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Australian Energy Market Commission
PO Box A2449
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Provided by direct lodgment

**National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2016**
**Reference: ERC0209**

The Major Energy Users (MEU) is pleased for the opportunity to respond to the AEMC draft rule on requiring better information disclosure on networks future replacement expenditure and for there to be a publicly available assessment of the reasons for implementing replacement of network assets.

In its response to the Consultation paper issued by the AEMC regarding the rule change proposed by the AER on requiring replacement capex (repex) to be subject to a regulatory Investment Test (RIT), the (MEU) expressed strong support for the proposed rule change.

The MEU is pleased that the AEMC is proposing a draft rule to implement this change and comments that the change is long overdue. The MEU makes this observation on the basis that there has been a massive increase in the regulatory asset base (RAB) of all the networks in recent years, just in pure dollar terms. But what is more concerning is that when the RAB is measured in real terms and normalised against consumer numbers and peak demands, the normalised real RAB for all networks has shown a near doubling over the past decade and this has resulted in major and unnecessary imposts on all consumers.

The MEU has also noted that in recent network revenue resets the amounts of capex claimed by networks have remained relatively steady. While on the surface, this is what might be expected, but in reality the MEU has noted a significant fall off of capex needed for augmentation (augex) reflecting that growth in demand has remained flat for some years with this trend forecast to continue.

The fact that capex claims at a reset are much the same as in previous resets despite lower amounts for augex, implies that the repex claims have increased significantly, with some networks claiming more than twice the amounts of repex in the most recent reset than they considered necessary at previous resets.

The AER proposed rule change reflects this change in dynamic and the MEU is pleased that the AEMC draft rule does provide a counter to this burgeoning growth in repex claimed by networks.

The MEU notes that the AEMC has used the same trigger values for both repex and augex to require a RIT process, While the MEU accepts that it is appropriate for both to have the same trigger value, the MEU reiterates its previous advice to other rule changes, that the trigger values are too high and lower values should be implemented. Bearing in mind that massive growth in the RABs for all networks, the MEU considers that the trigger value for both distribution and transmission capex (for both augmentation and replacement) should be $3m rather than $5 m for distribution and $6m for transmission.

While generally supporting the draft rule, the MEU is very concerned that the AEMC has seen fit to include a 13 month transition to the requirement to implement a RIT for repex. The AEMC states that the AER did not include a transition period in its proposal; the AEMC avers that time is needed for both the AER and the networks to implement the changed regulatory processes when deciding there must be a transition period.

The AEMC points out that there will be a need for the AER to recast its guidelines to implement a RIT for repex and this warrants a transition period to implement the change. The MEU disagrees. The MEU notes that the AEMC considers that the networks will need time to apply the new requirement to their internal processes. Again the MEU disagrees.

To provide time to implement a change to the RIT guideline is unnecessary.

With regard to the need for the AER to implement a new guideline, the MEU points out that the RIT already exists as it applies to augex – the MEU does not see that including repex under the RIT will require a substantive change the guideline at all. All that is needed is for some wording changes at most.

With regard to the internal processes involved with replacement and expansion capex, the MEU has been advised by its members that their processes for approving capital expenditure are the same regardless for what the capex is used for. This advice supports the MEU view that the internal approval processes in networks for replacement capex are no different regardless of the use the capex is for.

In considering a transition period is needed, the MEU considers the AEMC has not considered the reality of what should occur within a well run network[1] – that there should be a hierarchy of approval points within a firm which limits the capital expenditure each level of authority the firm has. That this hierarchy exists reflects

[1] This recognises that networks being capital intensive firms will have similar internal processes to capital intensive firms in a competitive environment, like MEU members.

the fact that capital expenditure must be closely controlled for very strong commercial reasons. Further, the internal auditing requirements of a well run firm requires the exercise of that authority to be formal and be clearly justified along with alternatives to that expenditure being explored and costed[2]. This process means that a well run network already implements a form of the RIT for its internal processes; this supports the view that there is little need for a transition period.

The MEU also points out that, in commercial enterprises, there is a difference between commitment and execution. While commitment implies that there is an authority to proceed, this does not mean that the enterprise has incurred any costs. If no costs have been incurred, a decision can be made not to proceed with an investment. Throughout commercial investment activities, there are many instances where a firm has committed to a project only to decide not to proceed with that investment based on new information that has come to light – there are even many examples where a decision to stop a project has occurred after the project has already incurred costs[3]. Allowing the draft rule a transition period so that commitments already made would not be subject to a RIT, merely allows the networks an opportunity to "game" the process.

In deciding there should be a transition period, the AEMC discusses the risk that a project might already be committed. The MEU accepts that there is a risk that this might occur. As noted above, the MEU is aware of the difference between commitment and implementation. The MEU considers that this AEMC concern is readily addressed by granting the AER discretion to allow a project to proceed in the absence of the supporting RIT process if the network has already incurred significant costs or the network has made commitments to other parties where there is a significant cost to terminate that commitment. The AER has already demonstrated such pragmatism in decisions it has made in the past, so the MEU does not consider that this discretion would be abused by the AER.

The MEU points out that this proposed rule change has been under discussion for over 12 months and that networks would be aware, not only of its need, but the likelihood of its implementation. As well run firms, this means that networks will have already made provision for its acceptance and implementation. To add another 12 months transition adds nothing but provides an opportunity for networks to abuse the time delay to the disadvantage of consumers.

The MEU is very concerned at the extended implementation period for networks to implement the change as the MEU considers that it provides an opportunity for the networks to "game" the process and to "rush through" commitments for repex

[2] While these internal approval processes are not publicly available, the RIT process provides the ability for these approvals to be made public and thereby satisfy those underwriting the investment being made (ie consumers). The MEU points out that the rules allow networks to automatically "roll in" to the RAB, regulatory approved capex and which then requires consumers to provide recovery of and a return on the capital that is used for capex

[3] If a commitment has been made and a subsequent assessment shows that the investment is not efficient, it should not be accepted as efficient for the capex to proceed, especially when others are forced to pay the cost of the inefficient investment for many decades.

unfettered without having to publicly demonstrate that the repex is needed. In this regard, the MEU considers there is a need **now** for networks to publicly demonstrate the need for more repex. The MEU notes that repex only increases the RAB on a real and normalised basis and increase the costs to consumers without there being a requirement to openly demonstrate a clear benefit for the increased costs they incur and which consumers will have to pay.

## Summary

The MEU supports the draft rule but considers that two changes are needed

- The trigger values for requiring a RIT process for all capex should be reduced to $3m for both distribution and transmission
- There is no need for a transition period and the rule change be implemented immediately

We appreciate the opportunity to have provided this input to the review process of proposed rule change to subject repex to a RIT process. Should you wish for amplification of any of the comments provided in this response, please contact our Public Officer (David Headberry) on 03 5962 3225 or at davidheadberry@bigpond.com .

Yours faithfully

David Headberry
Public Officer