NATIONAL ELECTRICITY AMENDMENT (REPLACEMENT EXPENDITURE PLANNING ARRANGEMENTS) RULE CHANGE REQUEST

Response to the Consultation Paper

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Executive summary

Energy Networks Australia welcomes this opportunity to respond to the Australian Energy Market Commission's (AEMC's) Consultation Paper on the National Electricity Amendment (Replacement expenditure planning arrangements) rule change request published on 27 October 2016.

Energy Networks Australia is the national industry association representing the businesses operating Australia's electricity transmission and distribution and gas distribution networks. Member businesses provide energy to virtually every household and business in Australia.

It is understood that the Australian Energy Regulator (AER) has two key concerns with the existing regulatory framework. First, that there is a lack of transparency concerning network asset replacement decisions by network service providers (NSPs). Second, that the current exclusion of replacement capital expenditure from the regulatory investment test (RIT) may create a bias against the consideration of non-network alternatives to 'like-for-like' replacement of network assets. In particular, the AER cites increasing alternatives to 'like-for-like' network asset replacement due to technological changes that are taking place.

Energy Networks Australia concurs with the AER on the nature of changes in the external environment and supports the intent of the rule change to increase the transparency and level of consultation in relation to network asset replacements.

In the interests of achieving a rule change outcome that is both reasonable and practical to implement, the AEMC will need to strike an appropriate balance between the additional regulatory burden placed on NSPs and the ongoing need to ensure that network investments are subject to a robust and comprehensive assessment. It is also important that any potential changes that may result from this consultation do not have a detrimental impact upon an NSP's ability to deliver timely investment to meet its reliability and other obligations.

Within this context, the Energy Networks Australia has proposed a number of suggestions to ensure fitness for purpose and that there is greater clarity in the scope of the proposed new requirements.

Energy Networks Australia also draws the AEMC's attention to considerations which impact on the nature and degree of additional obligations that may be required under a rule change. These are:

- Limited alternatives for replacement investments;
- Off-network solutions would sit outside the coverage of the *National Electricity Rules* (NER); and
- An extensive suite of existing mechanisms and safeguards

Energy Networks Australia would welcome the opportunity to work collaboratively with both the AEMC and AER to achieve an outcome that meets the *National Electricity Objective*. Energy Networks Australia encourages the AEMC to hold a stakeholder workshop to focus on the matters raised in stakeholder submissions and the identification of any unintended consequences of the rule change proposal. Such a workshop should take place prior to the draft determination.

In the longer term, and in the context of an industry that is under transformation, there may be scope to apply alternative, less costly regulatory arrangements which may better satisfy the needs of market participants. For example, pricing and incentive frameworks will allow for orchestration of distributed energy resources and information solutions such as the Institute of Sustainable Futures' Networks Opportunity Maps, may reduce the relevance of, or need for this particular form of regulatory intervention. For this reason, Energy Network Australia supports the inclusion of a review trigger in the event of a final rule change, to

reassess whether such changes remain relevant and justified.

Overlapping rule change requests

The AEMC is currently assessing a number of rule change requests which may result in changes to network planning arrangements. These include rule change requests on:

- local generation network credits;
- transmission connection and planning arrangements;
- alternatives to grid-supplied network services;
- the contestability of energy services; and
- the contestability of network services – demand response and network support.

In addition, a range of COAG Energy Council working papers relating to some of the issues above (such as treatment of off-grid energy solutions) are currently being progressed for further policy action.

Energy Networks Australia suggests that a holistic assessment of the full range of related issues that fall under the AEMC's direct responsibility is required. Otherwise there is a risk that a series of overlapping incremental and piecemeal reforms will be applied, and potentially forgo the opportunity to progress more enduring 'structural' solutions to underlying issues.

Workable and effective rule

Energy Networks Australia notes that the AER's rule change proposal seeks to support the efficient development of electricity networks and providing greater transparency to, and information on, network planning activities and NSPs decision making processes.

Members of Energy Networks Australia support the RIT principles of a robust and comprehensive project assessment as good regulatory practice, and follow these principles in their investment decision-making.

