15 January 2020

Mr Warwick Anderson
General Manager
Australian Energy Regulator
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Working for your business.
Working for South Australia

Dear Mr Anderson

I write in response to the AER's draft decision on SA Power Networks (SAPN)' 2020-25 revenue determination, and SAPN's subsequent revised regulatory proposal.

Executive Summary

- Business SA acknowledges the difficult circumstances SAPN and its field crews have been faced with during recent bushfires in both the Adelaide Hills and Kangaroo Island, and the efforts made to restore services in a timely manner.
- Business SA welcomes SAPN's revised regulatory proposal which will result in an average bill reduction of $62 for residential customers and $276 for small business customers in 2020/21, over double the reduction for business customers than the original proposal; largely based on declining rates of return.
- The growing penetration of solar, including amongst businesses, is providing new challenges for the management of the electricity distribution network and Business SA supports SAPN's prudent spending to avoid reduced reliability.
- Targeted reliability improvements to regional customers, particularly in the Adelaide Hills and on the Eyre Peninsula, are long overdue and recognise the broader economic importance of both these regions to the State's economy.
- Business SA supports the AER adopting a conservative forecast of wage cost increases, particularly given the Deloitte Access Economics forecast already provides for real wage increases (above CPI) and previous forecasts relied upon by SAPN have turned out to be materially higher than realised outcomes.
- Recognising the importance of vegetation management, particularly in relation to bushfire mitigation, Business SA acknowledges more justification is still required to ascertain why SAPN's customers are not seeing some cost increases being returned following spending to handle post millennium drought breaking growth.

Should you require any further information or have questions, please contact
Andrew McKenna, Senior Policy Adviser, on (08) 8300 0000 or andrewm@business-sa.com.

Yours sincerely,

Anthony Penney
Executive Director, Industry and Government Engagement

Why this matter is important to South Australian businesses

As South Australia's Chamber of Commerce and Industry, with a history dating back to 1839, Business SA is the peak business membership organisation in the State. Our 3,100 members are affected by this matter in the following ways:

- South Australian businesses have long faced high energy costs, with respect to both electricity and gas, and for these businesses to be competitive in both national and international markets they must be able to access competitive input prices.
- Local businesses are increasingly turning to solar to take control of their energy costs and with this trend set to continue, it will be important that the electricity distribution network can adequately cope with increasing levels of both residential and business behind the meter solar installations.
- Reliability of the electricity distribution network remains critical for businesses, including in the regions, despite advances in battery technologies which are yet to make off-grid options viable in the main.

Business SA has commented on relevant topics to SA Power Network's regulatory determination:

