



# ***Major Energy Users Inc.***

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Australian Energy Market Commission  
PO Box A2449  
Sydney South NSW 1235

Provided by direct lodgment

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

The Major Energy Users (MEU) welcomes the opportunity to provide its views on the rule change proposed by the AER to improve the planning arrangements for replacement expenditure (repex) in electricity transmission and distribution networks.

The MEU notes that in the development of the transmission rules in 2006, it proposed that repex should also be subject to an investment test, although this was not included in the final decisions established by the AEMC at that time. The MEU therefore welcomes the re-opening of this issue.

## **About the MEU**

The MEU represents the interests of large energy consumers operating in the NEM and in other jurisdictions. The MEU comprises some 30 major energy using companies in NSW, Victoria, SA, WA, NT, Tasmania and Queensland. MEU member companies – from the steel, cement, paper and pulp, automobile, tourism, mining and the mining explosives industries – are major manufacturers in both the NEM and other jurisdictions and are significant employers. Being located in many regional centres including Gladstone, Newcastle, Port Kembla, Albury, Western Port, Mount Gambier, Port Pirie, Kwinana and Darwin, they are major employers in these regions.

Analysis of the energy usage by the members of MEU shows that in aggregate they consume a significant proportion of the gas produced and electricity generated in Australia. As such, they are highly dependent on the competition that applies to the provision of gas and electricity, the retail functions needed to

enable the competition to apply and to the transport networks to deliver efficiently the energy so essential to their operations.

Many of the members, being regionally based, are heavily dependent on local suppliers of hardware and services, and have an obligation to represent the views of these local suppliers. With this in mind, the members of the MEU require their views to not only represent the views of large energy users, but also those of smaller power and gas using facilities, and even at the residences used by their workforces that live in the regions.

### **The expectations of consumers**

The MEU notes that as a result of the formal consumer engagement requirements applying to networks, there are two overarching outcomes that consumers want from their networks – that prices need to be reduced and that current levels of reliability are seen as acceptable and that no increase in reliability is wanted<sup>1</sup>.

The very clear outturn of these two observations as they apply to the proposed rule change is that consumers see that amount of repex now being claimed by networks is too high and levels of repex and reliability seen in the past are acceptable.

### **The reality of capital expenditure**

The implication of the current approach to replacement expenditure is that (especially on a like for like basis) there should be an automatic acceptance that such capital expenditure is needed and therefore does not need to be justified with consumers expected to accept the costs involved.

From a regulatory point of view, there is an assumption that the cost to prepare a cost justification is an unnecessary administrative burden and should not be placed on a regulated firm.

In competitive industry (and probably within a regulated firm), capital is closely controlled and management requires justification for all capital expenditure, regardless as to whether it is to replace or augment the asset base. In reality, access to new capital is a major concern of a firm's board and close controls and delegation limits are placed on all capital expenditure. With this being the case, even a regulated entity will be required to develop a business case for internal control to justify whether the proposed capital (including that for replacement of

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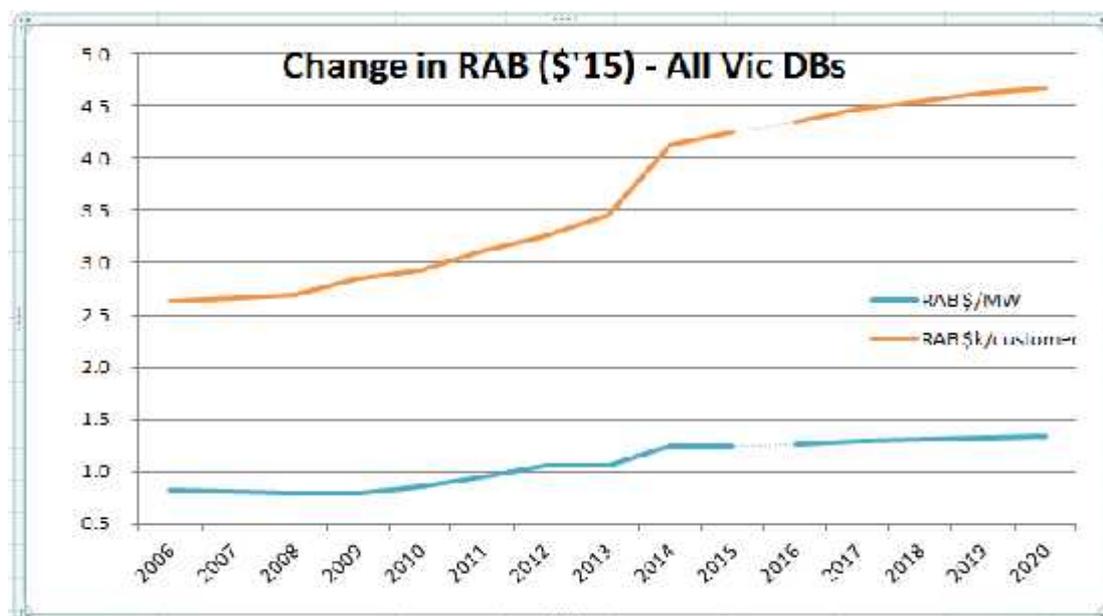
<sup>1</sup> The MEU also notes that consumers served by poorly performing feeders do want better reliability, but consumers so affected are generally in a minority, and the AER has allowed capex to bring these to a level similar to the reliability seen by the vast majority of consumers