It is our view that reliance on incentive-based regulation to encourage network businesses to make efficient investment and expenditure decisions is preferable to prescriptive rule-based solutions. However, it is also recognised that where a network-led solution represents the best way forward, greater transparency may be required to establish and preserve confidence in the market that all technical and economically-feasible options have been properly examined.

In the interests of achieving a rule change outcome that is both reasonable and practical to implement, the AEMC will need to strike an appropriate balance between the additional regulatory burden placed on NSPs (the costs of which are ultimately borne by customers) and the need to ensure that network investments are subject to a robust and comprehensive assessment.

Energy Networks Australia makes the following recommendations directed at ensuring the workability and effectiveness of the proposed rule change:

- The meaning of 'like-for-like' replacement, needs to be clearly defined. In particular, it should be made clear that the replacement of an existing asset with a modern equivalent replacement asset falls within the definition of 'like-for-like'.
- The meaning and scope of asset 'de-rating' needs to be clarified for the purpose of reporting requirements. (It is currently assumed the scenario contemplated involves an NSP determining a technical need to de-rate an asset, which leads to the need for restoration of capability.)
- Any new obligations must be cost effective and fit-for-purpose, recognising the nature of network asset replacement. For example, it appears to be reasonable to limit reporting to those assets that have the greatest potential for being replaced by a non-network alternative.
- The rule change process should set the key principles for the regime and provide the appropriate guidance to the AER. It is not desirable for any material matters to be determined outside of the rule change process. This includes:

  - The need to clarify the scope of the exemption report to ensure a cost-effective outcome.
  - The need to clarify the scope of the AER's Network Retirement Reporting Guideline. The guideline represents a reporting mechanism and its scope should not seek to prescribe business and asset management practices of NSPs.

- Consistent with the AER's rule change proposal, the same thresholds should apply for replacement projects as to augmentation projects. Currently these are $6 million in transmission and $5 million in distribution.
- Caution is required in relation to possible delays and deferrals in finalising asset replacement decisions as a result of this rule change. There needs to be an appropriate criterion for exceptions to apply to the conduct of the RIT where critical plant or equipment failure has occurred and where service is at risk.

In the longer term, and in the context of an industry that is under transformation, there may be scope to apply alternative, less costly regulatory arrangements which have scope to satisfy the needs of market participants. For example, access to innovative, collaborative 'open source' solutions such as the Institute for Sustainable Futures' Networks Opportunity Maps, may reduce the relevance of, need for this particular form of regulatory intervention. For this reason, Energy Network Australia supports any final rule change containing a review trigger, to ensure its relevance.

Energy Networks Australia draws the AEMC's attention to the analysis undertake by Energeia as part of the development of the Electricity Network Transformation Roadmap. The analysis focused on future tariff and incentive reforms. Energeia found that appropriate incentives for networks to buy distributed energy resource outputs from customers would replace the need for augmentation and replacement of parts of the grid and reduce network costs by over $16 billion to 2050.[1]

Pricing and incentive frameworks to allow for the orchestration of distributed energy resource at a localised, dynamic level are likely to supersede legacy regulatory arrangements involving "tests" for future augmentation and replacement investment decisions.

As such, Energy Networks Australia recommends that the AEMC consider whether additional prescriptive processes are consistent with new directions in the industry and preferable to incentive frameworks for networks, and, accordingly, whether the arrangements proposed through the rule change request are in fact transitionary only. More attention should be placed on the regulatory arrangements which are required to allow for the transformation of the energy sector over the next decade which will be informed in part by the Electricity Network Transformation Roadmap being released next month.

Network Opportunity Maps

The Institute for Sustainable Futures (ISF) at the University of Technology Sydney (UTS) has developed an interactive set of maps to consolidate information on current and planned capacity constraints in electricity network infrastructure across Australia, based on network planning report data. The maps make it easier for NSPs, their customers, and proponents of non-network alternatives to develop a common understanding of the potential value of reducing peak electricity demand in different parts of the network.

The maps address an information gap by providing clear, consistent and timely information on network opportunities and constraints to renewable energy and demand management project proponents and others.

[1] Energeia, Unlocking Value for Energy Customers Enabling New Services, Better Incentives, Fairer Rewards, October 2016, p.5.

