



UNITED ENERGY

Distribution

9 October 2007

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By email: MCETMarketReform@industry.gov.au

Manager, MCE Secretariat
Department of Industry, Tourism and Resources
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Dear Sir / Madam,

Re: UED Response to NERA/Allen Consulting Recommendations - National Frameworks for Distribution Networks:

Network Planning and Connection Arrangements August 2007

United Energy Distribution (UED) appreciates the opportunity to make this submission on the recommendations contained in the NERA/Allen Consulting report of August 2007.

United Energy Distribution expresses its willingness to assist with further development of proposals for network planning and connection arrangements to enhance efficient investment in electricity services.

Hugh Gleeson
Chief Executive Officer

**UED RESPONSE TO NETWORK PLANNING AND
CONNECTION ARRANGEMENTS – NATIONAL
FRAMEWORKS FOR DISTRIBUTION NETWORKS:**

**A JOINT REPORT PREPARED BY THE ALLEN CONSULTING
GROUP AND NERA ECONOMIC CONSULTING FOR THE
MINISTERIAL COUNCIL ON ENERGY MARKET REFORM
WORKING GROUP**



***UNITED ENERGY
Distribution***

United Energy Distribution

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5 October 2007

BACKGROUND TO UED

UED is one of the largest Victorian electricity distributors and provides services to some 600,000 end-users in Melbourne's southern and eastern suburbs.

KEY MESSAGES IN THIS SUBMISSION:

General

United Energy Distribution (UED) welcomes investigation of the issues raised in the NERA/Allen report. UED recognises that there is scope to further develop proposals for network planning and connection arrangements to enhance efficient investment in electricity services. UED also recognises that the present consultation follows from the Australian Energy Market Agreement which includes an objective of national consistency where feasible.

At same time, the NERA/Allen recommendations have, in UED's view, resulted in proposals for a measurable increase in the use of prescriptive Rules and regulatory oversight to be applied to distribution businesses. At a high level, UED does not believe that this is an appropriate response to devising improved incentives for network investment. Prescription (or heavy handed regulation) stifles business innovation, and shifts the focus of the business away from the customer to what the regulator requires or what the business thinks the regulator is likely to require (eg narrow compliance matters).

Network planning and connection are clearly issues where a network business can develop innovative approaches for more efficient investment, either individually or in conjunction with users (customers) and/or providers of non-network solutions, and supports moves to clearly improve the regulatory design to assist businesses to innovate in these matters. But UED cautions that a framework with prescriptive Rules and regulatory direction at its centre will not allow businesses to implement practical, customer-focused solutions at the local level, simply because Rules cannot provide for exceptional and/or unforeseen circumstances.

Process issues

UED supports a reference to the AEMC for many of the matters addressed in the NERA/Allen report, because:

- addressing network planning and connection matters from a national perspective would be consistent with the AEMC's market development role;
- the Rule development process offers a transparent national forum for addressing the very complex matters raised by NERA/Allen;
- UED considers that use of the Retail Policy Working Group's national (non-economic) framework process to address network planning and connection issues poses some challenges, particularly given that the recommendations to date from that process have no stated policy support.

UED view on particular recommendations in the report

(a) Network development and planning

- UED supports publication of planning reports in a central location to provide a low cost source of information for network users and non-network solution proponents, but considers the proposed NERA/Allen regime to be unnecessarily intrusive;

- UED considers that there should be a distinction between generally useful information available to the market and specific detailed information required by genuine applicants proposing non-network solutions. The latter should be met by specific information exchange between businesses and proponents;
- UED does not agree with the report's proposed application of the regulatory test to distribution assets.

(b) National framework for distribution network connection

- UED agrees that primarily the Rules should be used to set national connection requirements. However, NERA/Allen have not in many cases specified the content of the proposed new national Rules and UED submits that the AEMC is the appropriate body for this task;
- UED has significant concerns with the recommendation to appropriate the draft Chapter 6 negotiation framework for the purpose of a negotiated *connection application*. UED considers that this proposal needs very careful consideration in the light of the latest draft of the National Electricity Rules for distribution. UED considers that aspects of the NERA/Allen recommendations may not be consistent with the SCO design intention for the classification of distributor services into *direct control* and *negotiated* services.

