The draft report proposes inserting a provision in the NEL requiring the AEMO to establish a NTP Advisory Committee. The key roles of the NTP Advisory Committee will be to oversee the development of the NTNDP and to assist the AEMO carry out its functions. It is proposed that the NTP Advisory Committee will comprise between three and five members with an “appropriately balanced and diverse range of expertise.” The underlying principle behind the AEMC's proposal appears to be that the establishment of the NTP Advisory Committee would give focus and visibility to the national planning role.

The AER questions whether this level of prescription in the NTP governance arrangements is appropriate or necessary. The MCE has required a governance model where the NTP role resides with the board of the AEMO. Within this framework, the AEMO board can determine the nature and role of any committees that it believes are required for it to perform its functions. It is not clear what problems there are with this framework which warrant detailed prescription of NTP governance arrangements in the NEL. The AER considers therefore that the NTP Advisory Committee provisions should not be specified in the NEM.

## ***National transmission network development plan***

### **Scope of NTNDP**

Key to the success of the new national planning arrangements will be the extent to which the new framework moves beyond the limited approach to national planning now embodied in the Annual National Transmission Statement (ANTS) process.

A central limitation on the current arrangements is the manner in which national transmission planning has adopted a strict interpretation of NTFPs.

The AER considers that a strength of the model proposed by the AEMC is that the scope of the NTNDP includes both:

- the “portion of a transmission network or transmission networks used to transport significant amounts of electricity between major generators and load centre”; *and*
- “all constraints or network limitations, and possible options for relieving them, which are part of or materially affect the transfer capability across NTFPs.”

It is recognised that as load and generation investment patterns change over time, the network elements that affect NTFPs are likely to change significantly. Accordingly, the scope of the NTNDP must have an equally flexible definition. This is particularly important in the context of the development of renewable energy technologies. The Commonwealth Government’s 20 percent renewable energy target has the potential to fundamentally change how the transmission network is utilised.

Whilst the NTNDP will necessarily include a range of development scenarios for renewable energy generation, the exact location and extent of renewable generation in the medium term is unknown. Accordingly, it is not possible to include a static definition of elements that affect NTFPs, as the development of renewable energy technology is uncertain, even over the short to medium term.

In addition, the AER acknowledges that this is the first time that a full independent national transmission network development plan has been constructed. As a result, the formation of the first NTNDP will necessitate a degree of ‘learning-by-doing.’ This further underscores the need for a flexible definition of the elements that should be included in the NTNDP.

The AER considers that a rigid definition of NTFPs would likely be unworkable and would risk limiting the benefits that will flow from the formation of an independent national planner.

Accordingly, the AER is strongly supportive of the definition of the elements that are to make up the NTNDP, as it allows for the necessary level of discretion for the planner to develop a comprehensive plan. Importantly, this includes the ability of the plan to adapt over time with changing flows on the network and the development of renewable energy technologies.

## **Scenarios and transmission development strategies**

As noted in the draft report, under the current ANTS planning arrangements, conceptual proposals are relatively limited. This is a function of the fact that proposals are limited to those initiated by TNSPs, rather than the ANTS seeking to independently assess NTFPs and developing independent scenarios for network development.

As noted above, a significant factor in the future development of the transmission network will be the location and extent of renewable energy generation technology. In this regard, there are numerous development scenarios that could be contemplated. Given this, it is important that the NTP has the ability to develop its own conceptual proposals and be able to undertake cost benefit analyses of various options.

However, the AER does not consider that the development of proposals should necessarily be limited to longer term planning. One of the most significant limitations on the current arrangements is the fact that the ANTS does not develop independent proposals for the development of the network. Accordingly, the AER is supportive of the current draft rule (schedule 1 clause 5.5A.2(h)) to allow the planner to consider a range of development options, over a range of timeframes.

## **Relationship between the NTNDP and APRs**

The AER supports strong inter-linkages between the NTNDP and APRs. Whilst the AER notes the limitation placed on the AEMC by the MCE that the plan should not bind TNSPs to specific investment decisions, to ensure that the new regime is actually an advancement on the current ANTS process, links are required between TNSP planning processes and the NTNDP.

