

Ergon Energy Corporation Limited

Submission on the *Regulatory Investment
Test for Distribution*
Australian Energy Regulator
25 February 2013



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1. INTRODUCTION

Ergon Energy Corporation Limited (Ergon Energy), in its capacity as a Distribution Network Service Provider (DNSP) in Queensland, welcomes the opportunity to provide comment to the Australian Energy Regulator (AER) on its *Regulatory Investment Test for Distribution Issues Paper*.

Ergon Energy is a member of the Energy Networks Association (ENA), the peak national body for Australia's energy networks. The ENA has prepared a comprehensive submission addressing the AER's Issues Paper. Ergon Energy is fully supportive of the arguments contained in their submission.

Ergon Energy is available to discuss this submission or provide further detail regarding the issues raised, should the AER require.





2. TABLE OF DETAILED COMMENTS

Question(s)	Ergon Energy Response
<i>Similarities and differences between the RIT-T and RIT-D</i>	
<p>1. Stakeholders should have regard to the regulatory test, RIT-T and RIT-D guidelines when considering their response to this Issues Paper. We are interested in what provisions of the RIT-T should be included in the RIT-D, modified or excluded altogether.</p>	<p>Ergon Energy believes the definition of ‘economically feasible’ should be included in the RIT-D guidelines, in particular:</p> <p>‘... the AER considers that an option is likely to be economically feasible where its estimated costs are comparable to other <i>credible options</i> which address the <i>identified need</i>.’</p> <p>This definition sets a sensible limit on the requirement to use the most expensive credible option to trigger the application threshold. As is the case under the RIT-T, the RIT-D should also require credible options to be both technically and economically feasible.</p> <p>Ergon Energy supports the ENA’s suggestion that the operation and application of the RIT-D be significantly simplified from the process outlined for the RIT-T, particularly given the large volume of RIT-D tests that will be required to be performed annually by DNSPs relative to the number of RIT-T tests performed by Transmission Network Service Providers (TNSP).</p> <p>Furthermore, Ergon Energy believes that the guidelines should provide guidance as to who should be the lead party for a joint TNSP and DNSP project which is determined to be a RIT-T project under the National Electricity Rules and there is no agreement between the TNSP and DNSP. Ergon Energy firmly believes that the TNSP is best placed to be the lead party responsible for carrying out the RIT-T, as DNSPs generally do not have the necessary expertise or systems to undertake the level of analysis required under the RIT-T.</p>
<p>2. We are interested in how the differences in electricity distribution and transmission may require us to adjust our approach to the way RIT-T and RIT-D should be considered.</p>	<p>Distribution networks are usually radial in configuration and have multiple nodes along the network unlike transmission networks which are meshed and point to point with no nodes between end points, and these differences are also reflected in the type of alternatives that can present themselves in different locations. For DNSPs to effectively</p>



	<p>engage and invest in diverse non-network alternatives, DNSPs need to have flexibility in the way they can engage with demand side participants, which are likely to be discrete, separate entities.</p> <p>Engagement with non-network alternative providers will be more effective over larger geographical areas and for longer periods of time than the RIT-D process prescribes. It is important to ensure that the RIT-D guidelines do not hinder engagement or efficient investment in non-network alternatives outside the RIT-D (for example, as part of the demand side engagement strategy).</p> <p>The project focus and assessment of the current regulatory tests would not identify or support the installation of network wide programs that can have very significant impacts on managing capacity requirements (e.g. investment in Auto Frequency Load Control Programs). As such, the development of an approach that allows the consideration of these investments across constrained and unconstrained areas is required.</p> <p>Ergon Energy also supports the suggested approach to the differences listed in the ENA's submission.</p>
<p><i>Removal of the base case</i></p>	
<p>3. We are interested in how stakeholders believe this will change the analysis for RIT-D proponents.</p>	<p>Ergon Energy provides in principle support for this proposal. However, this change requires careful consideration. Although this approach can avoid an unnecessary regulatory burden in some circumstances, the relevance of 'do nothing' options could drastically increase in light of security standard reforms. Under proposed deterministic, risk-based or output-based security criteria it would be very difficult to quantify the impacts of such investment and the appropriate level of investment without a base case.</p> <p>Furthermore, problems may arise in situations where the preferred option has a negative value – i.e. is at an overall cost to the market – and the local jurisdiction requires a positive outcome in comparison to doing nothing.</p> <p>Ergon Energy supports the ENA proposal to provide the option for DNSPs to prepare a 'do nothing' option as the default base case or directly comparing options without the need for a base case in situations where it feels appropriate.</p>