(c) National framework for connection charges

- The report proposes that 'connection costs' charged to a connecting entity will include both dedicated and extension assets but *exclude shared network assets*. This reflects the NERA/Allen view that no element of shared network augmentation should be reflected in a compulsory connection charge (unless agreed) and that augmentation of shared assets should be paid for by all users;
- UED does not necessarily agree with this view and submits that other valid charging concepts may well include a place for the inclusion of shared network augmentation. UED notes that a prescriptive 'one size fits all' connection policy will contradict much past practice throughout several jurisdictions, and is more likely to raise concerns among existing network users rather than produce confidence;
- UED considers that no change to present charging regimes should apply, pending a wider review of the Rules for determining network connection charges. UED considers that the AEMC would be the logical body to undertake such a review for distribution.

(d) Network loss factors

- UED notes that network losses were not a matter to be considered through the AEMA and are therefore not required under the current consultation;
- UED does not agree that the public disclosure of average and marginal loss factors over a five-year planning period as proposed in the NERA/Allen report is a practical solution to presumed locational issues for network users. Requiring DNSPs to publish such detailed forecast network loss information would lead to a significant increase in complexity without corresponding benefits;
- Since the AEMA does not require network losses to be addressed now, UED submits that a comprehensive review of network losses should be undertaken by the AEMC, involving all market sectors.

STRUCTURE OF THIS SUBMISSION

PART A –GENERAL ISSUES

PART B – UED GENERAL VIEW OF THE NERA/ALLEN RECOMMENDATIONS

PART C – COMMENTS ON PARTICULAR RECOMMENDATIONS

Part A – GENERAL ISSUES

1. Implementation of NERA/Allen proposals

UED currently understands that the NERA/Allen recommendations (if accepted) could be implemented through:

- the national (non-economic) framework for distribution networks scheduled to be in place by 1 July 2008;
- Ministerial Order; or
- a reference to the AEMC for development of appropriate Rules relating to DSR and DG.

UED generally supports a reference to the AEMC for many of the matters addressed in the NERA/Allen report, because:

- addressing network planning and connection matters from a national perspective would be consistent with the AEMC's market development role;
- the Rule development process offers a well-defined national forum for addressing the complex matters investigated by NERA/Allen;
- UED considers that use of the national (non-economic) framework to address network planning and connection poses some challenges, particularly given the process used to date to develop the framework.

If the non-economic framework being developed by the Retail Policy Working Group (RPWG) were to be used, UED considers that MCE/SCO needs to provide greater certainty about the status of the framework that will eventually be adopted. The MCE/SCO have consistently stated that the views and recommendations presented to stakeholders by consultants have been those of the various consultants and not MCE/SCO. However, this has provided little guidance to stakeholders as to the relevance of the consultants' proposals to eventual MCE/SCO policy development, or the relevance of stakeholder submissions in the various consultations. Given that MCE/SCO have also advised that the various NERA/Allen reports have no policy foundation, the same shortcoming appears evident in respect of those reports.

2. References to previous consultants' reports

Certain of the NERA/Allen report's recommendations assume that elements of the framework proposed in the consultation/working papers issued as part of the RPWG's development of a non-economic regulatory package will be implemented (eg recommendation 10). The report specifically cites the following material:

- the NERA and Gilbert + Tobin Public Consultation Paper on a National Framework for Energy Distribution and Retail Regulation (May 2005);
- the Allens Arthur Robinson (AAR) Consultation Paper on a National Framework for Non-Economic Distribution and Retail Regulation (June 2007).

UED has serious reservations with consultants assuming that the recommendations of earlier reports will be accepted in the absence of specific MCE/SCO endorsement of those recommendations. This practice could hamper MCE/SCO in considering alternative options to design an appropriate overall framework. It also leaves stakeholders with little insight as to the relative significance of their submissions compared with consultants' views.

UED notes that the current NERA/Allen report appears to accept the recommendations of the two previous reports.

Part B - UED GENERAL VIEW OF THE NERA/ALLEN RECOMMENDATIONS

The NERA/Allen Consulting report contains 36 recommendations for MCE/SCO consideration in order to improve incentives for efficient network investment, including improved incentives for non-network solutions to network expansion.