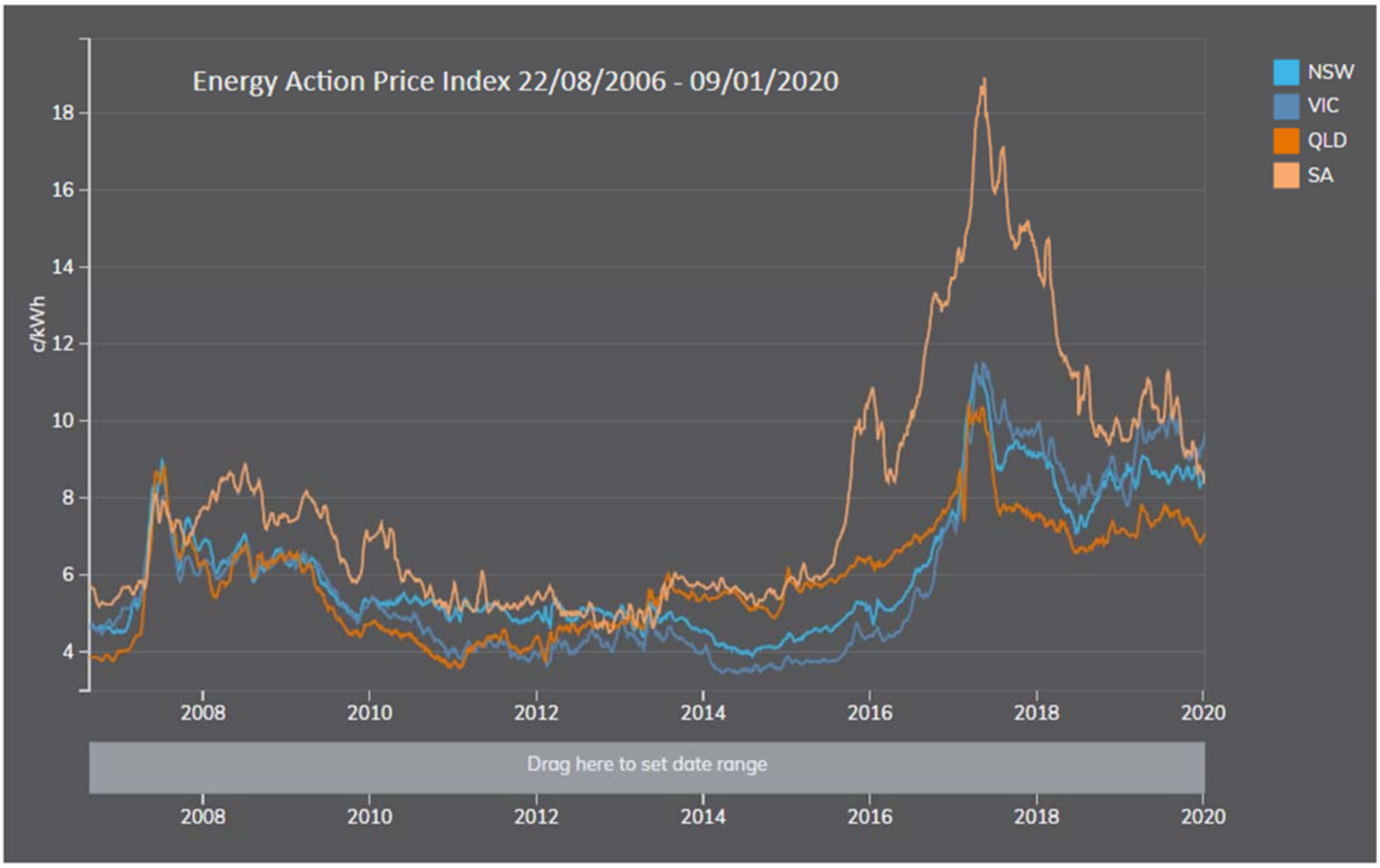
1. Competitive Energy Prices

Business SA's primary focus is to ensure South Australian businesses have access to competitive electricity prices, not only within Australia but even more importantly, against our export market competitors.

There has been some moderation of late in the wholesale spot electricity market which we welcome, but it is important to remember that South Australia has just come off a financial year record high for 2018/19, which averaged $128/MWh. This is three times higher than that experienced in 2014/15, $42/MWh, the year prior to the withdrawal of Alinta's Northern Power Station[1]. Lower demand over the past several months, some relief on gas prices and strong renewable output have all assisted to constrain the wholesale market, notwithstanding the spot market is inherently volatile and South Australian futures at the commencement of this summer for Q1 2020 were over $120/MWh.

The fall in the wholesale market has also translated to some easing in the energy (generation) component of contract electricity prices for large market customers, using over 160MWh per annum, noting that contract price levels still exceed pre-electricity crisis (2015-18) historic highs.

[1] Australian Energy Regulator, Annual volume weighted average spot prices, https://www.aer.gov.au/wholesale-markets/wholesale-statistics/annual-volume-weighted-average-spot-prices



It is important to remember that generation costs are only one component of the electricity bill and equally important is the contribution of network costs, including for distribution and to a lesser extent, transmission. In fact, according to the 2019 Australian Energy Market Commission (AEMC) residential Electricity Price Trends report, network costs are again equivalent to generation costs and combined account for over 86% of the bill in South Australia. The AEMC also found that a representative consumer across Australia will save $97 (or 7.1%) on their total electricity bill over the next three years but South Australian consumers will receive less than a third of that saving (2% or $27). Much of this price relief across the nation is due to increasing supply into the generation market, particularly from renewables.

