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17 April 2009

Dr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Email to: submissions@aemc.gov.au

Dear Dr Tamblyn,

Response to Scoping and Issues Paper - Review of National Framework for Electricity Distribution Network Planning and Expansion

EnergyAustralia welcomes the opportunity to respond to the Australian Energy Market Commission (AEMC) Scoping and Issues Paper for the Review of National Framework for Electricity Distribution Network Planning and Expansion ('the Review'). In the following attachment, EnergyAustralia provides broad comments on the timeframes, scope and decision-criteria for the Review, as well as discussion on issues relating to the three key deliverables in developing a national framework, namely;

- Requirement for an annual planning process and the publishing of an annual 5 year forward looking planning report;
- Requirement for distributors to undertake a case by case project assessment process to identify the most economic option for network augmentations, and determination of the thresholds to trigger the assessment; and
- A dispute resolution process.

EnergyAustralia agrees with the MCE that there is a need to ensure efficient network planning and development by distributors across all regions of the national electricity market and by doing so also ensure a level playing field for non-network alternatives. Whilst robust economic assessment of alternatives, information transparency and inclusion of all interested participants are important aspects of achieving these aims, the resulting national framework also needs to be efficient and proportionate.

Hence in establishing a National Framework for distribution network planning and considering requirements to be placed on Distributors, EnergyAustralia requests a framework that:

- Reflects clearly understood objectives for annual planning requirements, the regulatory investment test and triggers for case by case project assessments;

- Encourages economic non-network solutions where they can be shown to be efficient and meet reliability/network performance requirements;
- Sets out principles for economic analysis for all projects, but recognises that the level of analysis varies with project cost;
- Acknowledges the need for an appropriate balance between the extent of analysis, need for transparency and consultation, and reporting versus the available timeframes, the estimated value of the investment and the likely benefit from improved decision making; and
- Recognises that opportunities for non-network solutions vary with circumstances and that overly prescriptive obligations on distributors are not the best mechanism for encouraging the development of efficient non-network solutions.

EnergyAustralia is very interested in continuing dialog with the AEMC in the process of developing of a national framework for distribution network planning and expansion.

Should you have any questions in relation to this submission please contact Ms Catherine O'Neill on 02 9269 4171.

Yours sincerely

TREVOR ARMSTRONG

Attachment: Comments on key aspects of Scoping and Issues Paper

Attachment – Comments on Scoping and Issues Paper

1. Scope and timeframes of the Review

Summary: Scope of the Review should be confined to direct control services. An additional criterion ought to be added to the decision making criteria for the Review, as outlined below. EnergyAustralia is concerned the tight timeframes set to achieve the key deliverables of the Review could compromise appropriate and efficient outcomes.

The Australian Energy Market Commission ('the Commission') has proposed criteria to guide the approach taken to the Review of National Framework for Electricity Distribution Network Planning and Expansion ('the Review'). In addition to those criteria recommended by the Commission, EnergyAustralia suggests the decision-making criteria should also include a criterion to ensure that the levels of analysis, reporting and consultation required of distributors under the national planning regime is commensurate with the estimated value of the investment required, likely benefit from improved decision making and project development and delivery times.

EnergyAustralia believes the scope of the Review should be confined to direct control services. The concept of negotiated distribution services is not well understood or developed within the industry at this stage. In the absence of a more transparent service definition framework, broadening the scope of the Review is likely to complicate an already complex review. In any case, the nature of negotiated distribution services are such that they are provided to meet the specific requirements of a customer. The assets developed to provide such services are not subject to economic regulation under Part C of Chapter 6 of the Rules and as such are not subject to a regulated return to the DNSP. It would be expected that in general, the regulatory investment test would only need to be applied to options developed as part of the regulated asset base. Further, to regulate the planning and development of negotiated services to require the consideration of non-network solutions for example, would appear to undermine the conceptual basis for negotiated distribution services.

EnergyAustralia is very supportive of establishing an industry working group and for the Commission to convene industry workshops to assist in the design of the national framework, but considers the timeframes associated with the milestones of the review to be very tight. The Review process must be thorough and result in appropriate and efficient outcomes as well as ensure key deliverables are achieved.

2. Annual Planning Requirements - Content of an Annual Planning Report

Summary: Annual Planning Report requirements need to be developed based on clear objectives and result in information provided that is 'fit for purpose'.

EnergyAustralia agrees with the Commission that a useful first step prior to defining the scope and content for reporting under the National Framework is to clearly define the objectives of the annual planning requirement on Distributors. EnergyAustralia is concerned that without a clear articulation of these objectives, there is a risk of developing a distribution planning and expansion framework that is expensive, wasteful and ineffective. As a starting point EnergyAustralia proposes these objectives;

- A planning process and reporting regime that focuses on the efficient development of a distribution network;

- Requirements for information provision by Distributors in a format and level of detail that is fit for purpose, and not misleading by being out-of-date;
- Places appropriate information provision requirements on Distributors in terms of benefit to market;
- Incentivises opportunities for innovation rather than promoting compliance in reporting; and
- Avoids duplication in reporting and regulatory obligations.

