

9 October 2019

Mr Evan Lutton
Australian Energy Regulator (AER)
Level 38, 360 Elizabeth Street
MELBOURNE 3000 VIC

By email: evan.lutton@aer.gov.au

Dear Evan

Draft 2019 Annual Benchmarking Report – electricity distribution network service providers – September 2019

Thank you for your email of 26 September 2019 inviting comments on the AER's draft 2019 Annual Benchmarking Report for electricity distribution network service providers (DNSPs). SA Power Networks has reviewed the updated 'Economic Benchmarking Results for the Australian Energy Regulator's 2019 DNSP Annual Benchmarking Report' (**Economic Insights Report**) and the AER's draft 'Annual Benchmarking Report' and provides the following comments:

Economic Insights Report

SA Power Networks acknowledges that the 'DNSP consolidated benchmarking data (2018 updated 13062019) - corrected' spreadsheet has been updated to correct the state-based data for customer minutes off supply (CMOS) for South Australia. This CMOS data correction has generally been incorporated into the tables and charts contained within the Economic Insights Report, however there are instances where the changes may not have been appropriately reflected into the text of the report, these are detailed below.

In reference to Figure 4.16, the Economic Insights Report states that "SA's CMOS has been more volatile than for the industry and has had a relatively flat trend over the 13-year period"¹. This statement is in itself contradictory, with CMOS referred to as demonstrating both volatility and a relatively flat trend over the period. This was reiterated in reference to Table 4.8, where the report states "CMOS contributes less to TFP growth in SA than for the industry given the relatively flat trend in CMOS for SA"².

We note that while the trend may appear flat when considering the individual results reported in 2006 and 2018, as provided in Table 4.8, the annual results reported over the period demonstrate significant volatility. This volatility is demonstrated in Figure 4.16 of the report.

¹ Economic Insights Pty Ltd, Economic Benchmarking Results for the Australian Energy Regulator's 2019 DNSP Annual Benchmarking Report, 5 September 2019, page 44.

² Economic Insights Pty Ltd, Economic Benchmarking Results for the Australian Energy Regulator's 2019 DNSP Annual Benchmarking Report, 5 September 2019, page 45.

SA Power Networks recommends updating the Economic Insights Report to remove the reference to a relatively flat trend for CMOS in South Australia, this statement is misleading when compared to actual CMOS results over the period.

We also note that while the data in figure 4.16 - SA Output quantity indexes, 2006-2018 has been updated, the text within the updated report is still referring to the preliminary version of this figure. The report states "Since the customer numbers and ratcheted maximum demand outputs receive a weight of around 60 per cent of gross revenue in forming the total output index, in figure 4.16, we see that the total output index lies between these two output indexes". The total output index in the updated figure 4.16, is generally below customer numbers and ratcheted maximum demand over the period.

Draft Annual Benchmarking Report

The draft report acknowledges that SA Power Networks, CitiPower, Powercor and United Energy have consistently been the most efficient distribution service providers in the NEM, being amongst those service providers that are on the productivity frontier.³ SA Power Networks productivity performance improved in 2018, largely due to favourable weather over 2017/18, with no major event days recorded for the period.

We have identified some minor typographical errors in the draft report that we assume would be corrected in the AER's final benchmarking report. One inconsistency worth noting is related to Figure 5.5⁴, which refers to an average of 2013-17 in \$2016 whereas the other figures in section 5.2.1 (figure 5.3 and 5.4) refer to the average of the 2014-18 period and are reported in \$2018.

Impact of Operating Environment Factors (OEFs)

SA Power Networks is supportive of the AER's further review of OEFs, with the plan to collect and analyse data to quantify OEFs related to guaranteed service levels and vegetation management over the next twelve months.

SA Power Networks recognises that in 2017/18 the output quantity indexes have continued to be heavily influenced by the outcome of weather events across the National Electricity Market, with several distributors reporting large changes in CMOS. We also note that severe weather events will often result in increases in inputs related to higher operating expenditure (**opex**) for network remediation and Guaranteed Service Level (**GSL**) payments required under state based jurisdictional schemes.

The specific regulatory requirements of the current South Australian GSL scheme has historically resulted in large variations in SA Power Networks' opex, with annual GSL payments ranging between \$1m and \$26m⁵. The most significant being 2016/17, when SA Power Networks experienced an unprecedented nine major weather events during the period, resulting in more than \$25m in GSL payments over the period. We note that the South Australian GSL scheme will be amended from 2020. While this change will reduce the quantum of GSL payments, the payments will continue to result in significant volatility in opex reported.

Future Benchmarking Development

SA Power Networks welcomes the AER's review of DNSPs cost allocation and capitalisation approaches, with this review intended to be completed over the coming twelve months.

We feel that by 'freezing' the Cost Allocation Methods (**CAMs**) that applied in 2014 for benchmarking purposes, we are merely maintaining the cost allocation inconsistencies that applied at that time. We

³ Australian Energy Regulatory, Annual Benchmarking Report – Electricity distribution network service providers, September 2019, page iv

⁴ Australian Energy Regulatory, Annual Benchmarking Report – Electricity distribution network service providers, September 2019, page 35

⁵ Based on GSL payments made over the last ten years (\$ nominal)



note that the overhead capitalisation percentages applied by DNSPs has continued to change, in some cases significantly. These changes are generally made without requiring changes to the distributor's underlying CAM.