Table 1 - Average residential electricity bill breakdown across national electricity market (NEM)[2]:

	2018/19 Base Year		2019/20 Current Year		2020/21		2021/22	
	c/kwh	$/year	c/kwh	$/year	c/kwh	$/year	c/kwh	$/year
Environmental policies	**1.98**	**$90**	**1.94**	**$89**	**1.67**	**$76**	**1.51**	**$68**
LRET	0.77	$35	0.64	$30	0.40	$19	0.27	$13
SRES	0.68	$31	0.74	$34	0.67	$31	0.62	$29
Jurisdictional Schemes	0.35	$16	0.39	$18	0.39	$18	0.41	$18
Efficiency Schemes	0.18	$8	0.18	$8	0.20	$8	0.20	$8
Regulated Networks	**13.28**	**$601**	**13.36**	**$604**	**12.94**	**$584**	**13.06**	**$590**
Transmission	2.22	$101	2.09	$95	2.18	$100	2.28	$105
Distribution	10.05	$456	10.34	$468	9.88	$446	9.90	$448
Metering	1.01	$44	0.93	$41	0.88	$38	0.87	$38
Wholesale	**11.90**	**$540**	**12.14**	**$550**	**10.84**	**$496**	**10.45**	**$477**
Residual	**3.05**	**$140**	**2.92**	**$132**	**2.97**	**$134**	**3.04**	**$137**
Total	**30.21**	**$1,370**	**30.35**	**$1,375**	**28.42**	**$1,290**	**28.06**	**$1,273**

Source: AEMC analysis

Table 2 - Average residential electricity bill breakdown for South Australia[3]:

	2018/19 **Base Year**		2019/20 **Current Year**		2020/21		2021/22	
	c/kwh	$/year	c/kwh	$/year	c/kwh	$/year	c/kwh	$/year
Environmental policies	**2.95**	**$147**	**3.16**	**$158**	**2.83**	**$141**	**2.63**	**$132**
LRET - LGC cost	0.77	$38	0.70	$35	0.44	$22	0.30	$15
SRES - STC cost	0.64	$32	0.75	$38	0.68	$34	0.63	$32
Feed-in Tariff Schemes	1.29	$64	1.45	$73	1.45	$73	1.45	$73
REES	0.25	$13	0.25	$13	0.25	$13	0.25	$13
Regulated networks	**15.27**	**$763**	**16.82**	**$841**	**15.51**	**$776**	**15.93**	**$797**
Transmission	3.02	$151	3.25	$163	3.38	$169	3.52	$176
Distribution	11.62	$581	12.89	$645	11.45	$573	11.73	$587
ACS Metering	0.62	$31	0.68	$34	0.68	$34	0.68	$34
Wholesale	**16.90**	**$845**	**15.09**	**$754**	**15.23**	**$761**	**15.22**	**$761**
Residual	**1.96**	**$98**	**2.61**	**$130**	**2.67**	**$134**	**2.74**	**$137**
Market Offer	**37.07**	**$1,854**	**37.68**	**$1,884**	**36.24**	**$1,812**	**36.53**	**$1,826**

Source: AEMC analysis

As can be seen in Tables 1 and 2, average network costs are 15-27% higher in South Australia while average wholesale electricity costs are 42-56% higher[4]. Combined, these factors primarily contribute to drive our 35% higher bills.

[2] Australian Energy Market Commission (AEMC), Residential Electricity Price Trends 2019 report, P4
[3] Australian Energy Market Commission (AEMC), Residential Electricity Price Trends 2019 report, P12
[4] Range for both is % difference in c/Kwh rate followed by % difference in total dollar value per annum contribution to bill

Business SA recognises that the generation side of energy costs has largely driven bill increases over the past few years, but it is equally important for the AER to maintain a continued vigilance over network costs, particularly in South Australia where average network related prices remain materially above the national average; acknowledging network costs include both transmission and distribution, with SAPN only responsible for the distribution network component.

Business SA welcomes initial price reductions from the AER's draft decision on SAPN's 2020-25 business plan and subsequently agreed to by SAPN in its revised proposal, with some outstanding considerations related to price in both the short, medium and long term which still require attention.

2. Consultation with consumers

Business SA regularly consults with SAPN and has long been a member of its Customer Consultative Panel. We have also been in attendance for the vast majority of additional workshops held to facilitate consultation for SAPN's 2020-25 regulatory proposal. While the time requirements for non-profit organisations like ours can be onerous, including almost weekly meetings at times, we recognise the importance of many of the issues to our members and the business community more broadly and the need to ensure that adequate consumer input goes into decisions with material impacts.