There is a role for an Annual Planning Report to provide information on the expected future operation of the distribution system, including the identification of emerging constraints. Our experience in undertaking approximately 170 Demand Management investigations in the last 5 years suggests that it is a misconception that distributors' annual planning reports will, at least at this point in time, provide the information necessary for "private sector investors to....optimise investment and promote efficient decision making." EnergyAustralia believes there are more successful mechanisms for facilitating development of, and opportunities for, the market to provide efficient non-network options. Other incentives and schemes are likely to be much more effective in promoting the development of non-network solutions (for example, establishing a Demand Management Register of Interested Parties, information exchange with Interested Parties regarding; potential demand management opportunities, current demand management policies, and updates on the progress of demand management initiatives; provision of incentives to assist in the development of the market for non-network options).

In regards to the level of detail to be provided in a Distribution Annual Planning Report (APR), EnergyAustralia believes the APR should generally be limited to projects addressing zone[1] substation or sub-transmission system capacity issues. The project lead times to address emerging constraints at such installations are generally of the order of 2 to 5 years and the distribution industry generally prepares at least 5 year load forecasts for these substations. Augmentation costs for such infrastructure ranges from hundreds of thousands to tens of millions of dollars. These substations are presently the subject of the Annual Electricity Supply Development Review in NSW and it would continue to be appropriate that such substations be considered within a proposed Distribution Annual Planning Report (APR).

However, EnergyAustralia is concerned that the Scoping paper proposes that detailed information relating to distribution substations be included in the Annual Planning Report. EnergyAustralia uses the term distribution substation to describe substations that transform 11kV supply to low voltage, typically 433V. EnergyAustralia has almost 30,000 distribution substations ranging in capacity from 16kVA to around 3,000kVA. These substations can be categorised as either dedicated customer substations or network substations (used to supply multiple small customers via EnergyAustralia's low voltage network).

The establishment and augmentation of customer substations occurs as a result of an application for supply and customers requesting the connection contribute to the establishment of such infrastructure. EnergyAustralia does not see that publication of loading data for such installations is appropriate or will contribute to a reduction in expenditure on dedicated connection assets.

The establishment or augmentation of network distribution substations involves augmentation of shared network assets. The costs of such works average between $20K to $30K in rural areas and between $100K to $150K in urban areas. The lead times on such projects are generally quite short (<12 months) and as augmentation may be driven by the electricity requirements of one or two customers, it

[1] Such major substations transform sub transmission voltages to distribution voltages (generally 5kV, 11kV or 22kV).

is not possible to accurately forecast the timing for augmentation of such infrastructure more than 1-2 years in advance. Considering the costs of such projects and the inaccuracy of long term project forecasts, EnergyAustralia does not consider there would be any benefit in including such substations in an Annual Planning Report, and has concerns about publishing information which may be potentially misleading[2]. In addition, the costs of compiling and publishing such data, even electronically, would be significant.

3. Project Assessment and Consultation Process (RIT – D)

Summary: The Regulatory Investment Test should result in obligations on Distributor's that are productive; and should take into account both the value of transparent decision-making and the potential benefits of improved decision making.

The scoping paper proposes that the National Framework for Distribution Planning and Expansion will have a Regulatory Investment Test (RIT-D). This test, which will be instigated based on project cost thresholds will require a specified project assessment and consultation process to be undertaken. The Scoping paper states that the process (RIT-D test) will require:

- Procedures and criteria to be applied by Distributors in considering investments,
- Distributors to conduct a robust economic assessment of alternatives, and
- Proper assessment of non-network alternatives in a neutral manner.

EnergyAustralia supports the development of a Regulatory Investment Test for distribution augmentation projects (RIT-D). Existing requirements to assess the economic contribution or feasibility of network augmentation investments and the present regulatory test have instituted a discipline that has resulted in consistency and transparency in economic analysis and decision making. EnergyAustralia considers the development of a regulatory test tailored for use in the distribution context and taking into account changes in the NEM (e.g. rules changes to RIT-T, climate change policies) is appropriate.

Prior to developing the processes required under the RIT-D, EnergyAustralia requests the AEMC to explore the implicit link that has been established between requirements for a specified project assessment with requirements for consultation.

In the Scoping Paper the Commission posed a number of questions in relation to the development of the RIT-D test including questions relating to the nature of consultation on possible investment options, cost thresholds to trigger 'case by case project assessments', the costs and benefits that should be recognised and quantified in the assessment and the nature of the decision making criteria to determine the economically efficient option.