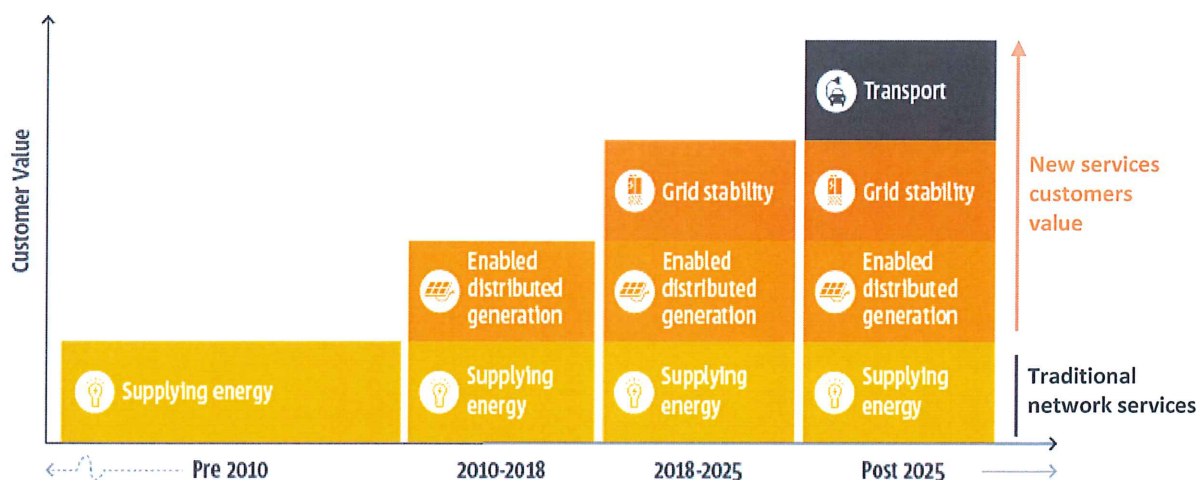
We are also concerned that a reliance on opex/capex ratios being broadly consistent as justifying a like-with-like comparison is flawed. Whilst opex is relatively stable, the same may not be true for capex and note that the percentage of opex/capex has fluctuated between 25% and 50% in some periods for some DNSPs. We also note that there is increasing potential for significant and lumpy changes to expenditures which distributors may incur at differing times, for example in shifting between inhouse ICT (mostly capex) to cloud based solutions (opex). We believe that a broad review of cost allocation and capitalisation approaches, will reveal whether cost allocation and capitalisation is a significant factor impacting on benchmarking results.

SA Power Networks also supports the AER's pending review of its benchmarking specifications to consider the impact of distributed energy resources (DER), noting we have provided a number of submissions⁶ to the AER and the Australian Energy Market Commission (AEMC) on this matter in recent years. We acknowledge the complexity of the review into DER and, noting this complexity, encourage the AER to commence this review at the earliest opportunity.

With the rapid increase in the number and total capacity of rooftop solar installations, the role of the distribution network, and the services required from it, have changed. Historically the role of the distributor was to deliver one-way energy flow, whereas now we are providing a platform for multi-directional energy flows from generation connected to our network. This is already having noticeable impacts in South Australia, where nearly one in three customers on our network have solar and there is ongoing growth in residential battery storage.

The distribution network is the critical infrastructure that enables the provision of many new services which customers have told us they value, as shown in Figure 1.

Figure 1 – The changing role of the distribution network



While energy throughput and maximum demand are factors included in AER benchmarking and opex growth forecasting, these factors are increasingly ceasing to adequately reflect the current drivers of network constraints and network costs. SA Power Networks is increasing its opex and capex inputs to manage the safety and reliability of the network with significant and increasing volumes of distributed energy being installed. This increased expenditure has been recognised by the AER in their recent Draft Decision for SA Power Networks Distribution Determination 2020 to 2025⁷. Specifically, the AER stated: "Overall, we accept this opex step change given that there is a likelihood

⁶ These include comments on various reports and reviews including the AER's 2018 Benchmarking Report, the AER's 2018 Productivity Review, the AER's OEF review in 2017, and the AEMC's Network Economic Regulatory Framework Review in 2019.

⁷ AER, Draft Decision – SA Power Networks Distribution Determination 2020-25, Attachment 6: Operating Expenditure, October 2019, LV Management, page 48-50; and AER, Draft Decision – SA Power Networks Distribution Determination 2020-25, Attachment 5: Capital Expenditure, October 2019, DSO Transition Program, page 25-27



that, at least in the short term, the output growth forecast may not fully compensate for the higher opex required to address DER”⁸.

In their recent report, Integrating Distributed Energy Systems for the Grid of the Future, the Australian Energy Market Commission has stated: “In particular, how the electricity distribution network is operated and the services provided by distribution network service providers (DNSPs) could change. A high DER environment could mean that DNSPs need to alter aspects of their operation, from transporting electricity one-way to being platforms for multiple services, facilitating electricity flows in multiple directions and facilitating efficient access for DER so that they can provide the greatest benefits to system as a whole. This change is likely to have implications on aspects of the regulatory framework.”⁹

SA Power Networks is well advanced on the transition to providing multiple new services to customers, with the penetration of solar and other embedded generation across the industry is forecast to continue to grow. This transformation needs to be reflected in the measurement of the efficiency of DNSPs.

Please contact Debbie Voltz on 08 8404 4074 if you require any further discussion or clarification of the above.

Yours sincerely



Richard Sibly

Head of Regulation

⁸ AER, Draft Decision – SA Power Networks Distribution Determination 2020-25, Attachment 6: Operating Expenditure, October 2019, page 50

⁹ Australian Energy Market Commission, Integrating Distributed Energy Resources for the Grid of the Future, 26 September 2019, page v