There is no doubt that SAPN has changed its approach to consultation for this regulatory proposal and we have found the engagement to be much more productive and structured for genuine dialogue. There has been a growing maturity in the consultation that recognises that agreement will not always be unanimous but that a range of perspectives needs to be adequately considered for, including from the business community.

SAPN has also tested some more practical ways of consulting on key aspects of its regulatory proposal, including a useful site tour. This was a great chance for consumer representatives to see firsthand some of the challenges SAPN face in managing their network and provided a welcome compliment to all the technical deep-dive sessions. Hearing from a remote community representative impacted by reliability issues and how SAPN has been working to improve their situation was also quite informative, as was the discussion about the reality of alternatives which were perhaps not as workable as the technological assumptions alone might dictate.

In relation to tariff reform, SAPN have genuinely sought to understand the impact on a range of businesses, particularly small to medium sized businesses; being quite open about how businesses are impacted in different scenarios with cost-reflective tariffs. While there will always be a range of impacts and Business SA recognises the nature of such reforms dictated by broader Government policy, both understanding and conveying the impacts for consultation remains an important process.

Notwithstanding the above, the AER still needs to recognise the inherent information asymmetries and power imbalance that exist within a consultation such as this. Although consumers representatives including Business SA can input into a range of issues, there are also some very complex considerations which form part of the regulatory proposal, including for IT spending, which are not necessarily as conducive to being debated in customer type forums. This is not to say that SAPN should not have to justify its more technical plans to customers, but the AER needs to bear in mind that consumer engagement on such matters needs to be weighted accordingly.

3. Capital Expenditure

Reliability

Business SA is largely supportive of SA Power Networks revised CAPEX proposal, particularly its inclusion of modest spending to improve reliability for customers in poorly served areas, and its network hardening program to bolster the grid's performance in regions which typically suffer more from severe storm events. Much of the feedback provided to Business SA on such matters comes from businesses in areas like the Adelaide Hills, which are also major tourism regions and hubs of light industry. The Eyre Peninsula is in a similar position, and again tourism is a vital industry there and growing strongly. ESCOSA's 2017 inquiry into reliability on the Eyre Peninsula articulates the situation there in great depth finding that '*There are ongoing reliability problems at the distribution feeder level, which are driven mainly by lightning strikes on radial distribution lines affecting local supplies'.* In terms of solutions, while generation was proposed in the short-term near the worst impacted areas, ESCOSA recommended '*Cost effective medium-term options for improving reliability of supply include targeted network hardening (re-insulating feeders prone to lightning strikes), which could be implemented over the next 3 to 5 years'.*

It is important for the AER to consider that the analysis often relied upon to determine the value of customer reliability (VCR) does not necessarily articulate outcomes for individual regions based on industry composition. In the context of South Australia which has underperformed the nation for many years from an economic growth perspective, it is important that every effort is made to ensure this State is positioned to enable economic growth predicated on having access to excellent essential infrastructure, including affordable and reliable power for a range of industries and their customers, incorporating tourists. Subsequent to recent bushfires and their significant impact on the key tourism regions of the Adelaide Hills and Kangaroo Island, the latter point has heightened relevance.

Facilitation of Distributed Energy Resources

Business SA supports SAPN's proposal to improve visibility of its low-voltage network, including through transformer monitors, particularly with the growing penetration of distributed energy resources. It is clear that the fast adoption of rooftop solar, including from businesses, is having a tangible impact on how SAPN manages the grid and overall grid security. Such scenarios also increase the need for additional interstate connectivity to ensure excess renewable electricity within South Australia can be matched with interstate demand.

CBD Upgrades

In light of the increase in reliability issues in Adelaide's CBD over the past couple of years, and the state of some existing infrastructure viewed by Business SA and others on a recent site tour, SAPN's modest upgrade proposals appear reasonable and prudent. Reliability in a state capital CBD is not only critical from an economic impact perspective but perception is heightened in this location, particularly considering only three years have passed since South Australia's state-wide blackout.