assets) is needed, and if it is, what approach has been taken to limit the cost to the firm.

The MEU considers that all significant capital expenditure needs to be justified, regardless as to whether it is for augmentation or replacement. As the AER points out in its proposal, in this time of declining consumption of grid provided electricity and little growth in peak demand, networks have moved to significantly increase their repex claims, well above the levels they had considered necessary in the past.

### Control of the RAB is needed

The MEU is very concerned about the growth in the regulatory asset base (RAB) of the NEM networks over the past decade. For example, in the AER preliminary decision on the Victorian distribution networks, it was noted that the growth in the RAB in constant dollar terms relative to the numbers of consumers and the peak demand identified was continuing to increase and is forecast to nearly double in the fifteen years from 2006 to the end of the current regulatory period in 2020. This trend is exemplified in the following chart



Source: CCP3 report to AER preliminary decision

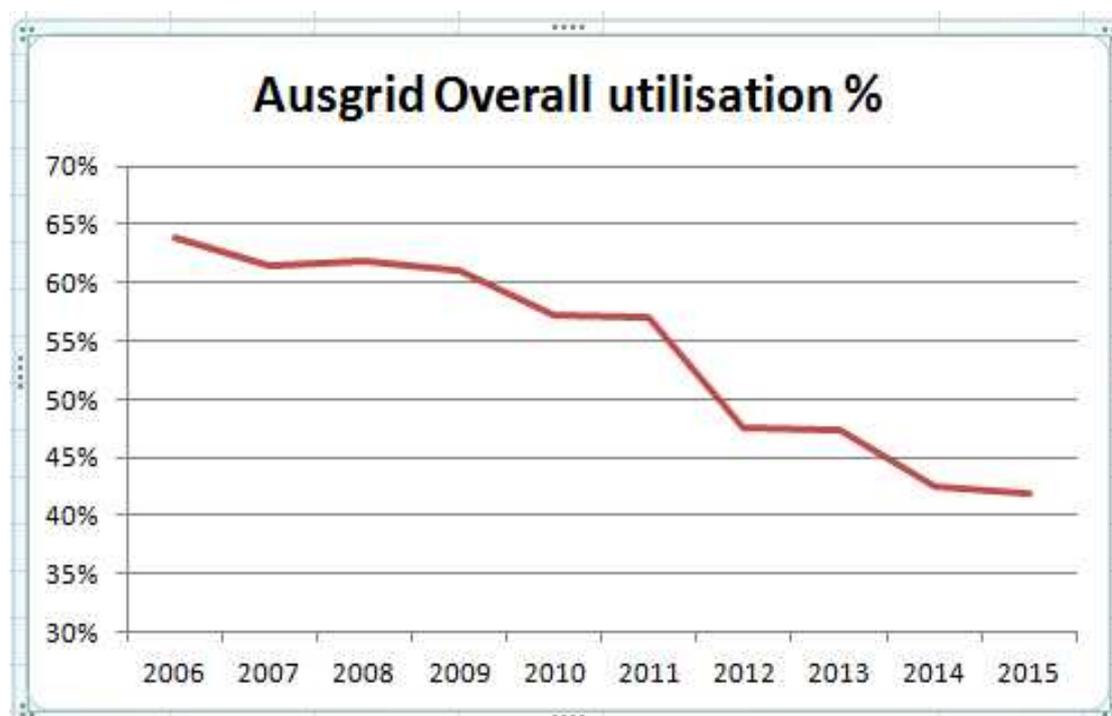
In that same report, subpanel 3 of the AER Consumer Challenge Panel (CCP3) noted that the proposed replacement expenditure had incurred a significant step increase from previous levels.