NERA/Allen appear to provide multiple rationales for the recommendations in their report, especially in chapter 2. Some reasons are theoretical, others practical. A key basis for the recommendations appears to be the 'imperfect incentives' faced by distributors invest efficiently, including a reluctance to embrace DSR and DG:

Another consequence of the presence of imperfect incentives is that the DNSPs may not naturally seek demand side responses (DSR) and/or network support services provided by distributed generation (DG) as an alternative to undertaking network augmentations, even where it would be efficient for one of them to do so. Administrative measures, therefore, have an important role to address the shortcomings in the incentive arrangements – at least for the time that those shortcomings remain¹.

UED particularly notes the reference to “administrative measures” as a means to improve the uptake of DSR and DG. As will be evident in the detailed discussion of the NERA/Allen recommendations below, this has generally resulted in proposals for a measurable increase in the use of prescriptive Rules and regulatory oversight applied to distribution businesses. At a high level, UED does not believe that this is an appropriate response. UED suggests that improved design of the economic regulatory framework may well be a better route to encourage efficient investment in both network and non-network solutions.

In summary, the NERA/Allen report proposes:

- a standard network economic evaluation and reporting framework for network planning, is to be applied by all DNSPs under new or modified Chapter 5 Rules, with significant AER involvement and oversight;
- a standard application framework for network connection is to be placed in the Chapter 5 NER, with modification of the draft Chapter 6 Rules to accommodate a new negotiating framework for connection;
- the AER is to develop a guideline for determination of connection charges/capital contributions, together with a methodology for the partial repayment of those charges upon connection of new customers. This will require some revision of the Chapter 5 and draft Chapter 6 Rules;
- a new basis for calculating network loss factors, involving modification of NER Rule 3.6.3.

¹ NERA/Allen Consulting Group August 2007: *Network Planning and Connection Arrangements – National Frameworks for Distribution Networks* p 4

UED's general conclusion is that the NERA/Allen recommendations will result in a cumbersome regime for networks in order to remove supposed biases against non-network solutions. UED sees no evidence that the recommendations will in fact increase the attractiveness of DSR and DG. Additionally, UED considers that the proposed modifications to sections of the draft Chapter 6 Rules may simply complicate the operation of those Rules for little gain to efficient outcomes, and may be inconsistent with the MCE/SCO intended design.

At the same time, UED fully supports efforts to improve the prospects for non-network solutions. In UED's view, distribution businesses will have sufficient incentives to pursue non-network options, so long as those solutions do not result in significantly increased risk being placed on distribution businesses². UED considers that mechanisms which improved incentives for distribution businesses to pursue DSR and DG, and which also minimised the additional risk faced by businesses from adopting non-network solutions, could be designed into the regulatory framework. This is a major topic for further investigation.

In contrast to the above approach, NERA/Allen have essentially assumed that information transparency and uniform administrative processes placed on distributors via the Rules (and overseen by firm regulation from the AER), will encourage DSR and DG proposals. This in turn assumes that there is a large unmet demand for non-network solutions and this demand would have materialised except for the existing non-uniform jurisdictional planning frameworks, which have involved limited regulatory direction. UED suggests that this very broad assumption seems most unlikely, given the negligible uptake of non-network solutions in South Australia where the NERA/Allen proposed planning framework has operated³. UED's experience with its Victorian network is similar, where a public planning process established by regulatory guidelines has received limited market response.

Further, UED finds it most concerning that the NERA/Allen report has persisted with the view that its recommendations for a national planning process should be implemented, despite recognising the poor SA experience. The report's stated rationale for this persistence is that *'if experience later demonstrates this belief to be in error, then the Rules (and AER statements of specific requirements issued thereunder) can be modified or removed in an expeditious manner from that time onwards'*⁴. UED does not accept this apparent proposition that a regulatory framework can be put in place on an experimental basis without an appropriately exhaustive process for evaluating and testing the initial Rules. The report's acceptance of this proposition appears conformed by the statement that *'it is because of this ability to review the regime in the future that this report is more definitive in its recommendations about the requirements for the future planning regime than otherwise may be justified'*⁵. UED strongly submits that implementation of this view would most certainly lead to inefficient outcomes, would not be capable of leading to long term benefits in accord with the NEL Objective, and would involve a misapplication of the Rule change process.

