



6 June 2017

Mr John Pierce
Chairman
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

Draft Rule Determination: Replacement Expenditure Planning Arrangements

Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy) appreciate the opportunity to provide a submission to the Australian Energy Market Commission (AEMC) on its *Draft Rule Determination: National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017* (draft rule determination). The draft rule determination proposes a number of amendments to the existing network planning and expansion framework under Chapter 5 of the National Electricity Rules, the overall aim of which is to increase the transparency of network service provider decision-making on investment in network assets.

While supportive of the general intent of the rule change, Energex and Ergon Energy have provided comments with respect to the draft rule determination in the attached submission. Specifically, feedback has been provided on certain elements of the draft rule determination which relate to the new annual planning report obligations, the proposed application of the regulatory investment test to replacement programs and the proposed transitional arrangements.

Should you require additional information or wish to discuss any aspect of the attached submission, please do not hesitate to contact either myself on (07) 3851 6416 or Trudy Fraser on (07) 3851 6787.

Yours Sincerely

A handwritten signature in blue ink, appearing to be 'Jenny Doyle', with a long horizontal line extending to the right.

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National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017

Joint response to the Australian Energy
Market Commission's Draft
Determination

6 June 2017



Part of the Energy Queensland Group



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1 INTRODUCTION

1.1 Background

On 11 April 2017, the Australian Energy Market Commission (AEMC) published its *Draft Rule Determination: National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017* (draft rule determination) in relation to a rule change request received from the Australian Energy Regulator (AER). The draft rule determination proposes a number of amendments to the existing network planning and expansion framework under Chapter 5 of the National Electricity Rules (the Rules), the overall aim of which is to increase the transparency of network service provider decision-making on investment in network assets. The draft rule determination, which is a more preferable rule:

- expands annual planning reporting requirements to include information on network asset retirements and de-ratings; and
- extends the application of the regulatory investment test framework to replacement expenditure.

The AEMC has requested that interested parties make submissions on the draft rule determination by 6 June 2017. This submission, which is available for publication, is provided by Energex Limited (Energex) and Ergon Energy Corporation Limited (Ergon Energy) as distribution network service providers (DNSPs) operating in Queensland.

As members of the Energy Networks Australia (ENA), the peak national body for Australia's energy networks, Energex and Ergon Energy have also contributed to and are supportive of the issues raised in the ENA's submission.

Energex and Ergon Energy are available to discuss this submission or provide further detail regarding the issues raised, should the AEMC require.

1.2 General comments

Energex and Ergon Energy welcome the opportunity to provide comment to the AEMC on its draft rule determination. We acknowledge that Australia's national electricity market is rapidly evolving, with non-network solutions, such as energy storage and distributed generation, having the potential to become viable alternatives to replacement of traditional distribution network assets. We are therefore supportive of the general intent of the rule change on the basis that the proposed amendments to the Rules will provide increased transparency on network asset retirement, de-rating and replacement decisions by network service providers as well as facilitate greater engagement with non-network providers and consideration of alternative solutions to address network limitations.

However, while Energex and Ergon Energy are supportive of the AER's overall policy intent in proposing this rule change, care should be taken by the AEMC to ensure that any additional regulatory obligations imposed on network service providers are sufficiently clear and that the costs of compliance do not significantly outweigh the expected benefits to non-network providers and energy market stakeholders.

To assist in the achievement of these objectives, Energex and Ergon Energy have provided comments for further consideration by the AEMC on key elements of the draft rule determination in this submission. Specifically, comments are provided with respect to:

- aspects of the proposed new annual planning report obligations that require further consideration or clarification;
- the proposed non-exclusion of "replacement programs" from the regulatory investment test; and
- the proposed transitional arrangements.

2 ANNUAL PLANNING REPORTS

The AEMC's draft rule determination expands the annual planning reporting requirements for network service providers to include replacement expenditure. Specifically, the proposed amendments to Schedule 5.8 of the Rules will require network service providers to report on all network asset retirements and de-ratings that would result in a network constraint over the forward planning period. In making its draft rule determination, the AEMC has also determined that:

- a new AER network retirement reporting guideline, setting out the types of assets that would be subject to the reporting requirements (as proposed by the AER in its rule change request), is unnecessary and that network service providers must provide information on all planned asset retirements¹;
- an asset cost threshold should not apply (as suggested by some network service providers), on the understanding that non-network providers and energy market stakeholders may also be interested in lower cost assets²;
- network service providers will not be required to report on non-network capital expenditure, such as IT and communication systems, on the basis that this information would be of no benefit to energy market stakeholders or non-network providers and is already considered as part of the regulatory determination process³;
- network service providers will not be required to report on asset retirements and de-ratings that occurred in the previous 12 months as the assets will already have been replaced and the information would therefore be of no benefit to non-network providers⁴; and
- replacement programs should not be excluded from annual planning reporting requirements⁵.