It is considered that the requirement on the TNSP to have regard to the NTNDP when formulating the APRs provides a sound basis for the national plan to be integrated into the TNSPs overall planning obligations. As noted above, the regulatory process will be streamlined where capital expenditure proposals from the TNSPs align with projects that have been included in iterations of the NTNDP. The requirement on the AER to have regard to the NTNDP when conducting a revenue reset is sensible addition to this process. Links of this nature will be crucial in ensuring that the NTNDP is meaningful and credible. This addresses some of the main concerns with the current ANTS planning regime.

## **Information provision and gathering powers**

The suggested provisions that allow the NTP to gather necessary information from TNSPs is strongly supported. The formation of a credible independent planner and drafting of the NTNDP requires that the NTP have access to all necessary information from the TNSPs.

The requirement on the NTP to publish a database of key assumptions and methodologies included in the formation of the NTNDP is also supported. This will assist in the transparency and robustness of the NTP processes.

## ***Regulatory investment test***

### **Regulatory test threshold**

The current threshold at which a regulatory test assessment is required is \$1 million, with a full public consultation process required for projects valued over \$10 million.

The AER supports the AEMC's proposal that all network projects estimated to cost (or contain an augmentation component valued at) more than \$5 million will be subject to a RIT analysis. The AER considers this is an appropriate threshold to enhance planning and consultation on projects which are more likely to affect the transmission network.

## Implications for distribution

The AEMC proposes that the RIT only apply to transmission, with the AER's *Regulatory Test version 3* to apply to distribution assets. The threshold issue to be considered is what is the appropriate form of investment test to apply to distribution.

As a general rule, the AER considers that investment decision-making in both transmission and distribution should be informed by a full consideration of alternative options and be technology neutral. In addition, investment proposals under both transmission and distribution benefit from the use of a consultation tool, to facilitate an open and transparent process.

The AER understands that concerns have been raised by stakeholders that applying the proposed RIT to distribution, including the requirement to undertake a cost-benefit analysis on all projects over a threshold, is too onerous due to the greater number of projects in distribution compared to transmission.

The AER appreciates that a full consideration of the application of a regulatory test to distribution networks, or the form of that test, is outside the scope of the current AEMC review. However, it is important that a full consideration be made before putting in place an on going regime. The question is then – what to do in the interim? It is possible to adopt the RIT for distribution, addressing stakeholder concerns by setting a higher threshold for distribution to filter out the ‘rats and mice’ projects but facilitating a cost benefit analysis of more significant projects. It is also an option to apply a single, albeit higher threshold to both transmission and distribution.

However, if the AEMC determines that it is not appropriate to use the RIT for distribution in the interim, the *Regulatory Test Version 3* could continue to apply but only as a transitional measure until distribution-specific measures are developed. The AER does not believe that simply allowing the *Regulatory Test Version 3* to continue to apply to distribution as anything but a transitional measure is a viable option, as it was developed in a transmission context.

## Urgent and unforeseen investment

The AEMC has proposed draft rules to exempt “urgent and unforeseen” investment from being subject to the RIT. The AER's submission on the scoping paper suggested that such a provision was unnecessary. It is very rare for a project to be “urgent and unforeseen.” Further, as all actual capital expenditure is rolled into the RAB, TNSPs would continue to be free to invest in any urgent and unforeseen projects.

The AER has concerns with excluding “urgent and unforeseen investment” from the RIT because it creates a gaming opportunity for the TNSPs. Therefore any exemption needs to be clearly defined to ensure it is immune from gaming. The AEMC has drafted provisions limiting the use of the exemption such that it only applies to:

- projects which need to be operational within 6 months;
- events which are not reasonably foreseeable and are beyond the control of the TNSP;

- situations where a failure to address the need will adversely affect reliability and security of supply; and
- projects which are not a contingent project.