EnergyAustralia recommends that the essential next step in developing the RIT-D process and addressing the detail of these questions requires industry discussion and consideration through industry workshops (or similar). EnergyAustralia considers that the assessment methodology prescribed in the RIT-D and the consultation process should be considered separately. Outlined below are some of the areas that would benefit from industry discussion in the development of the project

[2] Forecasts for such substations can vary substantially over the short term as a result of customer load applications and augmentation works can be identified and implemented between the preparation of one report and the publication of a subsequent report.

assessment and consultation process under a RIT-D test, as well as EnergyAustralia's views on these issues.

(a) Setting Thresholds to instigate a Regulatory Investment Test for Distribution (RIT-D)

Without any articulation of differences in the processes and costs for a RIT-D from the existing regulatory test it is difficult to understand the basis for developing different cost thresholds from those currently in place for transmission investments. However, if it can be determined that altering the thresholds can provide benefits that exceed any additional costs EnergyAustralia would encourage such an amendment.

In principle, the setting of cost thresholds should recognise the value provided from detailed analysis, and transparency in decision-making as well as the scale of benefits associated with improved decision making. To illustrate this EnergyAustralia provides the following data. In the last 5 year determination period, EnergyAustralia has undertaken, in the order of $2 billion in growth related capital expenditure (capex). EnergyAustralia undertakes a Demand Management Investigation process for augmentation projects with an estimated cost greater than $1million[3]. Approximately $60 million of the growth-related capex has been impacted by non-network alternatives.

- $7.8million of benefit has been achieved (savings in capital investment), and
- $5.2 million spent in direct costs to achieve the savings.

(Note: $5.5 million in foregone revenue has been recovered under the D-factor)

Based on these figures, improved decision making delivered a net $2.6million savings, which is about 4% of the value of investments subject to DM processes and 0.13% of total growth related capital expenditure within the period. These non-network options that were undertaken occurred as a result of EnergyAustralia's Demand Management process and not as a result of NER consultation or publication of the AESDR.

(b) Nature of consultation on possible investment options

Consideration needs to be given to the purpose of project consultation as this will inform the type(s) of consultation undertaken and the detail required for a consultation process. In the distribution context, a consultation process undertaken to provide transparency to the decision making process will have substantially different content to a consultation prepared to seek non-network alternatives. Whilst the present consultation process provides transparency to the investment process, in EnergyAustralia's experience the present NER process has not been effective in finding non-network solutions.

EnergyAustralia's experience suggests that a separate approach is more effective in identifying Demand Management opportunities than seeking to rely on the RIT consultation process. EnergyAustralia's existing process relies on a staged approach, with the depth of investigation determined by a relatively inexpensive 'screening' stage followed by a detailed investigation process involving public consultation in most cases, and then a development and procurement phase. This avoids an unnecessary use of resources in circumstances that are least likely to provide non-network options. In turn, this allows the development of a wider range of non-network alternatives at lower cost than would be achieved with an RFP driven process as described in the NSW DM Code of Practice. We also note that in South Australia, where a prescriptive RFP process is in place under Guideline 12,

[3] This threshold has been set based on EnergyAustralia's knowledge relating to past experience with DM options, an assessment of the likelihood that cost effective DM solutions exist, the potential deferral timeframes and the time typically available for implementation.

Evaluation Reports available on the ETSA website shows 21 RFP's issued between 2004 and 2006 resulting in 2 non-network alternatives being identified for consideration and none being implemented.

(c) Market benefits for Distribution Augmentation investments

The Commission states a national framework "should .....result in the Distributors having regard to a wider range of market benefits when considering prospective investments." As the majority of augmentation investments undertaken by EnergyAustralia in the last 5 years were driven by a need to meet a 'reliability-related' jurisdictional requirement[4], it is unclear what other market benefits distribution network investments may deliver, other than perhaps 'unserved energy' (an assessment of Value of Lost Load).

(d) Assessment of non-network solutions

EnergyAustralia believes it is important to distinguish between the objectives of providing transparency to the planning process, evaluating investment options and providing equal opportunity for non-network solutions.

It is important that the NER provides a framework that requires a thorough and transparent consideration of Demand Management (DM) and other non-network options. However, EnergyAustralia does not believe that the Rules should prescribe how investigations should be carried out. For example the Request For Proposal (RFP) process is only one way of investigating non-network options, and there are many circumstances where an RFP may not be appropriate. EnergyAustralia consider that mandating a particular approach such as an RFP, is heavy handed regulation which will not provide results which are commensurate with the effort involved both by distributors and proponents of DM.