Property

One area of CAPEX Business SA does question relates to how various proposals which benefit non-regulated businesses like Enerven are considered for in the AER's decision process. While we acknowledge the well-established ring-fencing processes, and we do not dispute that SAPN are following the appropriate guidelines, we question whether those processes adequately deal with CAPEX proposals which materially benefit a non-regulated business under common ownership. This would not only apply to Enerven, rather any non-regulated business which benefits from the assets of any regulated business. Considering Enerven now has over 500 employees, approximately a third of SAPN's total, any CAPEX proposals which substantially benefit Enerven should be considered in the context of what is appropriate for electricity consumers more broadly to bear the risk on.

For example, in SAPN's current regulatory proposal, the $3.5 million project to upgrade the transformer refurbishment depot at Marlston North does not appear to take into account that Enerven has a substantial presence on this site. Business SA acknowledges that SAPN have been open about how they will allocate costs accordingly, but the business case fails to mention Enerven, and in any case, will Enerven continue to utilise that site to the same degree as the initial cost allocation? In light of the rapid growth of Enerven and other non-regulated subsidiary businesses of regulated monopolies across the nation, Business SA would like to see the AER pay more attention to these particular scenarios, particularly through its current Ring-fencing Guideline Review.

4. Operating Expenditure

Labour Costs

Business SA reiterates its previously communicated position that the labour cost forecasts formulated by BIS Shrapnel and relied upon by SAPN for its last regulatory determination turned out be materially above the actual outcomes which transpired in South Australia during the current regulatory period.

In future, Business SA supports the AER adopting its more conservative Deloitte Access Economics forecasts. These forecasts are already above CPI, but there needs to be a realistic link to the market for skilled labour in South Australia, particularly when the most recent construction wage index rise came in at 1.3% for 2018.

Vegetation Management

Business SA recognises the importance of vegetation management, particularly in light of the spate of recent bushfires experienced in both South Australia and across the nation. Acknowledging that SAPN's 2020-24 regulatory proposal was submitted before major recent fires, we are unable to comment on the extent, if any, that SAPN's vegetation management practices may need to change in future.

Subsequently, our comments in this section are predicated on the broader costs of vegetation management, including from a historical perspective, without consideration of any updated changes as a result of recent fires.

Business SA acknowledges the AER has chosen to support SAPN's vegetation management proposal in its entirety based on it being acceptable compared to interstate benchmarks. While we respect that perspective, it does not sufficiently answer the underlying question as to why the program at $215m is triple that of 2005-10, $68m, when we are now 9 years beyond the break of the millennium drought. On behalf of consumers that pay these costs, the AER should be able to satisfy itself as to why the step changes from the break of the millennium drought have been locked in when the overwhelming majority of years since have seen South Australia experience below average rainfall. It is not enough to compare SAPN's spending against interstate on this measure when there are unique climatic and topographic considerations driving requirements of vegetation management in South Australia.

Business SA appreciates SAPN providing information on its endeavours to improve efficiencies in vegetation management, including trials of more automated trimming vehicles, and the additional background as to what drives its vegetation management costs. However, this does not adequately explain why the step change which began around 2010 remains in place. If consumers are to accept step changes in future based on drivers such as extraordinary rainfall, we need confidence of price relief on the reverse side of such events, i.e. drought periods. Consumers are willing to accept that certain drivers of vegetation management are outside SAPN's control and can lead to increased costs, potentially in relation to bushfire mitigation, but with that acceptance comes an expectation that SAPN's costs can also reduce at other times which should be subsequently passed back to consumers. The regulatory compact is a two-way street.

While there may not be a strict correlation between rainfall volume and vegetation management spending, the correlation is high enough for SAPN to have justified the previous step change increase. Subsequently, we see no reason why it would not be similarly high enough to facilitate some cost decreases over 2020-25.

In SAPN's 2015-20 regulatory proposal, it argued '*vegetation management costs have doubled with the breaking of the 'millennium drought' in 2010 and the subsequent rapid growth in vegetation and resulting clearance infringements around power lines. These additional input costs have been and continue to be incurred to ensure community safety but do not increase MTFP outputs'*.

Vegetation management costs have now increased even further than double that of the 2005-10 regulatory period, providing solid grounds for the AER to revisit this aspect of SAPN's operating expenditure. This is particularly relevant in the absence of any new regulatory drivers which have materially increased SAPN's vegetation management requirements.