

# **NATIONAL ELECTRICITY AMENDMENT (REPLACEMENT EXPENDITURE PLANNING ARRANGEMENTS) RULE CHANGE REQUEST**

Response to the Draft Determination

6 June 2017

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## Executive summary

Energy Networks Australia welcomes this opportunity to provide a submission in response to the draft determination *Replacement expenditure planning arrangements* from the Australian Energy Market Commission (AEMC).

Non-network options are becoming increasingly important as new technology and falling costs make them viable substitutes for network solutions. Energy Networks Australia is supportive of the Australian Energy Regulator's (AER) policy goal of increasing the transparency and level of consultation in relation to network asset replacements. Network service providers (NSPs) recognise that where a network-led solution represents the least cost option, greater transparency may be required to build and preserve market confidence that all technical and economically feasible options have been appropriately examined.

Energy Networks Australia is supportive of the policy objective of the draft rule. We support the opportunity for extending regulatory investment tests (RIT) to replacement expenditure to increase confidence that network investments are subject to a robust and comprehensive assessment.

Following review of the draft rule, however, Energy Networks Australia and its members have a number of implementation suggestions that would improve the balance between the additional costs of regulatory compliance that are ultimately borne by customers, and the potential savings the rule change could achieve for customers.

The proposed rule change will clearly impose additional regulatory compliance costs in reporting and undertaking additional regulatory investment tests. While the AEMC has not undertaken a cost-benefit assessment of the changes, it appears feasible for the implementation costs to be in the order of \$6 to \$26 million per year, assuming the AEMC estimate is correct that an additional 6 tests would be required to be assessed by each NSP, assuming a cost of the RIT assessment of \$50,000 to \$200,000 per test.

Clearly the potential for the costs to customers of the changes to outweigh the benefits if unnecessary process costs are imposed in the final determination, including during any transition. To ensure the intended benefits to customers are realised, we urge the AEMC to:

- » Review the benefits and costs of the RIT for replacement expenditure after a defined three-year period to confirm the intended benefits for customers have been realised.
- » Increase the threshold for group reporting of asset replacement from \$100,000 to at least \$200,000 to avoid significant greater process burden without material

benefit;

- » Ensure a practical transition timeframe with the commencement of July 2018 for the new RIT requirements; and
- » Ensure that distribution businesses are provided with a reasonable transition timeframe before being required to comply with new reporting requirements in their Annual Planning Reports (APR).

In this submission, we draw upon supporting evidence and examples provided by member businesses to highlight:

- » a number of aspects of the AEMC's draft determination that may prove difficult to efficiently implement; and
- » the need for further clarification to improve the workability of the rule and ensure its consistent application by NSPs.

One week before submissions in this consultation closed, the AEMC contacted Energy Networks Australia to informally explore feedback on an earlier timeframe for implementation of the regulatory investment test aspect of the draft rule. This submission does not represent a formal response to that enquiry raised in the final days of the consultation period. A further dedicated consultation should be undertaken transparently with all stakeholders if the AEMC was to seriously consider a departure from the transitional arrangements outlined in the draft determination, which stakeholders have assessed.

Members of Energy Networks Australia would hold serious concerns if the AEMC were to bring forward the effective date of the new proposed rule. Such an approach may compromise preparatory processes that are needed in the lead up to initiating an assessment under the test, as well as lead to inefficient deferral of scheduled projects.

Energy Networks Australia considers this rule change should also recognise related reforms to network economic regulation, which can support public confidence in efficient expenditure decisions. Given the transformation of the industry, there may be scope to apply alternative, less costly regulatory arrangements, which may better satisfy the needs of market participants. For example:

- » network cost reflective pricing and incentives can achieve the orchestration of distributed energy resources to avoid traditional expenditure; and
- » information solutions may reduce the relevance of this particular form of regulatory intervention - such as the Networks Opportunity Maps now hosted by Energy Networks Australia after development by the Institute for Sustainable Futures.

