Addressing key gaps in the regulatory investment test

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The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

The Energy + Water Consumers' Advocacy Program was established at PIAC in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council of NSW;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Good Shepherd Microfinance;
- Affiliated Residential Park Residents Association;
- Financial Rights Legal Centre; and
- The Salvation Army.

Introduction

The Public Interest Advocacy Centre (PIAC) welcomes the opportunity to comment on the Australian Energy Market Commission's (AEMC) consultation paper *National Electricity Amendment (Replacement expenditure planning arrangements) Rule 2016.*[1] The Australian Energy Regulator (AER) proposed the rule change to address limitations with the current distribution and transmission network planning and decision-making process.

The rule change proposes to strengthen reporting requirements in the Regulatory Investment Test (RIT) for both distribution and transmission. The RIT is a cost benefit analysis to identify the most appropriate investment option.[2] The proposed changes would require networks to conduct a RIT for replacement expenditure. Traditionally assets were replaced with a like-for-like rather than non-network or alternative solutions. Technology has changed in recent years and there are far more options when it comes to replacing ageing or damaged assets. PIAC supports the proposed rule change on the basis that it will encourage transparency and efficiency. We also call for the AEMC to consider extending the proposal, and outline our view below.

The lead author on this submission is Kristal Burry, Policy Officer.

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1 AEMC Consultation paper, *National Electricity Amendment (Replacement expenditure planning arrangements) Rule* October 2016.

2 Ibid 23.

Replacement expenditure

The AER identified that the following issues arise if replacement expenditure is not included in the planning and RIT process:

- there is no clear, transparent, consistent and timely planning process for the economic replacement of network assets,
- the framework provides limited requirement for network business to consider and assess alternatives for like-for-like replacement, and engage with non-network proponents,
- network users may not be aware of how the timing and location of their connections might affect network replacement decisions,
- the lack of transparency will make it difficult for policy makers to understand and assess the impact of the changing environment on network business asset management practices,
- it will make the assessment of revenue proposals more challenging as network replacement expenditure makes up a high proportion of revenue proposals and there is lack of detailed information on network replacements in APRs and no RIT assessments of major network replacement projects that would otherwise support their claims.[3]

There are large financial benefits to be gained by consumers from an increase in demand management and non-network solutions. For example, the AMEC found that the savings from peak demand reduction alone are between $4.3-11.8 billion over the next 10 years.[4] The RITs are an important tool in promoting the reduction in spending through demand management and non-network solutions. This is why we support the inclusion of replacement expenditure within the reporting framework.

In the past five years, the NSW networks have increased their regulated asset base (RAB) through capital expenditure to augment the system. The RAB determines a significant part of the regulated revenue the networks are able to receive. The networks have reached a limit on how much more augmentation can occur at the moment. In this context, consumer groups are concerned that the networks will use the replacement of assets as a means to further increase their revenue.

PIAC would like to see greater emphasis placed on alternatives to asset replacement, including life extension strategies or asset reuse (where an asset is moved to another location where it might be used for longer under a different load). Currently, there is no incentive for networks to extend the life of an asset. PIAC is concerned that assets could be replaced prematurely if more transparency in the decision making is not introduced. On this basis, we support the extension of the RIT to include alternatives to replacement.

Additionally, PIAC is of the view that this rule change should not be limited to replacement expenditure. There would be value in extending it to include non-load capital expenditure, such as ICT systems which serve a dual purpose. PIAC recommends that the AEMC assess the benefits of including non-load capital expenditure in the new reporting requirements.

3 AER *Request for rule change – Replacement expenditure planning arrangements*. June 2016, 11.
4 AEMC Final Report *Power of Choice Review – Giving consumers options in how they use electricity* 2012.

Recommendation 1

PIAC supports the AER's proposed rule change to include replacement expenditure in existing reporting requirements.

Recommendation 2

PIAC recommends that the new reporting requirements require the networks to investigate alternatives to replacement to extend the life of assets.

Recommendation 3

PIAC recommends that the AEMC assess the benefits of including non-load capital expenditure in the new reporting requirements.

Materiality threshold

The AER has not recommended changing the materiality threshold, which is the minimum dollar value that triggers the RIT process.[5] The current threshold is $5 million (distribution) and $6 million (transmission). This materiality threshold is designed to minimise regulatory burden by only requiring a RIT when the project is of significant value. This may be appropriate for the augmentation of the network which often requires large financial investments for activities such as building a substation. It is less appropriate for replacing assets, particularly if a non-network solution is used. To date no battery project has cost over $5 million. If the current materiality threshold is retained, the most common replacement options would never require a RIT.

Assets are also often not replaced in whole, but in stages or by incremental replacement of parts of the asset, which may mean these projects do not trigger the reporting requirement. If the goal is to encourage networks to adopt non-network solutions to ensure the least cost, then the RITs should also capture those alternative options.

PIAC recommends the materiality threshold for replacement expenditure to a range of $500,000 to $1 million. PIAC is aware that this may increase the regulatory burden for networks. One solution is a 'mini-RIT'. PIAC is happy to work with the AEMC and AER to design a modified RIT process that may reduce the regulatory burden, while still capturing smaller replacement expenditure and reaping the proposed benefits.