	<p>Alternatively, it may be useful to assess short, medium and long term deferral options as alternative base cases.</p>
<p><i>Distribution level market benefits</i></p>	
<p>4. We are seeking stakeholder views on how any of the factors which should deliver market benefits listed above should be clarified.</p>	<p>Ergon Energy believes ‘involuntary load shedding’ will impact on and be impacted by reliability incentive schemes. As such, consideration of a D-factor mechanism is required to ensure efficient outcomes are not disadvantaged by other regulatory incentive schemes.</p> <p>That said, Ergon Energy suggests that guidance on all benefits would be useful, giving particular regard to those suggested in the ENA submission. In addition, further guidance on ‘additional option value’ and ‘energy losses’ would ensure standard approaches are applied.</p>
<p>5. We are also interested in whether we should look at any additional distribution level market benefits, other than those specified under clause 5.17.1(c)(4). In particular, we are interested in whether broader types of demand side participation are likely to result in distribution level market benefits. In addressing this, we recommend that stakeholders have regard to the AEMC’s Power of Choice Review.</p>	<p>Ergon Energy believes there is a strong case for developing efficient investment in broader types of demand side participation (DSP). Particular consideration needs to be given to the application (and potential reapplications) of the RIT-D process and the potential for it to limit broader DSP.</p> <p>There are two major barriers to significant expansion of DSP and achieving the ‘overall objective’ of the Power of Choice Review:</p> <ol style="list-style-type: none"> 1. Information asymmetries – demand side participants cannot see when and where DSP is needed and most valued; and 2. Misalignment in DNSP and customer asset and appliance investment cycles – large amounts of DSP are linked with customer choices to invest or upgrade assets and these are rarely aligned to NSP asset investment cycles. <p>It is important that the application of RIT-D rules and processes does not inhibit a DNSP’s ability to send information and efficient signals to potential demand side participants showing when, where and how much DNSPs are willing to invest. Ergon Energy believes there is significant potential to increase efficient market engagement through demand reduction incentive maps such as the Dynamic Avoidable Network Cost Evaluation (DANCE) model proposed by the iGrid collaboration, the Commonwealth</p>



	<p>Scientific Industrial Research Organisation (CSIRO) and the Institute for Sustainable Futures (ISF)¹.</p> <p>Furthermore, Ergon Energy supports the ENA's submission that investment in demand management projects will occur in fewer circumstances than might otherwise be the case. Simply being able to consider these market benefits does not enable proponents to access funding for such projects within the regulatory period. The business case for a network proposing a demand management option is therefore effectively the same under the RIT-D as it is under the current investment test – i.e. savings within the framework must be sufficient to pay for the project, otherwise it cannot proceed. Although the benefits may be spread through the market and more than outweigh the costs, this does not entitle the network to access funding, and therefore does little to actually facilitate project implementation.</p> <p>Ergon Energy also suggests the value of disaster recovery / response could be included for consideration.</p>
<p>6. Specifically, noting the recently released Power of Choice report, does the RIT-D consideration of market benefits need to be amended to support demand side participation?</p>	<p>Ergon Energy believes a key challenge is aggregating end-use benefits up and down a vertically separated supply chain. In the absence of vertical integration it is difficult to construct business cases that assess the total supply chain and end-use costs and benefits. Overcoming the split-incentives that exist in the current market structure may be a driver for regulatory or government involvement in broad-scale non-network alternative programs.</p>
<p>7. How should the consideration of market benefits under the RIT-D recognise the impact the proposed works would have on the STPIS?</p>	<p>Ergon Energy suggests consideration of a D-factor mechanism is needed to ensure efficient outcomes are not disadvantaged by other regulatory incentive schemes. For example, if the cost of a given reliability standard can be demonstrated to be significantly higher than the value the customer places on the additional reliability, then the regulatory mechanisms should support an alternative solution.</p>
<p>8. How should the economic cost of electricity loss be treated within the market benefits assessment?</p>	<p>Ergon Energy supports the position outlined by the ENA.</p>