By focusing on force majeure – type events rather than errors in planning or demand forecasting, these provisions appear to place appropriate restrictions on the exemption from applying the RIT.

## Costs and benefits

The AEMC must advise the MCE on amalgamating the regulatory test criteria of reliability and market benefits and broadening the latter's definition to include national market benefits. This is intended to allow proposed transmission projects to be assessed against meeting both local reliability standards and their ability to maximise benefits to the national market.

The AER supports the AEMC's approach in integrating the two limbs of the test and considers the AEMC has the balance right in the RIT. Allowing a negative net present value (NPV) for reliability-driven investments accommodates reliability augmentations while still establishing a robust cost-benefit analysis framework for investment decision-making.

There may be the view that the proposal is overly onerous and requires a disproportionate level of analysis to be done in relation to determining market benefits for reliability-driven projects. However draft rule 5.6.5B(5) allows for the analysis to consider only *material* market benefits.

Draft rule 5.6.5B(6) requires that for a market benefit to be considered immaterial it must:

- not affect the outcome of the assessment; or
- carry a cost of analysis that is disproportionate to the size scale and potential benefits of the considered option.

The AEMC also canvassed a proposal (presented at the April public forum) to require that any regulatory test analysis for projects valued over \$25 million must consider all market benefits. This also provides flexibility as it allows for the network business to determine the materiality of different classes of benefits for any investment under \$25 million. This means that where market benefits are extremely limited, the TNSP need not consider them to the same level of detail.

Parameters around the ability of network businesses to limit the analysis of market benefits balances concerns about the cost-benefit approach being overly onerous with the need to ensure a full consideration of market benefits where they are relevant. The AER supports these provisions and recommends draft rule 5.6.5B(6) be retained. In addition, the AER submits that a \$25 million threshold be set for the compulsory analysis of all market benefits analysis to ensure the network businesses and the market get the major investment decisions right. This should be standard best-practice anyway for projects of this size. The AER notes that the new framework increases the minimum threshold for projects that require a regulatory test analysis *at all* from \$1 million to



\$5 million. This should free up planning time and effort to deliver more comprehensive analysis of larger projects.

The AER notes that the draft rules largely reflect the status quo in relation to the costs and benefits to be considered in a regulatory test analysis excepting the new concepts of optional value and inter-regional market benefits. The AER considers that there is the potential that the concept of optional value may be used inappropriately without clear direction in its meaning and application. However the use of this concept may be clarified in guidelines. Further the AER considers that the NTP's ability to make submissions on regulatory test analyses will act as a discipline on any misuse of this provision.

The draft report also seeks views on the RIT accommodating emissions trading costs into a cost benefit analysis. The AER agrees that the development of an emissions trading scheme will need to eventually be incorporated into the next version of the regulatory investment test and associated guidelines. A national emissions trading scheme is to commence in 2010.

The AER notes that until a policy is released it will be difficult for the AER to develop a clear and certain approach to valuing the associated costs and benefits for network and alternative options. It will be extremely difficult to quantify the costs and benefits of a project in the context of a regulatory test analysis until an emissions trading scheme and an emissions trading price has been determined. As such, any detailed guidance on this area of cost or benefit should continue to reside in the regulatory test guidelines, rather than the NER or the test, given the current uncertainty surrounding this area of government policy.

### **Consultation and dispute resolution timeframes**

Twelve weeks have been provided for consultation and response to the project specification stage of the regulatory investment test process. This is an appropriate amount of time to provide for quality responses to the project specification report and for the submission of considered and credible alternative options. The AER considers this will enhance the investment decision-making process and supports this reform.

The AEMC's draft rule shortens the timeframes in relation to:

- the consultation period on a TNSP's draft regulatory test report (which is equivalent to the current consultation period on an application notice under the NER); and
- the time provided for stakeholders to raise disputes in relation to final regulatory investment test reports.

These have been reduced from 30 business days (6 weeks) to 4 weeks.