Repex \$m (\$'15)	2006-2010 RQM +50% ESL actual	2011-2015 allowed RQM + 50% ESL	2011-2015 Actual	Initial proposal 2016-20	AER Preliminary Decision	Revised proposal 2016-20
AusNet	\$270	\$552	\$687	\$901	\$758	\$804
CitiPower	\$205	\$300	\$153	\$260	\$199	\$260
Jemena	\$96	\$196	\$163	\$224	\$224	\$256
Powercor	\$314	\$558	\$443	\$722	\$609	\$672
United	\$146	\$350	\$406	\$585	\$424	\$564
<b>Total</b>	<b>\$1,031</b>	<b>\$1,956</b>	<b>\$1,852</b>	<b>\$2,692</b>	<b>\$2,214</b>	<b>\$2,556</b>

Source: CCP3 report to AER preliminary decision

In contrast, the amount of augmentation capex forecast was similar to that in previous periods. This means that the continuing growth in the RAB both in nominal terms and in relative terms is now being driven by the growth in the replacement capital expenditure. Similar trends have been observed across the NEM in the current set of regulatory reviews just being completed.

At the same time as the RAB is increasing in relative terms, the MEU also notes that the utilisation of network assets is falling across the NEM, in all regions. For example in the Ausgrid economic benchmarking reports, the overall utilisation of Ausgrid assets has fallen consistently for the past decade by about a third (from 64% to 42%) as the following chart shows.



Source: Ausgrid economic benchmarking reports

This same trend is observed in most of the other networks in the NEM. So what is becoming apparent is that RABs are increasing but being used less.

The impact of this massive growth in the RAB and falling utilisation is being muted by the current low cost of capital, but it is effectively providing a “time bomb” for future consumers who will be required to pay considerably more for assets they use less and less<sup>2</sup>. This outcome will drive consumers to undertake inefficient investments to address the high prices resulting from this inefficient use of capital investment in the networks.

While the MEU recognises that replacement of needed assets should be undertaken when the reliability of those assets falls to unacceptable levels and action needs to be taken to maintain reliability, the MEU is also aware that there should be an investigation to identify the lowest cost option to provide the required reliability. What the current approach imposes on consumers is the cost to replace assets regardless of other options which might achieve the same outcome but at a much lower cost.

## Summary

The MEU considers that the AER proposed rule change is long overdue and should be implemented. The MEU also notes that the NEM has changed significantly over the past 5 years and there is every expectation that such change will continue. With the burgeoning amounts of replacement capex being sought by networks in recent years, it is becoming quite apparent that the AER rule change proposal is even more necessary than when the MEU sought in 2006 for repex to be subject to a RIT process.

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](mailto:davidheadberry@bigpond.com).

Yours faithfully



David Headberry  
Public Officer

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<sup>2</sup> The MEU points out that it proposed a rule change in 2012 for network assets to be optimised to prevent consumers paying for assets that are either underutilised or not used at all, but the AEMC considered that optimisation was not in the long term interests of consumers. The MEU begs to differ.

***The MEU notes that the responses to the specific questions need to be seen in context with the comments made in the foregoing part of this response to the discussion paper***

#	Questions for stakeholders	MEU response
1	<p>a) Are non-network solutions a viable alternative to replacing network assets on a like-for-like basis?</p> <p>b) How does this differ from the potential for a non-network solution to provide a viable alternative to augmenting the network?</p>	<p>Yes. Further, even if a network solution is identified to be the lowest cost option, the replacement could take a different approach to just a like-for-like replacement. For example, another network solution might be for a supply from another source, or a combination of a number of actions, including some non-network solutions and some alternative network solutions. Until an investment test is implemented, there is little knowledge as to what else might be implemented</p> <p>The MEU does not see much difference in the process although the final arrangement might be different. What the proposal is doing is to identify alternatives to a “straight” replacement option</p>
2	<p>a) Are the current annual planning reporting requirements in the NER relevant and likely to be useful for replacement expenditure?</p> <p>b) If any, where are the gaps in the current annual planning reporting requirements in the NER for replacement expenditure?</p>	<p>No. The APR needs to be expanded to specifically identify those parts of the network that might need to be replaced and that the network is seeking options to consider as part of a solution to limit the need for repex. Specifically, a slightly reduced reliability outcome (eg from extending the life of the existing assets) might allow a lower cost option to conventional repex, not unlike what is already seen when considering augex.</p>
3	<p>a) What do NSPs currently do to plan for asset replacement in practice?</p> <p>b) To what extent does this address the perceived problems identified by the AER?</p>	<p>The MEU is concerned that the current practices do not impose the effects of competition on NSPs and mere replacement is the “easy option”. As noted in the introduction, the MEU is concerned about the burgeoning RABs, and having to be active in seeking alternatives imposes a discipline that is the essence of</p>

