6 June 2017

replacement expenditure planning arrangements

APA response to AEMC draft rule determination

energy. connected.

Contents

1 Summary

APA is the operator of the Murraylink and Directlink interconnectors. It is in this capacity that we respond to the AEMC's draft determination.

APA does not agree with the draft view of the AEMC that the NEO is best served by the inclusion of all replacement and refurbishment expenditure in the regulatory investment test regardless of whether there are any potential network or non-network alternatives.

APA proposes that, with some modifications, the AEMC implements the AER's proposal to have a mechanism that exempts from the requirements to undergo a Regulatory Investment Test those replacement and refurbishment capital expenditure projects that have no viable alternative.

APA is of the view that avoiding the unnecessary customer costs associated with a Regulatory Investment Test process with no identified benefit is consistent with the promotion of the National Electricity Objective.

2 Administrative burden of the RIT-T

APA's main concern with the AER's draft rule determination is that it will require a Regulatory Investment Test – Transmission (RIT-T) to be undertaken for projects where a RIT-T will provide no benefit to consumers either in the long or short term.

An example based on an actual project highlights the flawed nature of the AEMC's analysis of this issue.

Directlink is undertaking a replacement of their control and protection system. The control and protection system operates the equipment of the transmission line and converter stations. It also operates the protection systems that protect the station from damage.

This system is integral to the operation of the interconnector. In order to continue operation of the network there is no alternative to the systems replacement. It was forecast in 2013 to cost $13m. In this example most of the information a RIT-T process delivers is already in the public domain as it forms part of the revenue determination proposal.

If that project was to occur past 1 July 2018 then ElI (the asset owner) would have to pay their operator to produce a project specification consultation report (PSCR) and a project assessments conclusions report.

To produce a PSCR information will need to be created in a form that meets the requirements of the RIT-T consultation report. This will involve:

- Collection of relevant information[1]
- Someone familiar with the requirements of the RIT-T to prepare the PSCR
- A project costing to be undertaken by an experienced engineer[2]
- A due diligence on costings by a senior engineer

[1] This will be easier where the project has previously been included in a revenue determination proposal.

[2] Even where a cost forecast has been prepared for a revenue determination proposal it will still need to be updated as costs change over time.

- A review of the consultation document by a senior engineer to ensure no technical errors
- Approval of the asset owners management/board (this will have no additional marginal cost).[3]
- Work from public relations and IT to support the consultation.

In the DIrectlink scenario a lot of this information already exists in a single document because the project was part of the revenue determination proposal. It is estimated that it will cost customers $10,000 to $15,000 for the PSCR and an additional $5,000 or so for the project assessments conclusion report which given the nature of the project would be largely a repetition of the consultation report. Notably APA's cost estimate does not include the significant additional cost of external validation that some projects would require.

While some people may be tempted to compare these costs with network revenue and suggest they are insignificant such an approach demonstrates a flawed understanding of cost benefit analysis that lies at the heart of promoting the NEO.

This is for a small network with a requirement for relatively few engineering resources. Other networks with more complex projects could expect that cost to be higher as it would require additional resources to be devoted to the estimation and proofing.

Without having to undertake a project assessment draft report, if everything goes smoothly, the RIT-T process takes 15 weeks. This is compared to the proposed 15 days to obtain an exemption. In this consideration it is worth remembering the longer the delay in replacing the asset the greater risk of asset failure.

It also must be remembered that the RIT-T process distracts engineering resources from the important task of designing, constructing and managing the implementation of a solution.

[3] For networks where operation is outsource d sign off by the service provider's management would be required as a precedent to the Management/Board sign off.

Undertaking a RIT-T in these circumstances is particularly galling in relation to costs and delays as there is no benefit to the customer to even partially offset the greater cost and risk.

If the Control and Protection system had not been forecast at the time of the last revenue determination proposal then the requirements for additional resources from engineers and subject matter experts is likely to be in the $40,000 to $50,000 range.

