27 June 2025

Arek Gulbenkoglu
General Manager, Network Expenditure
Australian Energy Regulator

Capital Expenditure Incentive Guideline Review – Draft Guidelines

Dear Mr Gulbenkoglu,

SA Power Networks welcomes the opportunity to comment to the Australian Energy Regulator (AER) on the 'Capital Expenditure Incentive Guideline Review: Draft Guidelines' (the Draft Guidelines).

While the CESS is largely fit-for-purpose, there are material challenges to ex-ante expenditure forecasting emerging from the transformation in the energy sector and broader economy. Regulatory response should be considered, via the CESS or other mechanisms, to maintain efficiency incentives while mitigating risks against good customer service outcomes. These challenges will manifest differently reflecting distributors' unique operating environments, stage of the energy transition, and jurisdictional policies. Therefore, CESS adjustments to manage these challenges must be flexible and customised, while maintaining the overall simplicity of the CESS which has driven its success to date.

The adjustments proposed in the Draft Guidelines require further consideration. Our key views are that:

- each distributor should be able to nominate, subject to agreed principles, the areas of capital expenditure (capex) that ex-ante adjustment mechanisms should apply to, rather than such a mechanism only applying to connections, given differing forecasting risks;
- any ex-ante exclusion mechanism for connections should be opt-in, given key differences in economic activity, jurisdictional policies, and connections policies among distributors;
- the proposed volumetric adjustment mechanism for connections is unworkable in its current form given it does not account for the significant variance in the cost / size of connections. Instead, distributors should be able to nominate which connection categories (if any) this mechanism should apply to;
- ex-post adjustments for bespoke connections will contribute the most to addressing forecasting risk within connections, and could be designed with a specified threshold (e.g. a net cost per project, or a percentage impact on forecast net connections expenditure); and
- the adjustments discussed in this submission do not warrant revision to the CESS' symmetry, as they are relatively minor, and there are already sufficient safeguards for efficient outcomes.

If you have any queries on the matters raised in this letter, please contact Bruno Coelho, Manager Regulatory Strategy on [redacted] or [redacted]

Yours sincerely

[redacted]

Jessica Morris
Chief Customer and Strategy Officer

Ex-ante exclusion mechanisms should apply more flexibly

We disagree with the Draft Guidelines narrowing the scope of any ex-ante exclusion only to connections expenditure. We maintain our view that the best solution to address material forecasting risk for networks and consumers, is to allow flexibility for distributors to apply in their Regulatory Proposals, subject to a set of agreed principles and appropriate consumer engagement, to exclude an area of expenditure that they consider poses the most material forecasting risk. This is on the basis that:

- there are likely to be areas other than connections expenditure which may in future present more pronounced forecasting uncertainty / volatility, in particular: forecast demand and network capacity augmentations; network resilience requirements of network asset replacement and augmentation; cyber security; new compliance obligations; and
- each network faces differing challenges and sources of forecasting risk reflecting differences in their operating environments and stage of the energy transition.

A broader mechanism could be designed as follows:

- distributors would have provision in the CESS guideline to outline in their Regulatory Proposals, the sources of material forecasting risk that they foresee, and propose their own customised exclusions, assessed against a set of principles / criteria;
- the criteria could mirror the approach to the transmission CESS with some nuancing;[1]
- the AER would assess proposed exclusions against the criteria via its Determination;
- distributors would have flexibility on the exclusions they can propose, be they exclusions of an entire capex category, project, program, or specific aspect of a project / program; and
- distributors would need to adequately consult with customers / stakeholders.

Any ex-ante exclusion mechanism for connections volumes should be optional

We disagree with the Draft Guidelines instituting on a default basis, a volumetric adjustment mechanism applying to connections expenditure. We recommend that any such mechanism should be opt-in, with distributors having discretion to opt-in to a connections exclusion or not, and if so, also define which types of connections are subject to this mechanism.

This is given that, consistent with our reasons for favouring a broader mechanism, there will also be key differences in the forecasting risks presenting for connections expenditure between distributors, noting differences in:

- approaches taken in distributors' connections policies, and in particular, with respect to the specific costs accounted within, and therefore materiality of, the rebates to connection charges that connecting customers can receive which in-turn determine their contributions and therefore distributors' net connections expenditures;
- jurisdictional government policies, with respect to electrification and transitioning from gas connections, and broader construction and economic development planning; and
- overall levels and types of economic activity (e.g. extent of interest in connecting by data-centres and major industrial loads) occurring in each jurisdiction.

Distributors who elect to not opt-in to any volumetric adjustment, should still have the option to apply for an ex-post exclusion for connections, as this mechanism will likely be better suited to circumstances

[1] The current criteria of considering consumer benefits from the exemption, the size of project (this could be augmented with reference to programs also), degree of capex forecasting risk, and views of customers / stakeholders, all appear to be relevant principles for a distribution context.

where distributors have had to enable bespoke connections driving unanticipated and material effects on expenditure.