While broadly supportive of the objectives of the proposed annual reporting obligations, Energex and Ergon Energy remain of the view that reporting at a program level would provide limited benefits for non-network providers. The potential for alternative technologies to provide credible non-network substitutes for like-for-like replacement of distribution network assets is limited. This is especially the case for the replacement of low voltage distribution feeders and transformers or equipment necessary for the protection and control of the network which are often undertaken as part of a program. There therefore does not appear to be sufficient justification for imposing this additional regulatory reporting obligation on DNSPs, particularly considering past reporting on replacement projects has not resulted in any meaningful engagement with non-network providers to date. Unless it can be clearly demonstrated that providing this information will deliver a benefit

¹ AEMC, *Draft rule determination: Replacement expenditure planning arrangements*, 11 April 2017, p.36

² *Ibid*, p.36

³ *Ibid*, p.37

⁴ *Ibid*, p.37

⁵ *Ibid*, p.36

to non-network providers, Energex and Ergon Energy request that the AEMC reconsider the application of annual reporting requirements to network assets that are to be replaced as part of an asset replacement program.

However, should the AEMC determine that there is value in providing this information and that the scope of annual reporting requirements is to remain largely as set out in the draft rule determination, Energex and Ergon Energy are of the view that further consideration is necessary to ensure clarity of reporting obligations and consistency in interpretation by network service providers as well as opportunities to limit the additional compliance burden. Key areas that require further consideration are detailed below and relate to the drafting of new clauses S5.8(b1) and (b2) with respect to network retirements, the level of information that is required for reporting purposes, the application of the replacement cost threshold and potential impacts on system limitations reporting.

2.1 Network asset retirements

There appears to be an inconsistency in the drafting of new clauses S5.8(b1) and (b2). While draft clause S5.8(b1) requires DNSPs to provide information “for all network asset retirements and network asset de-ratings that would result in a network constraint, that are planned over the forward planning period...”, draft clause S5.8(b2) refers to assets that are “to be replaced”⁶. It is unclear from this drafting whether DNSPs are required to report on:

- all network asset retirements, including both:
 - asset retirements that will result in a network constraint and are to be replaced; and
 - retirement of assets that are surplus to requirement and are not to be replaced; or
- as draft clause S5.8(b2) would suggest, only those asset retirement decisions that will result in a network constraint and a need for replacement.

It is therefore recommended that draft clauses S5.8(b1) and (b2) be amended to clarify whether DNSPs must report on all assets that are to be retired or only those assets that are to be retired and replaced over the forward planning period.

We recommend that DNSPs should only be required to include information on asset retirements that will result in a network constraint and therefore a need to be replaced by a credible network or non-network option. Providing information on retirements that do not result in a network constraint would not be of benefit to non-network providers.

⁶ AEMC, *Draft National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017*, p. 8-9.

2.2 The level of information required for reporting purposes

The draft rule determination proposes that network service providers are to provide information on all network asset retirements and de-ratings in their annual planning reports. However, as the term “network asset” is not defined and an asset cost threshold has not been included in the draft rule, it is not clear whether this reporting requirement is intended to apply to an asset class or to individual plant items and ancillary components. For example, the retirement of a specific asset class, such as poles or overhead conductor, would involve the retirement of a group of assets, including a range of individual plant items and components. Greater clarity and certainty is therefore required as to the expected level of reporting required to enable network service providers to comply with this new obligation.

In this regard, Energex and Ergon Energy recommend that, in order to minimise the regulatory and administrative burden, reporting should be at an asset class level rather than an individual component level.

2.3 Replacement cost threshold

Draft clause S5.8(b2) provides for network assets which are of the same type, to be replaced across more than one location, within the same calendar year, and with an expected replacement cost of \$100,000 or less, to be grouped for reporting purposes.