The maps visually present information about grid constraints and investment opportunities in a consistent and easily accessible format that was not previously available. They will help:

- the community and the emerging new energy service providers market to better evaluate opportunities to improve the operation of the grid;
- deliver better value and benefits to all electricity consumers through assisting in identifying where lower cost non-network options are possible; and
- network businesses to communicate with stakeholders about technical grid development plans in an accessible way.

The maps were developed under the guidance of a Strategic Reference Group which included representatives from:

- the Australian Energy Market Operator (AEMO);
- the Australian Energy Market Regulator (AER);
- the Australian Renewable Energy Agency (ARENA);
- the Department of Industry, Innovation and Science;
- Energy Networks Australia; and
- Individual network companies: TransGrid, Electranet, Ausgrid, Ergon, Energex and United Energy.

Energy Networks Australia has agreed to develop a guideline for future map updates, to allow NSPs to update the data annually, and which will include a data template.

Options for network replacement and regulatory framework

Energy Networks Australia draws the AEMC's attention to a number of considerations which impact on the nature and degree of additional obligations that are likely to be required. These are:

- Limited alternatives for replacement investments;
- Off-network solutions would sit outside the coverage of the NER; and
- An extensive suite of existing mechanisms and safeguards.

The limited alternatives for replacement investments

Energy Networks Australia provided a more detailed response to question 1 in the latter part of this submission. This question discusses viable non-network alternatives to replacing network assets on a like-for-like basis, as well as the important difference between augmentation and replacement expenditure. There are limited circumstances when non-network solutions represent a viable alternative to replacing network assets on a like-for-like basis unless the fundamental requirement of the network has changes. Also, these alternatives are more limited than for augmentation or new connections.

The RIT process contemplates a level of consultation and engagement around options to address network needs, which are positive features. In the context of network replacement, if this objective is to be achieved through the RIT, it is important to ensure that new obligations are cost effective and fit-for-purpose, recognising the nature of network asset replacement.

Off-network solutions would sit outside of the coverage of the NER

A further issue is that replacement of assets is necessary when there is an unacceptable risk of failure. The application of the RIT to asset replacement planning would therefore contemplate that the assets are removed from service, and potentially replaced by non-network solutions, such as microgrids.

Currently, there is uncertainty as to whether the distribution network component of a microgrid would fall outside of the current definition of 'distribution service' regulated by the AER under

Chapter 6 of the *National Electricity Rules*. This issue should be addressed as part of a wider review of the role and responsibilities of network businesses in those circumstances. This issue may become addressed through framework changes emanating from the COAG Energy Council current transformation work stream activity on stand-alone power systems.[2]

For example, the RIT process may provide an appropriate means for identifying when replacement of an existing line by a microgrid may result in a more efficient (lower cost) solution for the market as a whole. However, having undertaken this analysis, there is currently no clear pathway for how the NSP could then proceed to implement a microgrid solution. This highlights the need for any changes to be relevant to the networks' existing responsibilities and governing frameworks, to ensure practical application.

Extensive suite of existing mechanisms and safeguards

Energy Networks Australia notes that there are a number of existing mechanisms which already encourage consideration of non-network options, provide information to market participants who may be able to offer non-network solutions, and provide NSPs with incentives to invest in least cost options. (See Attachment A)

In addition, the proposed Demand Management Incentive Scheme (DMIS) will work in combination with the current distribution planning framework and the RIT-D to ensure the consideration of non-network options.

As such, there is no evidence that the existing arrangements create bias against the consideration of non-network alternatives to 'like-for-like' replacement of network assets. However, as previously recognised, where a network led solution represents the least cost option, greater transparency may be required to build and preserve confidence in the market that all technical and economically feasible options have been examined.

Transitional arrangements

Energy Networks Australia urges the AEMC to ensure that workable transition arrangements are put in place, to facilitate the efficient ongoing development of electricity networks.

Energy Networks Australia is concerned that the AER's rule change request provides no guidance as to at what stage NSPs will be required to comply with the RIT in relation to replacement projects that have already commenced analysis under the existing arrangements and, therefore, have not engaged in the formal Regulatory Investment Test.

We consider that projects where consultation has already commenced under the existing arrangements should be allowed to continue through to completion under the existing arrangements.

Further, the draft rule should clarify that compliance with the new requirements (e.g. both new reporting in annual planning reports (APRs) and the RITs) can only commence after the publication of the Network Retirement Reporting Guideline by the AER. NSPs should not be required to comply with the new rule before the AER has finalised its guideline.