## Assessment against AEMC criteria

### Transparency

Energy Networks Australia supports the objective of greater openness in relation to network asset replacement decisions. Therefore, we support the proposal to increase transparency in this area, in a way which maximises customer benefits through potential expenditure efficiency gains arising from greater transparency and enablement of any efficient non-network alternatives, whilst avoiding customers bearing unjustified additional compliance costs.

The AER proposed that a guideline be developed on asset retirement and de-ratings, as well as an exemption process so that a regulatory investment test (RIT) was not required for "like-for-like" replacements. The latter appeared to recognise the situation where the only viable option is like-for-like replacement. However, in its draft rule, the AEMC decided not to adopt the guideline nor introduce exemptions. As a result, the required information for the transmission and distribution Annual Planning Reports is broader than that proposed by the AER, and NSPs would be required to perform more RITs.

Overall, Energy Networks Australia agrees that the draft rule provides a greater level of transparency when compared with the proposed rule change request. However, we hold concerns about whether the extent of information required by the draft rule is useful/relevant to enable non-network service providers to propose alternative solutions, and whether the scope and detail of the information will reduce its practical usefulness.

### Regulatory and administrative burden

Energy Networks Australia considers that there is an opportunity to further minimise the regulatory and administrative burden arising from this rule change by reducing the scope of the data requirements, while ensuring that the objective of transparency of planned network asset replacements is not compromised.

The following considerations reduce the nature and degree of additional information that may be required:

- » There are a number of existing mechanisms, which already encourage the consideration of non-network options, provide information to market participants who may be able to offer non-network solutions, and provide NSPs with incentives to invest in least cost options.
- » The Networks Opportunity Maps provide clear, consistent and timely information on network opportunities and constraints to renewable energy and demand management project proponents. The Maps are now hosted by Energy Networks Australia after development by the Institute for Sustainable Futures and we are currently working with network service providers on the next updates.

- » The proposed Demand Management Incentive Scheme (DMIS) will work in combination with the current distribution planning framework and the RIT-D to ensure the consideration of non-network options.
- » The electricity distribution system limitations template will provide detailed information on constraints in a format that will be easily applied by non-network service providers to use in their analysis. The system limitations template was introduced to specifically target information that is seen to be sufficient to inform non-network service providers.

In relation to the regulatory investment tests for network replacement expenditure decisions, we note that the AEMC estimated that an NSP may need to undertake approximately six additional processes each year under the draft rule.<sup>1</sup> While this will vary across NSPs depending on the needs of each network, it represents a significant increase in the regulatory burden placed on NSPs in carrying out project assessments and consultation processes.

While NSPs accept that the draft rule would require additional RITs to be undertaken each year, it is important that the AEMC and stakeholders fully understand the level of analysis required to be undertaken for each RIT. Members of Energy Networks Australia are generally of the view that additional resources will be required in their businesses to meet the step change in RIT requirements for replacements.

We note that, consistent with the AER's rule change proposal, the draft rule applies the same threshold for replacement projects as to augmentation projects. Currently these are \$6 million in transmission and \$5 million in distribution. To minimise transaction costs that are ultimately borne by customers, Energy Networks Australia supports retaining the existing thresholds and other elements of the regulatory investment tests that currently apply to augmentation.

Given the significant expectation for network businesses to increase the efficiency of their operations, Energy Networks Australia urges the AEMC to ensure that the implementation and ongoing costs associated with this rule are taken into consideration and are clearly outweighed by likely realisable benefits to customers.

## Other criteria

### Technology neutrality

Energy Networks Australia agrees with the AEMC that the draft rule is technology neutral insofar it does not specify any particular technological requirements for potential investment projects.

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<sup>1</sup> AEMC, Draft determination, Replacement expenditure planning arrangements, April 2017, p56.

## Clarity and certainty

This submission highlights the need for further clarifications to the draft rule to improve its workability and to promote outcomes consistent with the *National Electricity Objective*.

## Annual reporting requirements

### AEMC position

The draft rule specifies that information on *all* planned asset retirements in distribution and transmission networks is to be included in annual planning reports. In addition, information on planned asset de-ratings that result in a limitation or constraint on a network is also to be included in Annual Planning Reports.