² For example, in such matters as system reliability, safety and risk management. These risks arise because the existing regulatory framework for capital efficiency does not quantify the increased risk faced by distribution businesses from the adoption of non-network solutions which may fail and therefore give rise to service level penalties.

³ This framework has since been abandoned. UED does not accept the conjecture in the NERA/Allen report (page 20) that ETSA Utilities could have rejected all non-network options inappropriately.

⁴ NERA/Allen, op cit p 20

⁵ NERA/Allen, op cit p 9

Part C – COMMENTS ON PARTICULAR RECOMMENDATIONS

(a) Network development and planning

(i) Information disclosure

- UED supports publication of 5 year planning reports in a central location to provide a low cost source of information for DG/DSR proponents, but considers the proposed NERA/Allen regime to be unnecessarily intrusive and unduly cumbersome. The regime does not balance costs imposed on businesses by the proposed release of highly detailed information versus the usefulness or relevance of the information to be provided to market participants;
- *UED believes that there must be a distinction between generally useful information available to the market and specific detailed information required by genuine applicants proposing non-network solutions. The latter should be met by specific information exchange between businesses and proponents;*
- UED supports publishing a single annual planning report including all relevant future projects, associated 'requests for proposals' (RFPs), responses to RFPs in the previous year's report and the outcomes and status of the projects identified in that year.

(ii) Application of the regulatory test

UED does not agree with the report's proposed application of the regulatory test to distribution assets.

The report says that *'the cost of administering the process of evaluating projects should be such that it is commensurate with the scale of the projects being considered'*⁶. UED agrees with this general principle – but the proposed application of the regulatory test to distribution projects - especially to projects in the recommended thresholds - does not meet the report's own criterion of 'proportionality' in regulatory design.

UED submits that there appears to be a solid case for applying a distribution-specific test to distribution network augmentation rather than the ACCC regulatory test which is more applicable to transmission. The AEMC would be the appropriate body for this evaluation.

UED notes that the AEMC is currently conducting a review of the regulatory test focused on transmission but that under the NERA/Allen proposals, distribution would be automatically covered by this review. UED considers that there needs to be a closer assessment of the most appropriate distribution route to follow.

(iii) Threshold levels for economic evaluation and issuing RFPs

UED agrees with the principle of an economic threshold for advising the market of potential network augmentation. However, UED does not support the NERA/Allen proposed framework of a \$2 million threshold for issuing individual RFPs, an associated public consultation process, and subsequent distribution business review and advice of outcomes to the market. The threshold is far too low and the corresponding costs will be far too high.

⁶ NERA/Allen, op cit p 7

The proposed lower threshold of \$0.5 to \$2 million for public reporting of economic evaluations is also far too low and would capture the majority of everyday network augmentation projects, resulting in a costly and inefficient regulatory obligation.

The particular components of network development and planning must also be defined appropriately for reporting. For example, asset replacement has no project deferral benefit and fault mitigation projects do not involve feasible non-network solutions. *UED submits that only demand related projects should be included.*

UED also seriously questions the cost-effectiveness of continually issuing RFPs as a basis for “discovering” non-network solutions. RFPs are not likely to be an effective mechanism, and UED supports efforts to determine more efficient and effective alternatives.

UED notes that the NERA/Allen report has specifically rejected the concept of a ‘filter’ for advising the market of potential DSR/DG projects, based (for example) on a feasibility test as currently applies in SA.⁷ As noted above, the costs involved in this process do not warrant the level of detail envisaged in the NERA/Allen report, and UED considers that further investigation of the ‘filter’ approach may be warranted.

(iv) Regulator involvement

The NERA/Allen report proposes that (a) the AER should be required to produce a statement of specific requirements that sets out the standard format and required contents of the annual planning report and that (b) the Rules should set out the matters the AER is permitted to address.

UED observes that this recommendation seems simply based on the NERA/Allen proposition that ‘*commonality of the planning procedures and planning-related information that distributors release is required*’⁸ on the grounds that this would minimise the costs that participants incur to determine their optimal location and timing across the NEM. As noted, UED questions this view.