The AER proposed to publish its Network Retirement Reporting Guideline within 12 months from the date of the final rule. The draft rule should specify the timeframe, after the release of the Guideline, within which NSPs are required to comply. Energy Networks Australia consider that a transition period of at least six months would be appropriate.

[2] http://www.scer.gov.au/current-projects/energy-market-transformation

Consultation paper questions

The problem

Question 1

a) Are non-network solutions a viable alternative to replacing network assets on a like-for-like basis?

b) How does this differ from the potential for a non-network solution to provide a viable alternative to augmenting the network?

a) Energy Networks Australia considers that there are limited circumstances in which non-network solutions represent a viable alternative to replacing network assets on a like-for-like basis. For example, there are currently no alternative commercially- and technologically-viable solutions available to low voltage distribution network feeders, distribution transformers or other network equipment such as protection relays. However, there may be viable options for replacement of higher voltage assets, such as power transformers.

There are many factors that NSPs have to consider when making a decision whether to adopt a network solution or a non-network solution. For example, a non-network solution may reduce connectivity capacity and may not provide like-for-like service to customers. This may apply to a cable or overhead line. The non-network solution cannot replace it, but could eliminate the need for it, by, for example, building a solar farm to supply the customers at the end of the cable. This solution, however, offers a lot less flexibility. This is because the cable could be used to supply customers from a number of different transformers by switching the network. However, once the customer is disconnected from the cable they can only be supplied from the solar farm.

It is also important to keep in mind that many network assets work together to provide supply to customers. For example, a substation would be supplied by one or more HV feeders, then possibly through a number of switches to one or more transformers. The transformer would then supply LV switchgear which would control the LV feeders leaving the substation. There are also secondary systems like protection and communication systems.

In most cases, NSPs would only replace some of the assets at the substation – for example the LV switchboard or the protection system. These individual, presumably aged, assets cannot generally be replaced with a non-network solution. When a whole substation is to be replaced, it is currently unlikely that a non- network solution can be found to supply the entire load on the substation.

Nevertheless, NSPs will investigate other alternatives, and APR provisions require this now.

b) Augmentation projects increase the transmission or distribution capacity of the network, whereas replacement projects replace one (or more) of the components (assets) of the integrated system – maintaining the capacity and connectivity of the system. Non-network solutions, such as distributed generation and battery storage, can be an alternative to augmentation as they can provide an incremental increase in capacity. In some circumstances, non-network solutions are, however, a less suitable alternative to maintaining the capacity and connectivity of the system, unless the functional requirement of the network has changed; i.e. when the component (asset) is no longer required and it can be retired in conjunction with a non-network solution under an integrated approach.

At least in the near term it appears less likely that retirement of a network asset (which is a part of integrated system), and its replacement with incremental non-

network solutions, would provide a viable solution unless the network functional requirements have changed.

Therefore, the rule change should provide for a streamlined process to ensure that investment is not delayed and that the costs do not outweigh the benefits.

Question 2

a) Are the current annual planning reporting requirements in the NER relevant and likely to be useful for replacement expenditure?

b) If any, where are the gaps in the current annual planning reporting requirements in the NER for replacement expenditure?

The NER already require NSPs to report on non-network alternatives to network solutions. For transmission, the rules also provide for AEMO to conduct an independent review.

Annual planning reporting requirements on replacement expenditure

Question 3

a) What do NSPs currently do to plan for asset replacement in practice?

b) To what extent does this address the perceived problems identified by the AER?

a) NSPs identify options to the planned replacement, which would identify the risk of 'doing nothing'. This is consistent with the AER's proposal which would identify the constraint upon retirement of the asset.

Individual businesses typically provide very detailed information to the AER about their asset management policies and practices as part of their revenue/regulatory proposals, including in relation to asset replacements. As part of its assessment of a revenue/regulatory proposal, the AER also interrogates and tests these practices through, among other things, a review of how such practices were applied to historical investments and whether any material changes have occurred that may impact forecast future investments.