The AEMC's draft approach removes the need for the AER's proposed guideline on asset retirement and de-ratings. The AEMC has also proposed a monetary threshold of ≤\$100,000 for group reporting in the context of asset replacement programs that involve multiple, like assets, irrespective of whether they are intended to be replaced across multiple locations in the network.

### Energy Networks Australia response

Energy Networks Australia supports the principle that information about the network and the potential opportunities to provide non-network alternatives should be available to those offering non-network solutions. However, we are concerned that there is a risk that the AEMC's draft rule will not provide a practical approach to transparency and may result in a heavy compliance burden due to its very broad reporting requirements.

Energy Networks Australia has reviewed NSPs' replacement volumes reported in Category Analysis RINs. Historical information is currently reported on the AER's defined categories and sub-categories.

Table 1 overleaf shows the total number of individual assets each network business replaced in the 2015-16 regulatory year (2015 regulatory year for Victorian DNSPs).

**Table 1** Asset replacements – a one year snapshot

Company	Number of asset replacements Excl: SCADA, public lighting, other	Kilometres: <ul style="list-style-type: none"> <li>• Overhead conductor</li> <li>• Underground cable</li> <li>• Service lines</li> </ul>
Ausgrid	4,498	20,005
Essential Energy	38,750	4,032
Endeavour Energy	2,696	13,693
ActewAGL	2,907	1,471
Energex	24,952	34,911
Ergon	35,137	5,161
AusNet Services distribution	14,337	2,021
Citipower	996	33
Powercor	12,193	164
United Energy	18,470	40,799
Jemena	4,049	8,220
SAPN	19,969 including "other"	12,076
TasNetworks distribution	2,910	1,179
Company	Number of asset replacements Excl: SCADA, other	Kilometres: <ul style="list-style-type: none"> <li>• Conductors</li> <li>• Transmission cables</li> </ul>
Powerlink	71	2
TransGrid	418	1
ElectraNet	13	0
AusNet Services transmission	6,615	47
TasNetworks Tx transmission	536	0

**Source:** RIN Responses, Category Analysis, Table 2.2.1 – Replacement expenditure, volumes and asset failures by asset category.

The analysis in [Table 1](#) indicates that the proposed the new reporting requirements may result in NSPs reporting on hundreds of individual assets for the forward planning period (5 years for distribution and 10 years for transmission).

The compliance burden (the costs of which are ultimately borne by customers) of the new reporting requirements may be material. In addition, there may be some one-off costs in establishing or modifying reporting systems to enable the preparation and maintenance of the data required by the new rule.

The compliance and administrative costs for each NSP will depend on:

- » the age profile of network assets; and
- » how many assets are eligible for group reporting; and
- » how many assets are not part of the replacement program and, therefore, need to be reported individually.

It is difficult to estimate the extent of these impacts on each NSP. Based on the initial analysis of the draft rule, a threshold of \$100,000 will result in the following outcome:

- » Ergon Energy would need to report separately on approximately 250 different assets per annum;
- » Energex would need to report separately on approximately 150 different assets per annum;
- » AusGrid would need to report separately on 1,000 individual assets asset in the next Annual Planning Report.

Energy Networks Australia considers that these examples demonstrate there is an opportunity to minimise this burden by reducing the scope of data requirements, while ensuring that the objective of transparency in relation to planned network asset replacements is not compromised.

## Energy Networks Australia proposed solution

Under the AEMC's proposed \$100,000 threshold, there remain many individual assets with a replacement cost greater than \$100,000. Therefore, Energy Networks Australia considers that the threshold should be increased to at least \$200,000.

Together with reporting on individual assets, reporting by summarised description of the network assets, including a summarised description of their locations, with a threshold of \$200,000 would still provide practical and meaningful information to non-network solution providers. Non-network solution providers who require detail of an asset replacement program in a particular area will be able to contact the relevant NSP and obtain detailed information.

Energy Networks Australia considers that the proposed solution provides a balanced approach, noting that it would still impose a significant regulatory burden on some NSPs (e.g. Ausgrid, Energy Queensland).