UED submits that it would be inappropriate for the AER to have unfettered discretion to direct the content of planning reports. Subject to meaningful content being developed, planning content should be specified primarily in the Rules, with sufficient detail for businesses to produce complete planning reports. The AER’s role would be one of guidance.

⁷ NERA/Allen, op cit p 28

⁸ Op cit p 9

(b) National framework for distribution network connection

(i) Development of connection framework

The NERA/Allen report recommends that a new national framework should apply to all network connections (except standard small user connections which have already been addressed)⁹.

UED agrees that primarily the Rules should be used to set national connection requirements. However, NERA/Allen have not in many cases specified the content of the proposed new national Rules and UED submits that the AEMC is the appropriate body for this task.

While UED supports nationally consistent arrangements for DG and other loads where appropriate, UED considers that the degree of national consistency attainable in connection arrangements is likely to vary considerably depending on the sizes of customer loads and (for DGs) the types of generation units installed.

(ii) Negotiation framework

Recommendations 12-14 in the NERA/Allen report cover what are termed “standard” applications for connection, the content of which is to be developed under the Rules (including standard contracts which will include details of charges). By definition, these contracts would only apply to customers with standard connection requirements. NERA/Allen observe that *‘the standard connection route will not be available in all circumstances’*¹⁰. Since NERA/Allen have excluded consideration of small retail customers from their recommendations, it may reasonably be assumed that NERA/Allen envisage that a significant number of connection applications – probably the majority – will be negotiated (see below).

NERA/Allen recommend that the Rules should state that the negotiation framework developed in accordance with Draft Rule 6.7.5 should apply in the negotiated connection application process, and for this purpose recommend extensive modifications to draft Rule 6.7.5(c).

UED has significant concerns with the recommendation to appropriate the draft Chapter 6 negotiation framework for the purpose of a connection application process, and suggests that a revised section 5.3 of the NER would be more appropriate for this purpose.

The NERA/Allen report notes that the form of regulation applying to entry and exit charges will under Draft Rule 6.2.1 depend on whether the AER defines the services as direct control’ or ‘negotiated’. The report continues: “Assuming however that the provision of connection assets is classified as a negotiable service in keeping with the AEMC’s conclusion in relation to transmission, then the relevant charge ---- (will be) based on the negotiating framework provided for in draft chapter 6, Part D”¹¹

⁹ NERA/Allen observe (p 41) that connection recommendations for small retail load customers have already been made by AAR for the RPWG process. The connections addressed by the NERA/Allen recommendations are described as micro/small/medium/large DGs plus large load customers, market customers and market network service providers.

¹⁰ NERA/Allen report p 60

¹¹ NERA/Allen report p 74/75

UED does not agree that under the new Chapter 6 Rules it can be assumed that particular network connection services will be automatically treated as 'negotiable'. Draft Rules 6.2.1 and 6.2.2 require the application of a series of market power tests to determine if distribution services will be categorised as direct control (regulated) or not, but the actual classification depends on the regulatory process. It cannot be specified in advance via the Rules.

There is a comment on p 64 of the NERA/Allen report that *'one implication of this recommendation is that for some DNSPs the negotiating framework would cover some services which are regulated as direct controlled services because the terms and conditions for those services are not pre-determined by other application of other regulatory instruments'*.

UED considers that this comment does not properly appreciate the nature of the distribution regulatory framework developed by SCO, which has specifically rejected any concept of categorising services in the Rules, instead relying on the regulatory process to do this. A mandatory requirement to produce a negotiating framework for a direct control service (which does not involve any major negotiation) appears contradictory to this framework.

(iii) Previous consultations

UED notes that many of the NERA/Allen recommendations from 17 to 28 overlap with small customer connection recommendations developed for the Retail Policy Working Group (RPWG) by Allens Arthur Robinson (AAR).

UED therefore considers it important that the AAR proposals for distributor connections should be considered as part of a total package of recommendations on network connections for MCE/SCO consideration, including further work on the issues raised in the present consultation, so that inconsistencies between customer groups can be avoided.