On the understanding that the replacement cost threshold of \$100,000 is intended to include the full cost to replace the asset (i.e. the “project” cost inclusive of overheads) rather than the value of the asset to be replaced, Energex and Ergon Energy are concerned that a \$100,000 cost threshold would capture a significant number of individual assets which form part of a larger replacement program, such as circuit breakers, transformers, and some concrete and steel poles. Energex and Ergon Energy estimate that the proposed \$100,000 cost threshold would result in approximately 150 and 250 assets respectively that would need to be reported separately each year. In our view there is unlikely to be any benefit to non-network providers in reporting large numbers of network assets individually.

Further, the proposed cost threshold of \$100,000 would also impact on the reporting of linear assets, such as distribution overhead or underground conductors. Reconductoring programs are budgeted for on a per kilometre basis, with the cost to replace those assets ranging from approximately \$170,000 for one kilometre of low voltage overhead cable up to approximately \$490,000 for one kilometre of low voltage underground cable. Consequently, if the \$100,000 threshold is intended to apply to linear assets, Energex and Ergon Energy would potentially be required to report on each kilometre of cable scheduled for replacement (currently approximately 325km for Energex and approximately 500km for Ergon Energy).

Energex and Ergon Energy therefore recommend that:

- the cost threshold be increased to at least \$200,000 to avoid unnecessary reporting of individual assets; and
- reconductoring be reported at a “program” level only to avoid reporting separately on a “per kilometre” basis.

We also recommend that the requirement to report by “calendar year” should be amended to “financial year” to align with other existing reporting obligations.

2.4 System limitations template

As the AEMC will be aware, the AER is currently consulting on a system limitations template which is to be included with future annual planning reports. In this regard, it should be noted that the drafting of the final rule and the application to replacement programs of a cost threshold, which will either result in grouping or separate reporting of individual assets, may potentially lead to a significant reporting burden in the system limitations template. Specifically, the expected level of detail required for each system limitation, as currently proposed by the AER, cannot be provided for individual assets within a distribution program without a substantial burden on resources. While it is anticipated that the AER will limit reporting requirements to the zone substation level and to the primary feeder level (where available and subject to confidentiality constraints), certainty in this regard will only be possible following the AER’s final decision on the template requirements.

Energex and Ergon Energy are cognisant that the system limitations template will be published prior to this final rule, and we therefore recommend that the AEMC undertake a careful review of the overall annual reporting obligations to ensure that the regulatory compliance burden resulting from this rule change is minimised and that the information is reported in a manner that will be of benefit to non-network providers and energy market stakeholders.

3 REGULATORY INVESTMENT TESTS

The draft rule extends the current distribution and transmission regulatory investment tests to network replacement expenditure decisions. Specifically, the draft rule:

- extends the regulatory investment tests to replacement and refurbishment expenditure;
- excludes maintenance expenditure from the regulatory investment test process;
- provides that the capital cost thresholds that currently apply to augmentation projects are to apply to replacement and refurbishment projects; and
- allows for the current dispute resolution arrangements to continue to apply without amendment.⁷

Energex and Ergon Energy support the rule change's overall aim of extending the regulatory investment test to increase transparency in investment decisions. However, while supportive of the proposal to extend the regulatory investment tests to major network replacement projects that exceed the cost threshold where there may be potential alternatives to like-for-like replacement, such as feeder replacement or substation refurbishment, we are of the view that further consideration is required with respect to the application of the regulatory investment test to replacement programs.

3.1 Application of the regulatory investment test to replacement programs

It is noted that the draft rule determination does not exclude replacement programs involving multiple assets of the same type across more than one location from the regulatory investment test process and that, for the purposes of determining whether the cost threshold is met, replacement assets that address the same identified need are to be considered together.⁸ Further, the regulatory investment test is to be applied to those replacement programs regardless of whether or not there is likely to be a viable alternative to like-for-like replacement. The AEMC considers that the regulatory burden of undertaking the regulatory investment test where there is no credible alternative to like-for-like replacement will not be significant.⁹

However, Energex and Ergon Energy recommend that the regulatory investment test should only be applied to individual replacement projects and that assets which form part of a replacement program should be excluded from the regulatory investment test process. We remain of the view that there is little value in extending the application of the regulatory investment test to replacement programs, particularly where it is acknowledged that there is unlikely to be a commercially and technically feasible non-network solution to address these, e.g. poles, cross arms, protection systems and circuit breakers.