Given that regulatory test analyses can be expected to be more comprehensive and complex under the new integrated market benefits assessment, the AER suggests the current timeframe of 30 business days (6 weeks) provided for consultation on a draft regulatory test assessment and raising disputes should be retained. This may be reviewed in time, as the new regulatory test framework is more established and

stakeholders become more familiar and comfortable with the kind of analysis results it produces.

The AER submits that the proposed time allowed for the AER to complete a dispute resolution process is insufficient. The proposed process provides the AER with only 40 days (a little under 6 weeks) to resolve all disputes. This was previously set at 30 business days (6 weeks) for reliability disputes and 120 business days (24 weeks) to resolve market benefits disputes. Given that all projects will now involve a market benefits assessment, the timeframes for the dispute resolution process are inadequate. At the very minimum, the AER should have 12 weeks to resolve a dispute. The AER notes that this is half the period of time which is currently provided for market benefits disputes.

### **Level of prescription**

The AEMC proposes putting a large amount of the RIT into the NER, taking them to a much higher level of detail than what currently exists. This creates a situation where there is a high level of detail in the NER, with the AER also required to publish the RIT and a detailed set of RIT Guidelines.

As currently drafted, the draft rules blur the line of demarcation between the Rules and the RIT. The proposed arrangements where the NER prescribes what the RIT is to contain, with the RIT holding the actual test, make it difficult to see what value can be added by having a separate test outside of the rules. The AER considers that either the RIT or the NER should contain the details on the operation of the RIT, not both.

The AER submits that the proposed arrangements are unworkable and do not provide sufficient flexibility. Given the need to maintain flexibility in the RIT and allow it to respond to market developments such as an emissions trading scheme or optional value, it would be better placed outside of the NER.

The AER's preference is for the NER to set high level principles regarding the coverage of the RIT, with the prescription to be added by RIT and details on application and dispute resolution by the guidelines themselves. This arrangement would also take advantage of the AER's experience and expertise in RIT issues.

Alternatively, the AEMC could place the RIT into the NER with the AER to publish enforceable RIT Guidelines. If the test is prescribed in the NER then an AER-published RIT should not be necessary if the RIT Guidelines are sufficiently detailed and are made enforceable (similar to the AER's transmission guidelines). The AER emphasises that this arrangement would only work if the guidelines are enforceable.

In any event, the AEMC needs to avoid creating unnecessary overlap between the RIT and the NER.

### **Repromulgating the regulatory investment test**

The AER notes that the draft rules require the AER to repromulgate the RIT before the end of 2008. However, it is considered that this timing for the development of the RIT and associated guidelines is unlikely to be feasible.

It is understood that the AEMC is to provide its final report to the MCE by 30 June 2008. However, the timing of the resultant changes to the Rules and NEL arising from the MCE response to the recommendations from the AEMC is not clear.

The MCE will need to consider the AEMC's final report and submit subsequent Rule change proposals, with any required amendments to the NEL having to be passed by the South Australian Parliament. These processes will necessarily take time to complete. Indeed it would appear to be highly unlikely that the changes to the Rules and the NEL arising from this review will be completed before the end of 2008.

The changes to the NEL and the Rules will provide the framework for the development of the RIT and RIT guidelines. The AER does not believe it is appropriate to commence consultation on the RIT and RIT guidelines until the framework governing their operation is finalised.

It is suggested that in preference to hard wiring a date into the NEL, provision should be made for the RIT and Guidelines to be published 12 months after the commencement of the new Rules. In this regard, the AER notes the 80 business day consultation requirement required under clause 6A.20. This means that the absolute minimum required lead time from the date of commencement of the new Law and Rules is four months.

## ***Revenue and pricing framework***

### **Simultaneous reviews for TNSPs revenue determinations**

The AEMC has found that TNSP revenue determinations should not be aligned, a finding which the AER supports. However, the AEMC is proposing to advise the MCE to conduct a more detailed review into the merits of aligning each region's transmission and distribution regulatory resets. The AER is about to commence the regulatory resets for the New South Wales transmission and distribution businesses simultaneously. This review will be instructive as to whether alignment of transmission and distribution resets should be applied more broadly across the NEM.