In addition to the above comments, Energy Networks Australia wishes to raise other changes that would further improve the draft rule:

- » Any new thresholds established by the AEMC in its final rule should be subject to the requirements of cl. 5.15.3 *Review of costs thresholds*. This is to ensure that the cost thresholds remain appropriate in light of changes to input costs.
- » There should be clarification in relation to the consistent use of terminology such that the reporting requirements apply on a “per asset” basis rather than a “per project” basis. As discussed with the Commission, this is a technical drafting issue to avoid confusion.

## System limitation template for distribution

In discussions with Energy Networks Australia, member businesses have raised their concerns that the AER's draft system limitations template requires information in excess of that proposed in the Local Generation Networks Credits final rule.

It is our understanding that the system limitations report is intended to supplement the distribution annual planning reports in order to provide detail on identified system limitations in a consistent and useable format, and is not intended to duplicate reporting requirements arising from this rule change. However, certainty in this regard will only be possible following the AER's final decision on template requirements.

## Regulatory investments tests

### AEMC position

The draft rule extends regulatory investment tests to include replacement capital expenditure, while clarifying that maintenance is exempt from both the RIT-T and the RIT-D.

Regulatory investment tests are to apply to all replacement and refurbishment capital expenditure above the capital cost threshold without exception. The AEMC is of the view that exclusions to the regulatory investment tests are not necessary as the regulatory burden of undertaking a RIT where a like-for-like replacement is the only viable solution is unlikely to be significant.

### Energy Networks Australia response

Energy Networks Australia understands that regulatory investment tests will continue to focus on 'projects' that address an "identified need", where the most expensive option exceeds \$6 million for transmission and \$5 million for distribution.

We note that the AEMC considers that the draft rule would provide NSPs with sufficient flexibility because:

- » NSPs are to identify and formulate the *identified need*.
- » Under the rules, distribution businesses can determine on reasonable grounds that there will not be a non-network option that is a potential credible option. If this is the case, a DNSP is required to publish a notice outlining the reasons for its decision. We note that this is not the case for transmission, where the rules require a 12-week consultation with interested parties on any such decision.

The assumed interpretation of the draft rule is that replacement programs which exceed the \$6m/\$5m cost threshold, may belong to separate projects, meeting

separate 'identified needs' for the purposes of the RIT-T/RIT-D.

While we support this interpretation of the draft rule, a number of NSPs brought to our attention that their investment documents for replacement programs are structured to have a common need even if the assets are located at multiple locations.

## Transitional arrangements

### AEMC position

The draft rule provides for the following transitional arrangements:

- » New Annual Planning Report requirements (for both distribution and transmission network capital expenditure) are to apply for the next scheduled Annual Planning Reports.
- » New regulatory investment test requirements (for both distribution and transmission network capital expenditure) are to apply from 1 July 2018. Replacement projects that have been committed to by a network service provider before that date will not be required to be assessed under the new regulatory investment test process. Replacement expenditure investments that become committed projects after 1 July 2018 will be required to be assessed according to the regulatory investment test.

### Energy Networks Australia response

Energy Networks Australia agrees with the AEMC's draft proposed timeframes above for reporting in the Annual Planning Reports for transmission and application of the RITs for both transmission and distribution. However, the proposed APR timeframe for distribution is not considered to be achievable or reasonable.

#### *Commencement of new reporting requirements in the APR*

Assuming a commencement date of 18 July 2017 for the final rule, NSPs consider that the AEMC's draft rule would result in an insufficient transition period for those businesses whose next Annual Planning Reports are due in September 2017 and December 2017.

**Table 2** Deadlines for the next Annual Planning Reports

Company	Next APR
Ausgrid	31 December 2017
Essential Energy	
Endeavour Energy	
ActewAGL	
AusNet Services distribution	
Citipower	
Powercor	
United Energy	
Jemena	
SAPN	
TasNetworks distribution	
Energy Queensland	30 September 2017
Powerlink	30 June 2018
Transgrid	
ElectraNet	
AusNet Services transmission	
TasNetworks transmission	

Energy Networks Australia considers that NSPs should be provided with a minimum period of six months before being required to comply with new reporting requirements in their Annual Planning Reports.