Energy Networks Australia notes that NSPs undertake cost-benefit analysis for all replacement/refurbishment projects, as well as augmentation projects under the current RIT-D and RIT-T thresholds. The cost-benefit analysis typically includes:

- Quantifying the economic cost of an asset failure;
- Formulating the most economical solution; and
- Determining the appropriate timing of the most economic option to proceed, which is when the project benefits exceed its cost.

b) Where a network-led solution represents the least cost option, greater transparency may facilitate and preserve confidence in the market that all technically- and economically-feasible options have been examined.

The RIT process contemplates a level of consultancy and engagement around options to address network issue, which are positive features. In the context of network replacement, if this objective is to be achieved through the RIT, it is important to ensure that new obligations are cost effective and fit-for-purpose, recognising the nature of network asset replacement. There is a considerable risk of delays that could affect service provision and increase costs without the identified benefits.

In the future, there may be scope to apply alternative, less costly regulatory arrangements which satisfy the needs of market participants. For example, access to innovative, collaborative solutions such as the Institute for Sustainable Futures' Networks Opportunity Maps, may reduce

the need for networks to be regulated in this regard.

Question 4

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?

Transparency of information on network constraints, and how they may be overcome, is supported by NSPs. Greater transparency may provide further opportunity for networks to receive offers for alternatives to network augmentation. However, it also important to re-emphasise here that any proposed annual reporting requirements should reflect the nature of replacement investment in order to balance the potential benefits with the compliance burden they impose. In this regard, it may be appropriate to limit reporting to those assets that have the greatest potential for being replaced by a non-network alternative.

Question 5

a) Is it appropriate that the scope of the new reporting requirements include planned asset de-ratings as well as planned retirements?

b) To what extent does this add to the administrative burden for NSPs?

De-rating and retirements are subject to similar considerations, assuming that de-rating here refers to the situation where an NSP finds that there is a technical need to de-rate an asset, which would then lead to need for restoration of capability. However, this understanding of de-rating needs to be clarified with examples by the AEMC/AER.

The administrative burden for NSPs will depend on the detail of the AER's Network Retirement Reporting Guideline. It is desirable that clear guidance is provided to the AER as a result of this rule change process. The thresholds and streamlining of the process are also important in ensuring a cost effective approach.

Question 6

a) Should all assets be reported on by NSPs in their annual planning report or are only certain asset types relevant?

b) What types of asset should be subject to reporting requirements by NSPs and what should not?

As discussed in response to question 4, reporting should be limited to network elements that have the greatest potential to be replaced with non-network solutions. For example, in transmission this could be node to node services (two ends of a line, or HV and LV sides of a transformer, or configuration capability).

As such, it is considered that reporting would not be practical on assets that:

- Support the network as a whole and are not optional;
- Have very limited potential to be replaced with non-network solutions.

Question 7

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) If an AER guideline is appropriate, what should it contain and how should the AER be guided in its development?

c) In addition, what would be the appropriate process be to make and review an AER guideline?

The rule change process should set out clear principles for the regime and provide the appropriate guidance to the AER in order to avoid regulatory uncertainty and the

administrative burden. It is not desirable for any material matters to be determined outside the rule change process.

Question 8

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) What should these principles and the broad approach be?

Energy Networks Australia consider that there is no need for further guidance as this would likely duplicate processes that already exist in seeking and assessing revenue requirements.

It is also important to clarify the scope of the AER's Network Retirement Reporting Guideline. The guideline represents a reporting mechanism and its scope should not seek to prescribe business and asset management practices of NSPs.

Question 9

Compared to the current arrangements, how much additional reporting by NSPs would be required under the AER's proposal? What would be the impact on NSPs?

It is clear that the AER's proposal will introduce new requirements with cost and time impacts. It is not possible to estimate the extent of these impacts until the AER's Network Retirement Reporting Guideline has been developed.

This highlights the criticality of the AEMC rule change process carefully taking into consideration of both potential costs and benefits of the rule itself, and the underlying application of the rule, including taking into account credible guideline and compliance scenarios (as well as potential unintended consequences).

Application of regulatory investment tests to replacement expenditure

Question 10

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?

Extending the RITs to replacement capital expenditure may have benefits for energy market stakeholders, including non-network service providers in situations where there are alternative commercially- and technologically-viable solutions to replacing network assets on a like-for-like basis. It is important, however, to balance these potential benefits with the compliance burden imposed by new obligations.

