

5 June 2016



Ms Meredith Mayes
Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

Dear Ms Mayes

AEMC draft rule determination—Replacement expenditure planning arrangements

SA Power Networks welcomes the opportunity to comment on the AEMC's draft determination on the rule change proposed by the Australian Energy Regulator (AER)—*National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2017*. Our views on the key features of the AEMC's draft determination are as follows:

- The additional reporting to be required in Distribution Annual Planning Reports (DAPR) is not supported as drafted. To avoid reporting large volumes of information of no benefit to third-parties looking to propose alternative solutions to our network needs, distributors should only be required to report individual asset replacements above a cost threshold of \$300,000;
- The extension of the Regulatory Investment Test for Distribution (RIT-D) to network asset replacements is supported providing the AEMC maintains key aspects of the RIT-D process as reflected in its draft determination. These include maintaining current: RIT-D eligibility criteria; distributor discretion on what comprises a project, a work programme, a network need, and network needs with viable alternatives; and, thresholds for determining projects needing either a draft and/or a final assessment report; and
- To transition to the new RIT-D arrangements, a commencement date of 1 July 2018 represents the earliest feasible date that will allow distributors sufficient preparatory time. Further, requiring compliance with the new DAPR requirements in the next scheduled DAPRs (2017) is only feasible should the AEMC accept our proposed cost threshold for assets needing reporting.

We also comment on other discrete issues with the AEMC's drafting amendments.

Reporting asset retirement and de-rating information in DAPRs

Network constraints

The AEMC proposes that distributors report on their anticipated asset retirements and asset de-ratings but that reporting of de-ratings is only required where these would result in a network constraint. The AEMC should clarify:

- Why the condition of only having to report asset de-ratings if they would result in a network constraint, is not also relevant to asset replacement; and
- What relevance the AEMC places on whether de-ratings or replacements result in network constraints. Ideally this should refer to situations resulting in a material network limitation.

Key information requirements

As a network business wanting to provide efficient solutions to customers as to the new and innovative ways in which they want to use energy, we see value in providing good network information to the market. We prefer to work collaboratively with stakeholders to identify targeted information needs rather than have these rigidly prescribed in regulation and becoming outdated.



If a regulatory approach is adopted by adding to DAPR requirements, this must better target information of genuine value to third-parties. In our view, a threshold of \$300,000 applying both to individual asset replacements and replacements within multi-asset projects (i.e. programmes) is the minimum required to better balance the potential costs and benefits of reporting. This is noting that:

- The AEMC proposes that distributors report on each individual asset replacement and de-rating forecast over five years, with allowance only provided for bundling asset replacements into reported multi-asset projects under certain conditions (i.e. each asset costs less than \$100,000);
- A cost threshold is not only relevant to multi-asset replacement projects, but arguably even more so to reporting of individual asset replacements. As the requirements are currently drafted, SA Power Networks might potentially have to report on circa 150,000 individual asset replacements over the five-year period. For example, the annual volume of asset replacements in 2015–16 was approximately over 20,000¹ which we anticipate to potentially increase to over circa 40,000 by 2020. It must be recognised that distribution networks are unlike transmission networks and the same reporting approach cannot simply be transferred from transmission;
- As covered in our submission to the AEMC's earlier consultation paper, the vast majority of our asset replacements will comprise of low-cost individual asset components such as individual poles, pole-top structures and switchgear.² Further, the vast majority of asset replacements are highly unlikely to have any viable alternatives to like-for-like investment. This includes both low value assets such as individual poles, and higher value assets such as zone substations, distribution switchboards and sub-transmission switchgear;
- An appropriate cost threshold could materially decrease the number of individual assets that would need to be reported. For example, a threshold of \$300,000 applied to individual asset replacements would decrease the number of asset replacements we would need to report by over 90 percent. Low-value individual poles and asset components with no viable alternatives to like-for-like replacement would not need to be reported. Reporting would instead likely focus on the circa 50–100 asset replacements that are most material, some of which might theoretically have alternatives to like-for-like replacement (e.g. entire line replacements, substation transformers) although many might still not (e.g. switchboards); and
- To avoid reported information being potentially misleading to proponents of alternatives to network asset replacements, this information must be on the basis of the total cost of replacing an asset (i.e. cover all costs such as asset purchase and asset installation cost). The installation costs can be material and alter the comparative benefits of a network versus non-network option.

Also, with respect to a discrete drafting issue, we support the AEMC's proposal to re-draft the current NER clause pertaining to reporting of Information Technology (IT) assets so that it only targets assets associated with network management, rather than for administrative purposes such as payroll or billing systems.