We recognise that this would result in businesses not including asset retirement and de-rating information in their APR until June/September/December 2018. However, it is important that NSPs have sufficient time to establish new or modify existing reporting systems to prepare and maintain the data required by the new rule, and to conduct any preliminary analysis required.

#### *Commencement of the RIT-T and RIT-D*

The draft rule provides for a one-year transition before the commencement of regulatory investment tests requirements for replacement expenditure. During this period, the AER would be required to update its regulatory investment test application guidelines in accordance with the transmission and distribution consultation procedures. After the AER has finalised its guidelines, NSPs would need to be provided with sufficient amount of time to fully understand the implications.

In light of these considerations, Energy Networks Australia considers that a one-year

transition is reasonable.

Energy Networks Australia would not support an earlier commencement date for the following reasons:

- » It would not allow an adequate transition period to prepare for compliance with the new regulatory investment project assessment and consultation process, and to modify existing processes and reporting systems.
- » It would risk the necessary amendments to regulatory investment test application guidelines be hastily developed following potentially insufficient consultation with NSPs.
- » It would delay scheduled projects and, therefore, potentially affect safety/reliability, at an additional cost to customers.

With regard to the last point above, if a project was not “committed” but scheduled and expected to be approved in the near future, the project would be delayed by approximately six to twelve months while the RIT process was undertaken. Potential delays to the delivery of replacement projects may also have flow on effects to subsequent projects for which near out projects may be pre-requisites.

#### Information box 1 RIT-T process timeframes and requirements

To inform the AEMC’s deliberations, it may be instructive for the AEMC and other stakeholders to better understand the practical requirements and timeframes involved in completing a RIT-T, for example, set out in the table below:

Timeframes	Process description
<b>Approx. 4-6 months</b>	Prior to formal commencement of the RIT-T process (i.e. publication of the Project Specification Consultation Report - PSCR) to undertake network planning and other analysis (e.g. condition review) to prove/verify the need to take corrective action. Feasible network options with estimates and commissioning dates would also be compiled, including characteristics of feasible non-network options. This analysis largely forms the basis of the PSCR.
<b>6-12 months</b>	To conduct the RIT-T process in accordance with the NER-required timeframes. This includes the more detailed network planning, estimating and other analysis that is required to prepare RIT-T documentation along with any reassessment or new analysis required to appropriately respond to stakeholder feedback.
<b>Approx. 2-3 years</b>	From approval to undertake the investment to implement the preferred option in time to meet the “need” date (or commissioning date). For a network option, this would typically include key elements such as procuring equipment (some of which may have long lead times), detailed design and project scheduling (including outage scheduling to get

access to the network, including customer interfaces/equipment, which may occur in stages or only in very narrow window each year), construction, testing and commissioning.

For replacements, the nature of the work is inherently more complex compared to an augmentation.

The timeframes above indicate that in order to meet a network limitation or “need” in December 2020, the formal RIT-T process would need to commence in July 2018.

These timeframes also indicate that if the AEMC were to bring forward the effective date of the new proposed rule to, for instance, September 2017, this suggests that transmission businesses would need to already have in the order of six RIT-T consultations underway since September 2016 – which is clearly not the case.

Further, Energy Networks Australia agrees with the AEMC that replacement projects that have been committed by NSPs should continue through to completion under the existing arrangements. The term ‘committed’ typically describes individual projects that have gained internal business case approval and, as a result, the NSP has commenced detailed design and procurement activities.

In addition, we consider that any projects that address State Governments’ safety obligations should be excluded from the requirements to undertake the RIT, with a current example being some specific Bushfire inquiry related investments being required by jurisdictional obligations.

Should the AEMC consider that oversight is required; the final rule could include a provision requiring NSPs to submit to the AER a list of replacement projects, which have commenced assessment under the current arrangements. Unless otherwise determined by the AER, these projects would then be exempt from the regulatory investment test. This approach was adopted when the RIT-D was first introduced.