This directly contradicts the AEMC's statement

> *"the regulatory burden of undertaking a regulatory investment test where a like-for-like replacement is the only viable solution is unlikely to be significant."*

As these figures suggest, the cost of undertaking an unnecessary RIT-T is not insignificant. There is a significant regulatory burden that the AEMC is imposing on businesses with the cost ultimately borne by customers. It is worth re-emphasizing – for no possible benefit for customers.

3 Exemption of "no alternative" replacement from RIT-T requirements

It is therefore more compatible with the NEO for the AEMC to include in its final rule an option for the AER to exempt some projects from the requirement to undertake a RIT-T.

Recognising the AEMC's concerns about a more sophisticated test because of concerns about administrative costs and complexity, APA is of the view that while its simple test will not exempt all projects that should be exempted it is better some projects be exempted from a RIT-T process that provides no customer benefit than the AEMC's approach where no project is exempt.

3.1 The proposed process

APA proposes the test:

"Is there an alternative to the replacement or refurbishment of the existing equipment with the same, or modern equivalent, equipment?"

Only in the circumstances that the answer is no is a RIT-T not required.

The addition of the words "or modern equivalent" is added to reflect that some equipment is replaced because it is obsolete therefore exact like for like replacement is not an option. However, the proponent will need to demonstrate that it is a modern equivalent to that equipment or a RIT-T will be required.

It is appropriate for the AER to be the decision maker on whether a project should be granted an exemption from the need to go through a RIT-T process.

While a public consultation will introduce delays, it is appropriate that other stakeholders have the opportunity to challenge a request for an exemption. A 15 working day objection period seems to provide an adequate balance with the need to provide people with the opportunity to put forward an objection and not overly delay the delivery of the project[4].

[4] Noting this is longer than the time period for interested parties to object to the AEMC expediting a rule change proposal which is meant to be a similar straight forward and obvious test.

After the consultation the AER makes a decision and issues a short statement as to why it has permitted or disallowed the exemption.

The AER should be required to keep a high level register of those projects that had been granted or denied an exemption.

3.2 The analysis

APA has the following observations about its proposed test.

3.2.1 Benefits of a simple test

In practice the RIT-T is not the only test that determines whether a project goes ahead. A project on a regulated network will only proceed if the network is confident it will be able to include the cost of that project in its regulatory asset base. This means the project is part of the public consultation that is part of the AER's consideration of the revenue proposal. So even if excluded from the RIT-T it is still subject to public consultation and must satisfy the requirements of the National Electricity Rules. This is still more efficient that including it in a RIT-T process.

The question of whether there are alternatives to replacement with similar equipment is much narrower, and therefore requires fewer resources, than whether a project satisfies a RIT-T. A RIT-T process, at its heart, is cost benefit analysis of competing options. This requires production of evidence as to the nature of the issue, possible costs and benefits associated with different proposed projects. An application for an exemption is a technical description of the issue and the solution. It should then be self-evident to an informed stakeholder that there is no alternative to that proposed. Returning to the Directlink example, anyone with an understanding of HVDC transmission networks knows there is no alternative in terms of the ongoing operation of the network to the replacement of the control and protection system when required. Other examples would be network control rooms and fire suppression systems.

The AER is prohibited from exercising its powers in an unreasonable manner, this introduces a reasonableness aspect to the test that is not necessary to explicitly spell out in the rules. Therefore, in answering that question the AER would not be permitted to include or exclude alternatives on an unreasonable basis. So the test does not need to be made more complex.

While some concerns have been expressed about the requirement for the AER to consult on an exemption introduces delays to the execution of the project. If the alternative is to be required to undertake a RIT-T on these projects the relatively short delay of an exemption process is preferable in terms of administrative costs and timing.