(c) National framework for connection charges

(i) Terminology and concepts

The NERA/Allen report recommends that the NER should adopt a proposed new terminology for the purposes of calculating a connection asset charge. This terminology does not coincide with that used by the AEMC for transmission, and UED suggests that the extent of consistency between transmission and distribution in this regard requires further investigation by MCE/SCO.

(ii) Shared network charges

The NERA/Allen proposed definitions of 'dedicated connection assets' and 'extension assets' are so contrived as to result in 'connection costs' encompassing both dedicated and extension assets but *excluding shared network assets*.

These definitions are designed to support the NERA/Allen view that no element of shared network augmentation should be reflected in a compulsory connection charge (unless agreed) and that augmentation of shared assets should be paid for by all users.

UED submits that this view of network charges is simply one view and other valid charging concepts may well include a place for the inclusion of shared network augmentation. UED considers that a more 'neutral' terminology should apply pending a wider review of the Rules for determining network connection charges.

Given that the AEMC has conducted a review of connection charging issues as part of its Transmission Rules, it would be the logical body to undertake such a review for distribution. In particular, the AEMC would be able to discern whether there are overall market efficiency gains that would support an element of shared costs being included in distribution connection charges.

(iii) “Contracting” to constrain generators

The NERA/Allen report section 4.4.1 (p 84) argues that some kind of (undefined) contracting approach should be applied by distributors in their contracting with unscheduled generators who choose not to fund improved network transfer capability. This contracting would “constrain” the maximum energy exports of the generator, and would replicate NEMMCO algorithms applied to scheduled generators as to maximum energy exports.

UED’s strong view is that the NERA/Allen proposed framework is loosely conceived, ignores the very different circumstances of NEMMCO as a specialised market operator, places unacceptable risks on distributors, and is most unlikely to result in equitable and efficient outcomes for both distributors and energy users. The proposed framework does not indicate how the complex provisions in the NER for NEMMCO to manage market dispatch could be replicated for a single distributor managing the loads of multiple embedded generators. UED suggests that in all probability, no simple, low-cost, and competition-neutral solution to this problem could be identified.

(iv) Current jurisdictional practice

The NERA/Allen proposals to not include shared network costs in connection charges are novel and are contrary to past reviews (eg the Code of Practice for Embedded Generation)¹².

UED also notes that the proposals are contrary to much jurisdictional practice – eg in Victoria, the ESC Guideline no 14 provides for an element of shared network augmentation costs to be recovered through network connection charges.

UED suggests that the impact of the NERA/Allen proposals on the distribution prices paid by all users could be significant, depending on the degree of shared augmentation currently funded by connecting network users.

¹² UED acknowledges that the AEMC did exclude such charges in its Chapter 6A Transmission Rule Review, but as suggested above, the AEMC could be asked to take a fresh look at this issue from a distribution perspective.

(v) Repayments of connection charges

UED notes that the NERA/Allen report has made only high level recommendations as to the refunding (or 'clawback') of single-user assets that subsequently become shared, instead leaving the detail to an AER 'guideline'.

UED supports equitable arrangements for the subsequent sharing of single-user network costs, but considers that such arrangements need a focused consultation with industry to address practical issues.

(d) Network loss factors

NERA/Allen take the view that the use of average loss factors in network pricing applied to DGs results in a bias against these projects since it does not reward them for the losses they alleviate (marginal losses, which are generally higher than average losses). Conceptually, this view may have some merit, and UED supports the further investigation of this concept, and the entire complex issue of applying appropriate loss factors.

However, UED does not consider that the public disclosure of average and marginal loss factors over a five-year planning period as proposed in the NERA/Allen report's recommendation 1 is a workable solution to presumed locational issues for DGs and other users. The NERA/Allen report itself states that calculating marginal loss factors for large numbers of customers is expensive (p 98). Requiring DNSPs to publish extensive forecast network loss information would be very complex and lead to a significant increase in costs without commensurate benefits.

Rather than being presented with information which is not focused on specific projects, UED considers that network solution proponents would benefit more by dealing on a one-to-one basis with distributors in order to determine site-specific loss factors.

Since the AEMA does not require network losses to be addressed now, UED submits that a comprehensive review of network losses should be undertaken by the AEMC, encompassing all market sectors including distributed generation.