¹ Langham, E. Dunstan, C. and Mohr, S. (2011). Mapping Network Opportunities for Decentralised Energy: The Dynamic Avoidable Network Cost Evaluation (DANCE) Model, iGrid Working Paper 4.4, Prepared by the Institute for Sustainable Futures, University of Technology Sydney as part of the CSIRO Intelligent Grid Research Program.



<i>Material and adverse NEM impacts for the purposes of interested parties</i>	
9. We are seeking stakeholder views on who should be considered an interested party under this definition. We are interested in what guidance stakeholders would find useful in interpreting the definition of interested parties.	Ergon Energy supports the position outlined by the ENA.
10. We are of the view that the change in terminology from material and adverse 'markets impacts' to 'NEM impacts' improves clarity. We are seeking stakeholders' views on this.	Ergon Energy supports this change as it is likely to maintain the purpose and objectives of the RIT-D consultations.
<i>Estimating costs</i>	
11. We are interested in stakeholder views regarding what other financial costs are likely to be relevant.	Ergon Energy suggests that other relevant financial costs should include any significant costs incurred over the life of the investments. In particular, financing costs and the cost of capital incorporated in an appropriate discount rate.
12. The RIT-T specifies that transmission network service providers could determine additional classes of costs if we agreed that they were relevant. We are seeking stakeholders' views on whether it should make a similar specification for RIT-D proponents under the RIT-D.	Ergon Energy believes that flexibility should be provided to include all relevant costs; without which an efficient investment decision cannot be made.
13. The RIT-T specifies that if the costs were materially uncertain, the cost should reflect the probability weighted present value of the direct costs of the credible option under a range of different cost assumptions. We are seeking stakeholders' views on whether we should make a similar specification under the RIT-D.	Ergon Energy believes this may introduce unnecessary complexity. DNSPs will have a larger number of investments exposed to the RIT-D process, and this requirement may introduce additional requirements without additional benefit. Ergon Energy suggests that an appropriate sensitivity analysis may achieve the same outcome with lower costs.
<i>Determining discount rates</i>	
14. We seek stakeholder views on whether the RIT-D should specify the same methodology for determining the discount rate as the RIT-T and current regulatory test.	Ergon Energy suggests consideration be given to the appropriateness of using private sector and commercial discount rates for projects in regional areas. DNSP infrastructure investments in regional communities are often 'net cost' projects supported by government contributions. As such, alternative discount rates may be more appropriate under certain conditions.
<i>Methodologies for estimating costs</i>	
15. We seek stakeholder views on the methodology that the RIT-D should specify for estimating costs. We are interested in whether	Ergon Energy considers the methods of estimating costs under the RIT-T guidelines are suitable for application in the RIT-D guidelines.