Applying the RIT-D to network asset replacements

We accept extending the RIT-D to include network asset replacements. However, this is conditional on the AEMC not departing from its draft determination. The following must be maintained:

- The current \$5 million cost threshold for determining projects eligible for a RIT-D. This avoids conducting RIT-Ds for projects unlikely to have any alternatives to like-for-like replacements;

¹ This information is set out in our annual response to the AER's Category Analysis Regulatory Information Notice. Our 2015/16 RIN reports an annual replacement volume of approximately 20,000 asset replacements and approximately 19,000 kilometres of cable / conductor replacement which would represent hundreds of individual projects in addition to the 20,000.

² SA Power Networks, *Submission to AEMC consultation paper—Replacement expenditure planning arrangements rule change*, pp.2–3.



- Avoiding prescribing by way of the NER or an AER guideline, the type of assets which are or are not likely to have alternatives to like-for-like replacement, and what constitutes a programme versus a project.³ These decisions are subject to change as technology evolves and are matters of detail which are best managed by distributors in a reasonable and transparent manner;
- The same level of distributor discretion to determine the viability of alternatives to network asset replacements as currently exists for network augmentations;⁴
- The current cost thresholds for projects requiring public consultation on a Draft Project Assessment Report and preparation of a Final Project Assessment Report (over \$10 million), as opposed to projects which only need a Final Project Assessment Report with no consultation round (under \$10 million). Where we determine there are no viable alternatives to like-for-like replacement, there is little benefit in requiring lengthy reporting of these considerations and doing so would introduce significant, inefficient and potentially dangerous delays to distributor response timeframes. The cost thresholds are fundamental to avoid significant impost with no identifiable benefit. We note that the vast majority of our past asset replacements that had no viable alternatives to like-for-like replacement, were below the \$10 million threshold.
- Distributor discretion on the scope of a 'network need' that is to be subject to a RIT-D. In some cases, replacement works could span several years and if this work becomes subject to a RIT-D then this should only be required once for a multi-year replacement;
- Distributor discretion to not conduct any aspect of a RIT-D process where the network need is 'urgent and unforeseen'.⁵ As mentioned in our submission to the AEMC's earlier consultation paper, we would interpret this category of exclusion to include:⁶
 - Assets which have failed;
 - Assets which have failed but for which the reliability impacts might be unapparent at the time of replacing;⁷
 - Where unforeseen and unacceptable risks are identified upon inspection, for example, the potential for imminent asset failure or a breach of performance requirements;
 - Assets which deteriorate unexpectedly during the lengthy RIT-D consultation process such that it becomes urgent and / or unforeseen work; and
- Other current categories of exclusion from the need to conduct a RIT-D, albeit with the AEMC's proposed re-drafting to remove the word "refurbishment" and replace it with "maintenance of assets not intended to augment a network or replace a network asset". This better clarifies the nature of the current exclusion.⁸

An issue not addressed in the AEMC's draft determination is that of the costs to include in comparing network and non-network options as part of a RIT-D relating to a network asset replacement. Comparisons must be based on total project costs noting that:

- There will be costs in purchasing assets, installing assets and removing / disposing of network assets safely (unique to replacements as opposed to augmentations); and

³ Programmes are referred to in the AEMC's draft determination as being, "multi-asset projects".

⁴ We will publish a notice in situations where we deem there to be no viable alternatives to like-for-like replacement.

⁵ The NER allow an exclusion from having to conduct a RIT-D for "...urgent and unforeseen network issues..." NER clause 5.17.3(a)(1).

⁶ SA Power Networks, *Submission to AEMC consultation paper-Replacement expenditure planning arrangements rule change*, pp.2-3.

⁷ Examples could be where a neighbouring asset could temporarily take on some of the extra load from a failed asset.

⁸ The current exclusion is listed in NER clause 5.17.3(a)(6).