⁷ AEMC, *Draft rule determination*, p.51

⁸ *Ibid*, p.55

⁹ *Ibid*, p.54

The AEMC's position that the additional regulatory burden is unlikely to be significant is, in our view incorrect, as significant administrative effort will be involved in undertaking a regulatory investment test process regardless of whether or not it is determined that there is a potential credible non-network option to address the identified need. We estimate that the requirement to apply the regulatory investment test to replacement programs would result in between 20-25 regulatory investment test processes for each business annually. Therefore, Energex and Ergon Energy do not consider it reasonable to impose additional compliance costs on network service providers where there is little likelihood that the process will yield a viable alternative solution.

It is our view that the additional annual reporting requirements will provide sufficient transparency of network asset replacement decisions to enable non-network providers to identify potential opportunities that can be explored further with network service providers.

4 TRANSITIONAL ARRANGEMENTS

In its draft rule determination, the AEMC has proposed the following steps for implementation of the final rule:

- application of the new annual planning report requirements by DNSPs in their next scheduled annual planning reports; and
- commencement of the new regulatory investment test requirements on 1 July 2018, following publication by the AER of the new regulatory investment test application guidelines by 31 December 2017.¹⁰

The proposed implementation steps are contingent upon the AEMC publishing the final determination and rule in July 2017.

Energex and Ergon Energy are generally supportive of the draft transitional arrangements, with the exception of the proposed commencement of the new annual planning report requirements in 2017. Further consideration is also required with respect to the exclusion of “committed projects” from the new regulatory investment test process.

4.1 Application of the new annual planning report requirements

Distribution businesses in Queensland are required to publish their 2017 annual planning reports by 30 September 2017 (in accordance with clause 2.2.1 of the Queensland Electricity Distribution Network Code), which is earlier than other DNSPs who will publish their annual planning reports by 31 December 2017. If the AEMC makes its final rule determination in July 2017 as proposed, Energex and Ergon Energy would have difficulty in complying with the new reporting obligations within such a tight timeframe. We therefore request that the application of the new annual planning report requirements be delayed for Queensland DNSPs until September 2018 to allow sufficient time for compliance.

4.2 Commencement of the new regulatory investment test requirements

Energex and Ergon Energy are supportive of the AEMC’s proposal for the new regulatory investment test requirements to commence within six months of the publication of revised regulatory investment test application guidelines by the AER. While a 1 January 2019 commencement date would be preferred, a six month implementation timeframe should allow sufficient time for network service providers to implement new processes and account for and reschedule planned works to accommodate the necessary regulatory investment test timeframes where necessary.

¹⁰ *Ibid*, p.70

Our planning processes are programmed 12 to 18 months in advance. A regulatory investment test process is expected to take approximately six months and could extend up to 18 months if it is necessary to undergo the process in its entirety. As existing planning and scheduling does not include an allowance for a regulatory investment test to be carried out, any projects that might be subject to the new requirements after the proposed implementation date would therefore be suspended until the process has been completed. For example, if a current project was significantly progressed but not eligible for exclusion from the new obligations upon commencement of the final rule, it would be delayed by at least six months (and possibly up to 18 months) while the regulatory investment test process is undertaken. This delay would potentially result in:

- contractual consequences and costs for the duration of the delay period;
- internal resources intended to be employed on the project being unproductive or diverted and dispersed;
- capital expenditure funding and borrowing schedules and plans being jeopardised, resulting in financing inefficiencies; and
- flow-on effects upon future program of work construction schedules.

Accordingly, a reasonable timeframe must be allowed for network service providers to develop the processes and procedures commensurate with the new regulatory investment test obligations, and also to account for and reschedule works to accommodate the necessary timeframes. As noted above, an earlier commencement date would potentially result in project delays and have financial, contractual, resourcing and program of work scheduling impacts. Therefore, we do not support a commencement date any earlier than that proposed in the draft determination, i.e. 1 July 2018.

Energex and Ergon Energy also endorse the proposal for replacement projects that have been “committed to” by a network service provider prior to the commencement date to be excluded from the regulatory investment test process. Energex and Ergon Energy consider that all projects that have already gained financial approval or are significantly progressed (i.e. where detailed planning and design has commenced and, in some instances, where long lead time assets have been procured) should be excluded from the requirement to be assessed in accordance with the new obligations. We consider that network service providers are best placed to determine whether a current project has progressed to a stage where it should be excluded from the new process.

Energex and Ergon Energy would also support consideration of a similar transitional arrangement to the one that was applied when the regulatory investment test for distribution was introduced in 2014 where DNSPs submitted a list to the AER of current projects that should not be subject to the new regulatory investment test process.