<p>stakeholders think the methodology should be adopted from those specified under the RIT-T and regulatory test.</p>	
<p><i>RIT-D guidelines issues</i></p>	
<p>16. We seek stakeholder views on what guidance and examples for distribution would be useful to include in the RIT-D guidelines.</p>	<p>Ergon Energy recommends including examples showing construction of prudent and efficient assessments of broad-scale non-network alternative customer programs. The long-term benefits delivered through these programs (e.g. direct load control) are significant yet remain challenging to estimate and demonstrate in the face of split incentives.</p> <p>Inclusion of examples showing the prudent and efficient consideration of larger investments that deliver benefits that extend beyond current regulatory periods would also be beneficial, including a discussion of revenue certainty and regulatory risk.</p> <p>Furthermore, inclusion of examples showing significant investments (e.g. sub-transmission lines) which can create upstream and downstream costs and benefits would provide industry with useful guidance. Moreover, Ergon Energy supports the inclusion of guidance and worked examples for the cases listed in the ENA's submission.</p>
<p><i>Operation and application of the RIT-D</i></p>	
<p>17. The RIT-T guidelines provide guidance and worked examples on these topics. Having regard to the RIT-T guidelines, we are interested in whether the RIT-T guidelines provide useful information which should be adopted in the RIT-D guidelines.</p>	<p>Ergon Energy supports the ENA's suggestion that it would be more useful to be given guidance on a range of worked examples focusing on the assessment of common types of RIT-D projects, and the consideration and decision of whether to quantify the relevant RIT-D specified market benefits.</p>
<p>18. Additionally, we are interested in whether stakeholders consider the guidelines should provide guidance and worked examples on any additional areas that have not been specified under clauses 5.17.2(c) or 5.17.2(b)(2) of the NER.</p>	<p>Ergon Energy suggests further guidance is required on the ability for DNSPs to scale the RIT-D process to multiple investments in geographical areas or network-wide investment decisions to test for non-network alternative solutions that may be more efficiently procured and delivered as programs.</p>
<p><i>Application of guidelines</i></p>	
<p>19. We seek views on what guidance we should give on when a regulatory test assessment will be considered to have commenced for the purposes of 11.50.5(c).</p>	<p>To allow a sensible changeover between the old and new regulatory test rules, Ergon Energy suggest that any tests that have a Request For Information released before 1 January 2014 should be allowed to continue under the old regulatory test rules. This provides a reasonable transition period to avoid re-work of regulatory tests that have already commenced or are currently being prepared. This proposal assumes publication</p>



	of the AER final RIT-D guidelines by 31 August 2013.
<i>Process to be followed</i>	
20. We seek stakeholders' views on whether there are any particular areas where further guidance on the RIT-T assessment process would be useful.	<p>Regulatory test consultations are very similar to Expression of Interest (EOI) procurement processes that may also be used to efficiently engage and procure DSP. As such, Ergon Energy suggests that guidance on the appropriate integration of regulatory test consultation with procurement consultations would be of value.</p> <p>As with EOI processes, Ergon Energy recommends the RIT-D consultation process encourage early DSP involvement and responses from proponents who can provide:</p> <ul style="list-style-type: none"> • part of a solution that may be optimised with network solutions; and • less than fully costed proposals that may be developed with DNSPs and other parties. <p>Furthermore, Ergon Energy supports the areas for further guidance proposed in the ENA's submission.</p>
<i>Estimating market benefits</i>	
21. We seek stakeholder views on what methodologies the RIT-D application guidelines should adopt for valuing market benefits.	Ergon Energy suggests that market benefits are estimated and compared by DNSPs in the credible option and the analysed options. Further, Ergon Energy sees merit in interested parties retaining the right to submit market benefit estimates for 'do nothing' options for cases where these have not been analysed under a RIT-D.
<i>Dispute resolution</i>	
22. We seek stakeholder views on what dispute guidance would be of assistance. The RIT-T guidelines provide guidance on dispute resolution. Having regard to the RIT-T guidelines, we are interested in whether this content should be adopted into the RIT-D guidelines.	For RIT-D processes requiring a 'draft assessment report' the dispute resolution process may erode the effectiveness of the 'draft assessment report' consultation. Ergon Energy suggests it would be preferable for parties to lodge disputes during the draft assessment report consultation period so that these disputes may be assessed prior to the 'project assessment conclusion report' being published, unless there is a material difference in the recommendations between the draft and conclusion reports. Ergon Energy also recommends limiting the lodgement of disputes to parties who have made submissions within the specific RIT-D process under dispute, where there is no material change to the draft and final recommendations.