The volumetric adjustment mechanism for connections is currently unworkable

The desire in the Draft Guidelines to produce a one-size-fits-all volumetric adjustment mechanism for connections, has resulted in an approach that is unnecessary and unworkable in its current form. This is noting that:

- for SA Power Networks, our historic data has not demonstrated a high correlation between connection volumes and net connections expenditure when taken in aggregate across all connections – with the mix of connection types / projects having a key overall impact;
- the proposed approach of holding connection unit rates constant is problematic, as in practice, there would be connection types covered by this mechanism (mainly 'negotiated connections') which differ materially in size and therefore cost, and with differing customer contributions; and
- this mechanism is likely to be more applicable to some 'basic connections' given their more standard form and cost, however, the need for this mechanism will vary by distributor as we stated above.

Instead, the Guidelines should allow distributors to nominate to the AER, which connection categories they would like to apply to be subject to the volumetric adjustment mechanism. For example, rather than having regard to the overarching connection classifications of 'basic connection services' and 'negotiated connection services', some distributors might seek to select from the more specific categories of connections reflected in Regulatory Information Notices (RINs).[2]

A targeted ex-post mechanism for connections will reduce forecasting risks

We support the Draft Guidelines including an ex-post mechanism for connections. Many distributors in other jurisdictions are confronting increasing challenges from unanticipated increases in materially large and typically bespoke connections (particularly data centres and other commercial and industrial loads) and expect similar challenges to present in South Australia in future. This mechanism would ensure that:

- networks are not penalised for efficient work that they are obligated to undertake and could not have been expected to forecast; and
- there is no perverse incentive created for networks to change connection arrangements to discourage emerging types of connections.

In applying this mechanism, our views are that:

- it should apply irrespective of whether the formal 'ex-post review' process under the National Electricity Rules (NER) is triggered, and irrespective of whether the AER identifies connections as the subject of its 'ex-post review' where one has been initiated – in either case, the impact on net expenditure and CESS performance would be material if there is a large unanticipated increase in bespoke connections;
- where expenditures are found to be efficient, there should be an adjustment not only to the CESS penalties but rewards also (with the latter dependent on the extent to which the distributor has overspent their capex forecast outside of connections);
- we would expect that the AER could undertake a fairly targeted review of outturn connection expenditures, similar to how it currently assesses capex deferrals; and

[2] Category Analysis RINs 2.5.2 – Cost metrics by connection classification

- the connections subject to the ex-post mechanism should be clearly defined by each distributor as appropriate to their circumstances, and we envisage this could be done several ways as follows:

  Option 1 - connection category:

  Distributors nominate which connections apply, having regard to the categories in the category analysis RINs. For example, we anticipate that the following connection categories are likely to present the greatest forecasting risk given their highly customised / bespoke nature:

  - Commercial/Industrial HV (Customer connected at LV, upstream asset works);
  - Commercial/Industrial HV (Customer connected at HV);
  - Commercial/Industrial sub-transmission;
  - Subdivision connection (with upstream asset works); and
  - Embedded generation complex HV (large capacity).

  Option 2 - customer type:

  Distributors could nominate by customer type (e.g. embedded generation, major sub-division, data centres etc), although this option would risk obsolescence if new types of customer connections emerge.

  Option 3 - cost threshold:

  Distributors could nominate a cost threshold, for example, 'projects with a net cost greater than $1 million', or alternatively, nominate a percentage threshold as to the effect on the net connections forecast, for example 'greater than 1% impact on net connections expenditure'.

  Our view is that this option 3 and the percentage threshold is likely to be optimal, being simple to define and nominate on an ex-ante basis through the Regulatory Proposal.

The adjustments being considered will still maintain the CESS' overall balance

The adjustments proposed in the Draft Guidelines and in this submission, represent fairly measured and minor approaches by which to mitigate the effects of unanticipated and efficient capex overspends. As such, implementing these approaches does not lend weight to needing adjustments in the reverse, that is, to assess underspends. The CESS is already somewhat imbalanced in favour of penalties and there are other consumer safeguards, noting that:

- the CESS reduces rewards for underspends greater than 10 percent, but does not reduce penalties for equivalent overspends;
- distributors are required to report to the AER (via the RINs) on material variances in expenditure from AER forecasts / allowances;
- there is a strong reputational incentive and engagement expectation created via the expectation in the AER's Better Resets Handbook that distributors engage with their customers / stakeholders on the drivers of their performance in the period leading up to their Regulatory Proposal and therefore the drivers of their expected CESS outcomes; and
- the AER expects distributors in their Regulatory Proposals to outline the details of the circumstances of their performance versus AER allowances; and
- the AER expects, as required by the CESS guideline, distributors in their regulatory proposals to account for any capex deferrals that materially increased their forecast expenditure (subject of the Regulatory Proposal), and distributors including ourselves, have voluntarily nominated examples of deferrals to exclude from the CESS calculations.