Recommendation 4

PIAC recommends the materiality threshold be reduced to capture non-network solutions and to better reflect the nature of replacement expenditure.

Recommendation 5

PIAC recommends the AEMC investigate an alternative or modified RIT process for smaller non-network projects

AER reporting guidelines

The rule change will require the AER to produce a network retirement reporting guideline.[6] PIAC welcomes the development of a guideline to assist both the AER and network participants to comply with the new rule. PIAC recommends that the AER use a prescriptive approach to

5 AER see above no 3, 18.
6 AEMC see above no 1, 9.

developing the guideline rather than a principles based approach. Given the guidelines are not binding, prescriptive guidelines will provide greater certainty and clarity for all participants. A principle based approach will provide too much discretion to the networks and will result in too much variation across the NEM in relation to reporting and transparency.

Recommendation 6

PIAC recommends the AER use a prescriptive approach to developing the reporting guidelines.

Exemptions

The rule change proposes to provide an exemption in the circumstances where there is no alternative to like-for-like replacement, with the requirement to publish a shorter exemption report.[7] PIAC cautions against any proposal that would allow networks to avoid providing additional or greater information through exemptions. There is already insufficient information in the market place for non-network providers to determine where they should be active. Allowing the networks to be exempt from reporting on projects further obscures where and if there are constraints in the system. In such cases, we recommend that a RIT should apply, but that consideration could be given to a modified or mini-RIT, as discussed above.

Recommendation 7

PIAC recommends that there should be no exemption in cases where a network cannot identify an alternative to a like-for-like.

Current RIT

There are limitations with the existing RIT process. The Productivity Commission conducted an assessment of the RIT-T process in 2013.[8] Other independent reviewers have also found issues with the process.[9]

The key limitation is the lack of independent oversight and assessment of the proposals. The AER has an administrative function and can only assess if the network has followed due process with the RIT. The AER does not analyse the effectiveness of the proposals.[10] The AER itself recognises that this hampers their ability to assess the RITs. The Productivity Commission recommended many of the changes in the rule change in 2013. In addition, they recommended that the AER be given authority to do a full assessment the merit of the proposal as they do with the revenue determination.[11] This would mean the RIT-T would become a full cost-benefit analysis. PIAC recommends that these changes be made to both the RIT-T and RIT-D.

The productivity commission also found that the current RIT-T is too narrow and does not require the network to consider gas transportation options, which may result in an inefficient energy generation mix and/or transportation of energy.[12] Given the interconnected nature of Australia's

7 AER see above no 3, 17- 18.
8 Productivity Commission *Electricity Network Regulatory Frameworks* 2013, 627 – 651.
9 Hugh Grant AER Consumer Challenge Panel advice on Transgrid's proposed demand management innovation allowance September 2014, 13-14.
10 Ibid, 14.
11 Productivity Commission see above no 8, 639.
12 Ibid 651.

energy generation portfolio, it would be sensible to ensure that networks are required to consider all energy generation mixes.

PIAC appreciates this may not be the appropriate forum for this issue, however, given there are a number of reviews in place, including a COAG review of the RIT-T process, PIAC considers it appropriate that the AEMC consider the broader context when making its decision.

Recommendation 8

PIAC recommends the AEMC work with COAG to ensure this rule change and concurrent reviews are aligned.

Local Generation Credit rule change

The Total Environment Centre, City of Sydney and Property Council of Australia recently sought a rule change in relation to local generation network credits. The AEMC's more preferable rule would require distribution networks to publish system limitation reports to supplement existing Distribution Annual Planning Reports (DAPRs). The AEMC claims that this will further enhance transparency in related processes such as this one.[13] PIAC supports the view of the Institute for Sustainable Futures that this is would result in the duplication of information already reported by the networks, including the voluntary reporting networks have done to contribute to the distribution opportunity maps.[14] It is not sufficient to rely on this proposed information provision.

The networks are required to submit their RITs and DAPRs to the AER. However, the AER does not provide a public repository of these documents. Instead participants and individuals must go to each network's website to find the right document. PIAC considers it would be a greatly preferable for the AER to collate these documents on its website.

Recommendation 9

PIAC recommends that the AER collate the RIT and DAPR documents in a central location on their website.

Conclusion

PIAC welcomes the AER's proposed rule change and supports the introduction of greater clarity and consistency in the reporting of asset replacement. This will facilitate greater uptake of non-network solutions and greater competition in the provision of these services, both of which are highly likely to benefit customers.

PIAC is also of the view that the rule change should go further to capture a number of issues beyond those raised by the AER. It is timely that COAG is reviewing the RIT-T, and it is an oversight to not review the RIT-D at the same time. The AEMC should take the COAG review into account in considering this rule change.

13 AEMC see above no 1, 9.
14 Institute for Sustainable Futures *Guidance on the draft determination on the Local Generation Network Credit rule change submission* October 2016, 8.