An example may be drawn from the way the NSW Demand Management Code of Practice ('DM Code) operates in practice. The NSW Distribution Licence is the regulatory mechanism for placing a high level requirement on Distributors to investigate and report on demand management strategies when it "would be reasonable to expect that it would be cost-effective to avoid or postpone the expansion (of a distribution system) by implementing such strategies". The DM Code provides guidance on the level of detail and principles to be followed. The principles are more detailed, but not prescriptive of process. They include: transparency of network planning processes and data on network needs; use of formal processes for determination of the need for demand management investigations; effective demand management investigations, including public participation; transparent and equitable treatment in comparing augmentation and DM options; implementation of cost effective demand management options; and public reporting of these activities.

The DM Code also provides a highly prescriptive process, but this is not a binding requirement. The provisions of the Code are required to be taken into account in formulating Network Management Plans, which are approved by the Minister. This is in essence a "propose-respond" approach where the legislative principles are set at a high level, the Code provides non-binding guidance on interpretation, and these two elements allow Distributors to develop their own processes to deliver the intent of the Code. Distributors must publish their DM processes in their Network Management Plans, but are free to design processes that are effective in the circumstances; that can respond to new ideas or information over time; and processes that appropriately balance the costs and benefits associated with DM investigation. The Code and its implementation deliver an economic regulatory environment that is strongly supportive of demand management and results in Distributors developing process that are effective in terms of DM delivery and cost-effective.

[4] Jurisdictional licence conditions were introduced in 2005

EnergyAustralia has found it much more effective to carry out a screening process to determine whether DM can be reasonably expected to be effective, and to then target detailed investigations of those projects for which DM may provide a solution. This avoids the need for Distributor's to prepare, and for DM proponents to consider, substantial quantities of RFP's which could not realistically be expected to be feasible. In 2007/08, the DM screening phase undertaken by EnergyAustralia typically cost $6,400 for each investment reviewed. Detailed investigation costs varied according to the size of project, but were typically $20,000 - $30,000, with some larger investigations costing $60,000 - $80,000.

Separate to the development of a Regulatory Investment Test for Distribution and associated requirements, EnergyAustralia is supportive of a National Framework that sets out the principles for analysis for all projects. However, the framework must recognise that the efficient level of analysis will vary with project cost.

4. Consideration of the interaction between transmission and distribution planning

As EnergyAustralia operates dual function assets and regularly carries out joint planning with TransGrid, much of its sub transmission works program involves investment decisions between new large transmission and new large distribution assets. The present framework has allowed efficient least cost investment without regard to whether works involve the transmission or distribution investment. It is critical that any future framework continues to provide consistency between the planning requirements for distribution assets and those for transmission assets.

The proposed RIT-T recognises that dual function assets and those transmission assets involved in distribution supply, should be subject to the same assessment process as distribution. EnergyAustralia supports this view.

5. Dispute Resolution Process

EnergyAustralia considers the dispute resolution process established for the RIT-D should be consistent with the process established for transmission and remain focused on administrative issues, distributor's compliance with the NER and the test itself.

6. Guidelines versus Rules

We note the Commission's comments that "Prescription in the NER promotes certainty and stability of regulatory outcomes, but it may reduce the regulator's ability to accommodate the particular circumstances of individual market participants in regulatory decisions." However the development of guidelines by the AER does not resolve this limitation, unless they are developed separately for different jurisdictions or businesses. Guidelines should not be used as a substitute for clear policy that should be reflected in the Rules. Further it is critical that the AER is not charged with developing guidelines which impose substantive obligations on Distributors, which are also subject to enforcement by the AER. In such circumstances, the AER would have a role as both rule maker and enforcer. This offends the principles of good regulatory design and leaves the AER with little accountability particularly as there would be no scope for industry or other stakeholders to seek changes to the guidelines should they be developed or applied in inappropriate ways. For these reasons it is important that substantive

obligations are set out in the Rules and so that they can be subject to proper rule change processes. Guidelines should only be developed to assist in understanding substantive obligations and the way in which such obligations can be met (i.e. the AER's interpretation of the Rules).

7. Errors in previous report

EnergyAustralia has some concerns that errors in the report published by NERA Economic Consulting (NERA) and Allen Consulting Group (ACG) titled, Network Planning and Connection Arrangements – National Frameworks for Distribution Networks (NERA/ACG Report) have not been recognised in the recent Scoping paper, although these have been previously raised by industry.

We note that some of those errors are now contained within the Scoping paper and the Commission has "assume[d] the NERA/ACG Report.... have been read and taken into account by stakeholders prior to considering this Scoping and Issues Paper". These errors of fact misrepresent existing obligations on distributors, features of the NSW Demand Management Code of Practice and the Demand Management screening thresholds. It is important for the starting or reference point to be accurate and existing processes and obligations to be correctly represented.