		competition.
4	<b>To what extent would the proposed information to be reported in the APRs be useful for energy market stakeholders, including non-network service providers, network service providers, connection applicants and the AER, and why?</b>	Any information provided has the potential to increase the efficiency of the delivery of service. The MEU is aware that many end users of the networks are looking at options to reduce the costs of their energy. When it is recognised that the cost of electricity transport is the single largest element in the cost of delivered energy, end users and other stakeholders being able to take actions to reduce the cost of delivered energy is a significant step forward. There is already significant activity to increase the ability of consumers (and other stakeholders) to be involved in the energy supply chain (eg the Power of Choice program) and being able to influence the cost impact of repex is just another aspect of empowering consumers.
5	<p><b>a) Is it appropriate that the scope of the new reporting requirements include planned asset de-ratings as well as planned retirements?</b></p> <p><b>b) To what extent does this add to the administrative burden for NSPs?</b></p>	<p>Yes. This information is just as necessary as any other information to assess a network investment program. Not to provide such information results in only half the story being provided to consumers and other stakeholders for them to implement appropriate actions.</p> <p>The MEU considers this does not add significantly to the administration of the network assets. If an NSP is acting responsibly, then it should already have this information as it is part of a “normal” capital expenditure program. Including the information in a report is a straight forward and low cost action</p>
6	<b>a) Should all assets be reported on by NSPs in their annual planning report or are only certain asset types relevant?</b>	All assets are used to provide the service, so all assets should be reported on. However, just as some assets are combined to provide the actual service, there could be groupings of assets that are impacted by the repex program that could

	<b>b) What types of asset should be subject to reporting requirements by NSPs and what should not?</b>	be reported on as a group. Equally, there may be classes of assets that might not require the same level of reporting, but these should be the exception but such exceptions should require acceptance by the regulator to be excluded.
<b>7</b>	<p><b>a) Is the proposed AER network retirement reporting guideline the appropriate means of requiring NSPs to report on certain asset types and not others or would an alternative mechanism be more appropriate?</b></p> <p><b>b) If an AER guideline is appropriate, what should it contain and how should the AER be guided in its development?</b></p> <p><b>c) In addition, what would be the appropriate process be to make and review an AER guideline?</b></p>	<p>As noted in Q6, there may be some assets that might be exempted from reporting, and these could be treated in a different way. The development of a guideline by the AER would provide stakeholders the ability to provide input on those assets where an exemption might be appropriate.</p> <p>This should be decided in the development of the guideline where all stakeholders (including consumers) have the ability to provide input</p> <p>This should be the same as for other guidelines developed by the AER. The MEU does not consider there should be different classifications of guidelines</p>
<b>8</b>	<p><b>a) Should the AER guideline also set out principles and a broad approach that NSPs must follow in deciding whether to plan to retire assets?</b></p> <p><b>b) What should these principles and the broad approach be?</b></p>	<p>Yes</p> <p>This should be decided in the development of the guideline where all stakeholders have the ability to provide input</p>
<b>9</b>	<b>Compared to the current arrangements, how much additional reporting by NSPs would be</b>	While there will be additional information provided in the NSP reports, the MEU considers that the NSP should already have this information to hand so

	<b>required under the AER's proposal? What would be the impact on NSPs?</b>	incorporating it in a report should not be onerous.
<b>10</b>	<b>Will extending the regulatory investment tests to replacement capital expenditure benefit energy market stakeholders, including non-network service providers, network service providers and the AER, and why?</b>	Yes. It will be useful to consumers too (both current and future), as it should reduce capital expenditure and thereby reduce the RAB. It needs to be remembered that some end users will also be providers of non-network solutions and this might be a way of them reducing their energy costs.
<b>11</b>	<b>Should the regulatory investment tests also apply to maintenance and refurbishment expenditure or should these categories of expenditure continue to be exempt from the tests?</b>	Yes. The MEU cannot see any reason to exclude these costs from a RIT. If the costs for the work exceed the lower limit set for a RIT, then they should be costs that are demonstrably the lowest that they can be.
<b>12</b>	<b>Should the cost thresholds for asset replacement projects be the same as cost thresholds for network augmentation projects?</b>	While the MEU considers the current thresholds for the augex are too high, it also considers there should be consistency in application of a RIT across all types of capex. However, the MEU considers there is potential for NSPs to game the system for repex by making such work a number of small projects when they are in reality only one project. The MEU considers the AER could address this issue in the development of the proposed guideline.
<b>13</b>	<b>Is it appropriate for a regulatory investment test to not be required where an NSP considers a like-for-like replacement of the asset is the only option to address the problem?</b>	To gain an exemption from a RIT, the NSP should have to prove that there is no viable alternative for like-for-like. However, in a market experiencing falling consumption, flat demand and falling utilisation, the MEU considers that it would be an unusual circumstance where the only option for repex is like-for-like.
<b>14</b>	<b>a) Is the proposed requirement for NSPs to</b>	Yes. The requirement to publish a report provides an opportunity for consumers