Question 11

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?

There are good reasons to consider the exclusion of maintenance expenditure from the RIT, as it requires the asset to be kept rather than retired, or the service to be altered. When asset maintenance is no longer cost-effective, asset replacement is considered. In this situation, any major projects that exceed RIT thresholds will automatically fall within the scope of the proposed RIT.

Question 12

Should the cost thresholds for asset replacement projects be the same as cost thresholds for network augmentation projects?

Energy Networks Australia would support that the same thresholds apply for replacement projects as to augmentation projects, currently

$6 million in transmission and $5 million in distribution.

Question 13

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?

Given the significant costs of compliance it is not appropriate for the RIT to be required where it is considered that a like-for-like replacement of the asset is the only option to address the problem.

Question 14

a) Is the proposed requirement for NSPs to publish an exemption report where there is no alternative to like-for-like replacement appropriate?

b) Do the benefits of this mechanism outweigh the administrative costs that it may impose?

c) Is there an alternative mechanism which would be more appropriate?

The proposal to provide NSPs with the opportunity to seek exemptions from the RIT-T and RIT-D for replacing network assets is fundamental to achieving a practical, workable and efficient framework. Exemptions will be applicable where the NSP analysis reasonably demonstrates it is unlikely that there would be viable alternative options to like-for-like replacement. The exemption report should only require reporting on projects that exceed the RIT thresholds.

However, we note that the APRs will also identify whether there are feasible alternatives, and interested stakeholders have opportunities at this stage to provide comments on NSPs' planning.

Question 15

a) What information should NSPs be required to provide in an exemption report?

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?

c) Do stakeholders agree that AEMO must publish the exemption report on its website within three business days?

If it is determined that NSPs must publish an exemption report, the information provided within the report should be limited to:

- Brief information about the assets being replaced; and
- Reasons supporting why there are no alternatives, e.g. non-network option is not competitively priced or a secondary system project where a like-for-like replacement is the only feasible option.

As an additional measure, the AEMC may wish to consider defining categories of assets which are exempt from new obligations. See answers to question 4 and question 6.

Question 16

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) Is 30 business days, as proposed, the appropriate timeframe for allowing interested parties to raise a dispute with the AER?

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?

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?

Energy Networks Australia notes the existing formal dispute resolution process provided for within cl. 5.15.5 of the NER. There may be benefits in aligning these processes for both augmentation and replacement projects.

Restrictions should be considered to avoid unnecessary delays or unfounded disputes.

Issues specific to Victoria

Question 17

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) Would AEMO or AusNet Services be the most appropriate body to apply the RIT-T for replacement expenditure in Victoria and why?

a) The asset replacement program should be included in the single Victorian TAPR, which AEMO produces. This would be consistent with the approach currently applied, via which AusNet Services asset replacement plans are reported in the TAPR by AEMO.

b) AusNet Services conducts the RIT-T for asset replacement. This is consistent with the separation of responsibilities in Victoria.

Other NER changes proposed by the AER

Question 18

a) Are the additional changes proposed by the AER appropriate and useful to stakeholders?

b) What compliance burden would arise for NSPs?

c) As these requirements currently apply in a limited way in the NER, how useful have they been to date?

The information on potential system limitations arising from planned asset retirement and de-rating may be useful to stakeholders. We note that the 'system limitations report' proposed by the AEMC as part of local generation network credits rule change, if implemented, would also provide this information. We also note the mechanisms listed in Attachment A, which provide market participants with large volumes of information.

Transitional arrangements

Question 19

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?

Energy Networks Australia urges the AEMC to ensure that workable transition arrangements are put in place, to facilitate the efficient ongoing development of electricity networks.

Energy Networks Australia is concerned that the AER's rule change request provides no guidance as to at what stage NSPs will be required to comply with the RIT in relation to replacement projects that have already commenced analysis under the existing arrangements and, therefore, have not engaged in the formal Regulatory Investment Test.

We consider that projects where consultation has already commenced under the existing arrangements should be allowed to continue

through to completion under the existing arrangements.

Further, the draft rule should clarify that compliance with the new requirements (e.g. both new reporting in APRs and the RITs) can only commence after the publication of the Network Retirement Reporting Guideline by the AER. NSPs should not be required to comply with the new rule before the AER has finalised its guideline.