- The cost of removing / disposing of a network asset is likely to be material, particularly if the network asset requires specific environmental considerations (e.g. it contains a pollutant such as oil).⁹

Transition approach

RIT-D commencement

The AEMC's draft determination proposes that the new RIT-D requirements should apply on 1 July 2018.¹⁰ However, AEMC staff informally communicated to distributors a desire to reset the start date to 1 January 2018, with the latest communication now proposing a start date of September 2017. These latest proposed timeframes are unrealistic. The earliest feasible commencement date is 1 July 2018. Preparatory processes are needed in the lead up to initiating any RIT-D, including having sufficient time for the following:

- To provide information to stakeholders who might seek to engage with our RIT-D processes:
 - A common stakeholder complaint in relation to the RIT-Ds is that there needs to be more information disseminated much earlier and prior to a RIT-D commencing to allow adequate preparation for contribution of alternatives to network options.
 - Ideally, the new RIT-D requirements should only commence after at least one DAPR has been prepared / published in accordance with the new requirements. This would provide stakeholders with a more solid basis of information in anticipation of any RIT-D.
- To allow distributors to practically prepare for the new requirements by:
 - Determining any re-prioritisation of network activities / projects that might need to occur, as the possibility of having to conduct a RIT-D for a set of activities might alter the priority of these activities in our work schedules;
 - Considering any stakeholder engagement implications. We engage with our stakeholders on an ongoing basis. The possibility of having to initiate public processes in relation to RIT-Ds, might require us to reconsider the nature of our ongoing engagement so that our regular stakeholders adequately understand the drivers of these RIT-Ds;
 - Identifying how to re-direct funds to the conducting of RIT-D processes, as these represent new regulatory requirements for which we have not been funded; and
 - Undertaking sufficiently detailed elaboration of analysis behind the network need in question, to enable effective communication from the moment the public RIT-D process commences.
- To allow the AER to conduct a thorough, transparent and consultative process on any necessary changes to the RIT-D guideline and application guideline documents, noting that:¹¹
 - Changing these documents to extend their application to asset replacements might involve more than basic definition changes. For example, in this submission we have commented on the costs relevant to comparisons of network asset replacements with non-network alternatives; and
 - It would be inappropriate to circumvent the distribution consultation procedures, in considering changes to the AER's RIT-D documents. The AER might be able to change these documents in an efficient timeframe. However, there must be sufficient opportunity for distributors to contribute views and for the AER to consider and respond to these, consistent with the distribution consultation procedures.

⁹ All such costs need to be included in RIT-D comparisons and added to the cost of any non-network option as well.

¹⁰ This is, for projects not yet committed by the date of 1 July 2018.

¹¹ AER, *Final—Regulatory Investment Test for Distribution*, 23 August 2013; and AER, *Regulatory Investment Test for Distribution Application Guidelines*, 23 August, 2013.



The AEMC indicates that RIT-D eligible projects would not be subject to the new RIT-D requirements if these projects are “committed” by the chosen RIT-D start date. We are generally comfortable with the definition of “committed” currently set out in the AER’s RIT-D guideline.¹² Should the AEMC seek to amend this definition this needs to be subject to adequate consultation. A more basic interpretation of “committed” could be that a decision has been made by the relevant financial decision-making authority. In our business, depending on the project’s materiality, this authority might be a general manager, the chief executive officer or our Board. In all cases, the decision is reflected in internal documents by way of a decision pro-forma or business case document that is signed and approved.

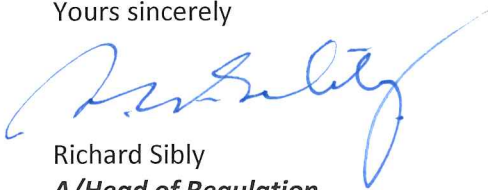
DAPR commencement:

The AEMC proposes that the new DAPR requirements apply to the next scheduled DAPR round (31 December 2017 for our business). In our view:

- Ideally, distributors should only comply with the new DAPR requirements in their subsequent scheduled DAPR (i.e. 31 December 2018 for our business) noting that:
 - We will not have certainty on new reporting requirements until the AEMC publishes its final determination later this year;
 - Sufficient time will then be needed to communicate these requirements within our business;
 - Resources will need to be reallocated to this new regulatory requirement, for which we have not been funded, and which will impose significant additional reporting burden;
- If the AEMC adopts our proposed reporting threshold (discussed earlier in this submission) then a 2017 start date would be more feasible; and
- If a 2017 start date is adopted in order to provide stakeholders with information ahead of any RIT-D commencing for a network asset replacement, then distributors should only be expected to employ their ‘best endeavours’ in complying with the new DAPR information requirements. It should be recognised that it might take time to resolve practical issues that could arise in complying with new reporting requirements.

If you wish to discuss any of our comments further, please contact Bruno Coelho on 08 8404 5676.

Yours sincerely



Richard Sibly
A/Head of Regulation

¹² Clause 22 of AER, *Regulatory Investment Test for Distribution*, 23 August 2013.

