

AER asset replacement forum: Discussion summary

Matter name:	Asset replacement planning industry application note (Application Note)
Date:	Tuesday 25 September 2018
Time:	10:00 am to 4:00 pm (AEST)
Location:	PARKROYAL Melbourne airport
Chairs:	John Thompson and Mark Wilson — AER Senior Technical Advisors

Note: This document provides an overview of the main points discussed during the AER Stakeholder Forum on its draft Application Note. Its use is purely informative.

The Australian Energy Regulator (AER) held a stakeholder forum on 25th September 2018, which was during the submission period for its draft Application Note. John Thompson gave a presentation, which is available on the project page of the AER’s website.

Session 1: Overview and background

The AER discussed that the Application Note is encouraging network businesses to consider asset retirement decisions based on asset condition (or more relevantly, economic end-of-life), as opposed to age. It was noted that some network businesses consider asset age when forecasting network needs over the medium term, but their analysis of individual network limitations is based around asset condition. The AER agreed that while ‘on the ground’ assessments tend to be conditions based, the network planning that informs regulatory proposals tends to be based on asset age. The AER would like capex proposals to have regard to asset condition rather than age (but more broadly, to economic end-of-life as opposed to technical end-of-life).

On the purpose and plans for the Application Note, the AER said the Application Note:

- Would be updated as business practices change.
- Aims to clarify the AER’s approach to analysis.
- Is not expected to become a binding guideline, but there may be scope for it to inform the AER’s forecast expenditure guidelines in the future.
- Aims to assist network consultation with consumer advocates by encouraging them to frame replacement expenditure assessments in a consistent and structured way.

Session 2: The asset retirement or de rating decision

There was extensive discussion around how to characterise the business as usual (BAU) base case. Following this discussion, the AER committed to revisiting the Application Note to provide greater clarity. Some of the points discussed included:

- The preference of some network representatives to include a credible option to address the identified need in the base case where the base case would be unviable otherwise. The AER clarified the importance of not having a credible option to address the identified

need in the base, because including this may exclude some viable options from the analysis (such as options to extend the asset life).

- How the AER should clarify what costs would be included in the BAU base case. For instance, page 25 of the Application Note suggested 'replacement and disposal costs' would be BAU. Some network representatives felt this contradicted the AER's position that no credible options to address an identified need should be included in the base case. It was reasoned that these 'replacement and disposal costs' might be a reaction to increasing service costs under a BAU approach rather than constituting costs associated with a planned credible option that aims to address the identified need.
- There was some confusion around distinguishing reactive opex (such as opex in response to assets degrading in the base case) from proactive opex (such as proactive maintenance, which might entail intervening to refurbish the asset). Several network representatives understood from a previous workshop that both forms of opex would go towards keeping an asset in service under the BAU base case, but it was unclear whether the AER had changed its position on that point. Many network representatives shared the view that BAU base case costs concerned costs required to maintain the asset in a safe environment. The AER clarified that proactive opex might be associated with a credible option to address the identified need if the asset was to be refurbished in a big way – that is, this might be a materiality question. A consumer representative suggested that a definition of materiality might be helpful in this context.

In addition to discussions on the BAU base case, a consumer representative flagged the value in exploring how fringe of grid projects might be considered in this analysis (such as standalone power systems).

Session 3: Identifying and considering options

A consumer representative cautioned against double counting risk costs. For instance, when performing their assessments, network businesses should consider that there is typically an inverse relationship between risk costs and maintenance costs, as improved maintenance would be expected to reduce risks.

A network representative observed that Figure 1 in the Application Note suggested that the 'preferred option' was based on costs rather than net benefits, which appeared to contradict the guidance elsewhere in the Application Note. The AER advised that Figure 1 intends to illustrate the trigger for when to explore options as opposed to how to determine the preferred option. The AER committed to clarifying this in its revised Application Note.

Session 4: Uncertainty and risk

A consumer representative saw value in having commonality between the assumptions adopted by networks (such as probability of failure). There should also be transparency with what numbers are being used, preferably in a centralised place, so these assumptions can be tested.

Another consumer representative observed that the language around 'least regrets' is becoming more commonplace, and there might be value in the AER clarifying this terminology and forming a robust opinion on it.

There was notable interest around the treatment of legal and regulatory costs.

- The AER held the view that this analysis is about finding in the efficient level of costs you need to bear to avoid non-compliance issues. While there is a distinction between a cost-benefit assessment and a hard obligation under the law, most of the relevant obligations are based on reasonableness tests or best endeavours. Similarly, often when compliance breaches are identified, the legal/regulatory body will negotiate a pathway to rectify the issue rather than having the business face prohibitive costs and timeframes.
- Several network representatives considered that while some laws and regulations are based on reasonableness, others are more 'black and white' in terms of compliance. These representatives advised they would find it difficult to willingly break the law on the basis of 'economic efficiency'.
- The AER advised that its Application Note would need to provide more clarity on this area, and there may be value in differentiating how to apply the economic assessment to black and white areas of the law versus areas based on best endeavours.

A stakeholder questioned whether the AER should put further consideration into using disproportionality factors to capture the costs incurred after the public loses trust in the organisation that is managing safety. This might warrant a further discussion around social concerns when selecting disproportionality factors.

A network representative flagged the difficulties of aggregating assets within an asset class and looking at options to replace them before they fail. For instance, these small assets might include protection systems that operate in a redundant network and only last for 10 to 15 years. Analysis around asset failure is more difficult for these small assets than it is for large assets, and it would be good to have further thought go into how to aggregate these assets and perform an economic analysis on the associated replacement decision. The AER discussed how the analysis is similar around managing an asset fleet versus a single asset (it is as if the fleet is just one asset and every element of that is just a part). A consumer representative and a network representative both suggested the AER include a worked example on applying the analytical approach in the Application Note to an asset fleet.

Closing points

It was raised that the Victorian network businesses had been doing some work on forming a common approach to asset management, similar to work that the ENA Asset Management Committee had been doing previously.

Attendees generally considered there would be value in having similar forums to this in the future, and the AER flagged it will likely hold another one of these forums later in 2018. A consumer representative flagged that there would be value in discussing IT replacement expenditure in future forums.