Concerns have also been expressed in terms of the possibility that networks may use an exemption process to somehow undermine the intent of the rule change to require networks to consider non network options. A test defined in the narrow way APA has set out leaves no scope for this to occur.

3.2.2 Stakeholder requirements

The AEMC raised a possible benefit that a blanket RIT-T requirement is that it creates a single process for consideration of replacement and refurbishment.

> *The draft rule extends the current NER framework to all potential replacement investments without any additional process that would only apply to some investments. Network service providers will use the same process for all replacement investments without having to identify which investments would meet the criteria for the exemption process.*

APA does not agree with the AEMC's suggestion that there is any; let alone significant, administrative savings in not "having to identify which investments would meet the criteria for the exemption process".

All regulated networks have, or have access to, regulatory specialists whose job it is to understand the requirements of the rules and the processes required. In light of this, the suggestion that an additional process for exemption would somehow prove to be problematic for networks to manage seems untenable.

While concerns about the resourcing of customer representatives are well known, it is not clear how the removal of a less resource intensive AER led exemption process in favour of the business led RIT-T process is likely to reduce customer representatives resource requirements or improve their ability to engage with the issues of asset replacement/refurbishment and non-network alternatives.

The AER's resource requirements will be limited given the narrow scope of the test. The obligation is on the requesting party to provide sufficient information to justify its exemption. APA also note the AER proposed a mechanism to exempt certain projects.

3.2.3 A register of decisions

The register will help inform proponents on their likelihood of success or failure. This will help publicise the precedent in the AER's decision making. This will lead to a reduction in the number of unsuccessful applications over time.

As the exemption test considers the nature of the project rather than its costs and benefits this means that precedent value can be established. This is not possible for a RIT-T process where the individual circumstances of each proposed project make it a unique evaluation. In the example provided, EII (the owner) will also have a very strong understanding of the likelihood of the Murraylink control and protection system being granted an exemption based on the decision on Directlink as the projects are the same for the purposes of the exemption test despite there being differences in cost, location and complexity of the two control and protection systems.

4 The AEMC's assessment framework

This proposal is compatible with the Framework that the AEMC has outlined for itself in its consideration of the rule change.

The AEMC has outlined their assessment framework as:

- *Transparency. Whether sufficient and relevant information about a network is available to enable non-network providers to engage with network service providers and propose feasible and credible alternatives to address network needs. In addition, information about a network may assist connection applicants make more efficient decisions about where and when to connect. Publicly available information regarding the investment plans for a network may also assist the AER in making its regulatory decisions and stakeholders to engage in regulatory processes. Information provision may therefore lead to more efficient network investment decisions.*
- *Technology neutrality. Whether the NER is sufficiently flexible to adapt to changes in technology over time and not stifle innovation and investment.*
- *Regulatory and administrative burden. That the administrative costs of any new regulatory requirements should not outweigh the benefits that may emerge from the application of those requirements.*
- *Clarity and certainty. Whether the requirements of the NER are clear and certain, enabling network service providers to comply with their obligations. In addition, whether the requirements support consistent network planning processes and provide certainty for investment into the future.*

The Commission has also considered the overall purpose of the planning and investment framework currently set out in the NER as well as its relationship with the incentive-based economic regulatory framework applied to electricity networks. (1)

The APA proposed exemption test is simple and requiring the proponent for the exemption to public justify why it deserves an exemption is transparent and enables stakeholders to participate.

Nor does it favour a technology. The criterion is that there not be an alternative to a replacement with similar equipment basis. By definition this means that the only viable technology is the one selected. Where a realistic alternative exists then the non-technology specific RIT-T would be required.

It significantly lowers the regulatory and administrative burden that the AEMC's current draft rule determination imposes.

As noted above the effect of precedent will produce greater certainty for businesses as time progresses.

A narrow exemption is consistent with the outcomes the AEMC is seeking to achieve with the broader policy.

Most importantly the reinstatement of an exemption framework is consistent with promoting the NEO.