	<p><b>publish an exemption report where there is no alternative to like-for-like replacement appropriate?</b></p> <p><b>b) Do the benefits of this mechanism outweigh the administrative costs that it may impose?</b></p> <p><b>c) Is there an alternative mechanism which would be more appropriate?</b></p>	<p>to challenge the assumption and even for other stakeholders to be aware of the proposal and provide an alternative that the NSP might not have considered.</p> <p>The MEU considers the administrative costs will be small when it is considered that the NSP has already had to prove to the AER that an exemption is being sought.</p>
<p><b>15</b></p>	<p><b>a) What information should NSPs be required to provide in an exemption report?</b></p> <p><b>b) Is it appropriate that an NSP has to provide a summary of an exemption report to AEMO within five business days and to interested parties, on request, within three business days?</b></p> <p><b>c) Do stakeholders agree that AEMO must publish the exemption report on its website within three business days?</b></p>	<p>The same information that the AER requires to assess whether an exemption is not unreasonable</p> <p>The purpose of publishing the report is to give notice for potential providers or opponents of a proposed repex to provide their views on the proposal that an exemption is to be granted. Failure to give others opportunity to provide input does not guarantee the most efficient outcome. The MEU considers that the timelines are not unreasonable</p>
<p><b>16</b></p>	<p><b>a) Is it appropriate that parties can raise a formal dispute with the AER on the conclusions of an exemption report published by an NSP?</b></p> <p><b>b) Is 30 business days, as proposed, the appropriate timeframe for allowing</b></p>	<p>To not allow stakeholders the opportunity to dispute an AER decision is unacceptable. There must be a dispute mechanism provided in the process. The ability to initiate a dispute is an essential step in good regulatory practice.</p> <p>There should be consistency across all dispute processes, so the MEU</p>

	<p><b>interested parties to raise a dispute with the AER?</b></p> <p><b>c) Is 31 business days after publication of an exemption report the appropriate timeframe for an NSP to wait to undertake a like-for-like replacement where no dispute is raised?</b></p> <p><b>d) If an exemption report is determined by the AER to be non-compliant, should the NER explicitly exclude an NSP from being relying on the report to carry out a like-for-like replacement?</b></p>	<p>considers that the timelines should be as for other disputes stakeholders have with AER decisions.</p> <p>If no dispute is initiated then the project should be allowed to proceed. If there is a dispute, the project should not proceed until there is resolution of the dispute. Once the dispute is resolved, the project should be allowed to proceed immediately.</p> <p>Yes. There must be compliance before a project can proceed</p>
<p><b>17</b></p>	<p><b>a) Would AEMO or AusNet Services be the most appropriate body to report on the proposed additional annual reporting requirements at the transmission level in Victoria and why?</b></p> <p><b>b) Would AEMO or AusNet Services be the most appropriate body to apply the RIT-T for replacement expenditure in Victoria and why?</b></p>	<p>It is AusNet Services that implements repex, so it should be responsible for meeting the requirements of this rule change. If there are elements of the Victorian transmission network that are not owned by AusNet, then it is the owner of the assets that has to comply with the requirements applying to the repex RIT-T</p>
<p><b>18</b></p>	<p><b>a) Are the additional changes proposed by the AER appropriate and useful to stakeholders?</b></p>	<p>Yes.</p>

	<p><b>b) What compliance burden would arise for NSPs?</b></p> <p><b>c) As these requirements currently apply in a limited way in the NER, how useful have they been to date?</b></p>	<p>The MEU sees little costs would eventuate</p> <p>Even if there was no apparent benefit, the MEU considers the that the increased transparency provides a benefit of itself, as well as a form of discipline on NSPs.</p>
<b>19</b>	<p><b>What transitional arrangements should be put in place to allow NSPs and the AER to be able to comply with the proposed rule if it were to be made?</b></p>	<p>The MEU considers that the changes can be implemented immediately and should be – no transition is necessary. Consumers want to see the benefits of the rule change now.</p>