The AER proposed to publish its Network Retirement Reporting Guideline within twelve months from the date of the final rule. The draft rule should specify the timeframe, after the release of the Guideline, within which NSPs are required to comply. Energy Networks Australia consider that a transition period of at least six months would be appropriate.

Attachment A - Existing mechanisms and safeguards

It is important to consider the existing mechanisms under the *National Electricity Rules* (NER), which impact on the nature and degree of any additional obligations that may be required.

These mechanisms were designed to encourage consideration of non-network options, provide information to market participants who may be able to offer non-network solutions, and provide NSPs with incentives to invest in least cost options.

The existing incentives and obligations are listed below illustrating how the current framework assists in meeting the policy objectives sought by the AER.

Planning and investment framework

- **Electricity Transmission and Distribution Annual Planning Reports**. Existing planning processes such as the Transmission and Distribution Annual Planning Reports require transparency around network replacement plans and the consideration of viable alternatives to 'like-for-like' asset replacement.
- **Regulatory Investment Test for electricity transmission and distribution.** The current network planning arrangements in the NER require the network businesses to apply the RIT-T and RIT-D before augmenting their networks. These tests require alternatives to network augmentation to be considered, which should include both network and non-network options.
- **Demand Side Engagement Strategy (DSES)** Distribution businesses are required to develop a DSES. The published strategy details a business' processes and procedures for assessing non-network options as alternatives to network expenditure and interacting with non-network providers. Distribution businesses are also required to maintain a register of parties interested in being notified of developments relating to distribution network planning and expansion.

Incentive Regulation Framework

- **Efficiency Benefit Sharing Scheme**. **(EBSS).** The EBSS provides incentives for a business to pursue efficiency improvements in operating expenditure over the regulatory period and to share the benefits of efficiencies with customers.
- **Service Target Performance Incentive Scheme (STPIS)**. The STPIS provides incentives for businesses to maintain or improve service standards and to limit the risk of cost reduction incentives compromising appropriate service quality over time causing service standards to decline over time.
- **Capital Expenditure Efficiency Sharing Scheme (CESS).** The CESS provides incentives for businesses to pursue efficiency improvements in capital expenditure over the regulatory period and to share the benefits of efficiencies with customers.
- **Ex post reviews**. If a business's capex exceeds the regulators forecast, the AER will examine its spending and can disallow some or all of the capex overspend to be included in the regulated asset base (RAB). The network firm faces never obtaining a return on these assets, but bearing the costs of their upkeep and maintenance.
- **Demand Management Incentive Scheme (DMIS) for electricity distribution businesses.** The AER is due to develop a DMIS by 1 December 2016. The objective of the incentive scheme is to provide distribution businesses with an incentive to undertake efficient expenditure on relevant non-network options relating to demand management.

Regulatory determination process

- **Ex-ante cost reviews**. If a business's total capex exceeds the regulators forecast, the AER may examine its spending and disallow some or all of this capex overspend from the regulated asset base (RAB). Should this occur, the business will not earn a return on these assets and will bear the full costs of their upkeep and maintenance.
- **Regulatory Information Notices (RINs)**. The RIN data on past expenditure provides the AER, as well as market participants, with large volumes of detailed information on the costs incurred by network businesses in providing services.
- **REPEX model**. The AER has recently developed and applied its REPEX model, designed to provide an objective and evidence-based tool to test replacement expenditure allowances.
- **Annual Benchmarking Reports.** The AER's benchmarking process provides an additional tool for addressing information asymmetry.
- **Better Regulation Guidelines.** The AER's expenditure forecast assessment guidelines describe the process, techniques and associated data requirements for the AER's approach to setting efficient expenditure allowances for the regulated activities of network businesses.

Further, there are other measures which encourage transparency and accountability in network expenditure. These include, for example:

- board member sign off on assumptions underpinning the expenditure forecasts; and
- the confidentiality regime which requires supporting information is provided in the public domain (noting that NSPs can make a formal claim of confidentiality).

In summary, it is evident that there is an extensive suite of arrangements which are designed to overcome the information asymmetry problem between industry, regulator and market participants and to encourage NSPs to make efficient investment decisions.