PUBLIC SUBMISSION ON THE AER’S RESPONSE TO SA POWER NETWORKS’ REGULATORY PROPOSAL

To: The Australian Energy Regulator
Attention: Mr Sebastian Roberts, General Manager – Network Regulation

By email: SAelectricity2015@aer.gov.au

SUBMITTED BY: Mr John Herbst

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3 July, 2015

Dear Mr Roberts,

Thank you for the opportunity to provide independent feedback on the AER’s Draft Determination on SA Power Networks’ Regulatory Proposal 2015-2020 (‘The Proposal’). I understand that the Draft Determination is in force for this year along with a previous version of the National Electricity Rules (pre-November 2014), as a transitional measure. The use of the old Rules concerned me greatly, as the customer protections in Chapter 6 have been ignored for several years[[1]](#footnote-1). I am, however, relieved to find that the AER has acted with strength and diligence by rejecting the additional revenue requests that stemmed from SA Power Networks’ inefficient investment plans.

The AER appears to understand that The Proposal contains many fallacies, contradictions, overstated problems, and absurd solutions. The Proposal would have increased network costs and network profits at the expense of consumers, in both the short-term and long-term. Right now, customers are paying inflated prices due to previous ‘gold-plating’ and unnecessary capacity investment. While the AER has done well in spotting current inefficient expenditures, it unfortunately does not have the ability to dictate how the network spends its allowance. If there is any risk for investors in SA Power Networks, it is that the network will continue its out-dated model of incremental growth, which virtually ignores the potential of alternatives like distributed energy generation and consumer engagement. This business plan will create more stranded assets and ultimately bring about a ‘death spiral’ scenario, where fewer and fewer will be willing to pay for the upkeep of the crumbling and inefficient network. I hope it is clear to the regulators that the death spiral does not have to occur. It will require a strong, proactive effort from the regulator, because it appears that SAPN has veered off-course at present.

In making its final decision on the Revised Proposal, I ask the AER to consider the ways that it could promote long-term, dynamically efficient investment by SA Power Networks. Perhaps the AER can recognize a path to a less-costly network that is entirely different from SAPN’s plans. It is possible that this path costs a similar amount to the one we are own now, but promotes investment which will lower costs significantly over the coming years. We can look to other countries for ideas, and we can also be leaders in trials, promotion and adoption of new technology. For example, South Australia is well-situated for high-level penetration of community generation like Solar and solar-thermal, thanks to its vast area and low population density between population centres. Solutions to problems like voltage regulation and backflow could effectively increase the capacity of the existing network. When an efficient path is identified, the AER needs to send a signal for the network to immediately get on that path. Perhaps the AER can inform SAPN that future decisions about ‘efficient’ revenue will get smaller based on the new plan, whether or not the network adopts it. If the network is given warning and opportunity, then it cannot complain that it is too costly or too late to change course. This excuse to continue with inefficient plans is being used now! For the past several years in pricing proposals, SA Power Networks has refused to hold itself to the standard of an efficient network because the path is too costly[[2]](#footnote-2). While it is important to do the best with the investment that has already been made, it is even more important not to throw good money behind bad. ‘Efficient investment in the network’ is more than providing the correct rate of return, but also ensuring that decisions are made which put us onto the long-term efficient path.

We all hope that the benchmarks and associated revealed costs will help the regulator to recognize inefficiencies, but right now it is difficult to model an efficient network. The benchmarks just aren’t mature enough at present, but will certainly get better. While the benchmarks remain poor, there is a disincentive to getting too far ahead of ‘the pack’ when it comes to network efficiency. It is similar to a strategic problem in the AFL a few years ago, when players would not try their hardest to grab a ball off the ground, preferring instead to tackle the guy who picks it up. The problem led to packs of players following the ball around, pretending they were really playing their hardest. The rules were changed to reduce the number of ‘holding the ball’ calls, and now the players try their best again.

In preparation for the Final Determination, I ask that the AER scrutinize the claims of SA Power Networks carefully and thoroughly, to ensure that the public interest is protected and to apply the same level of rigor to the economics and statistics in The Proposal as SAPN and the other networks (and potentially the Tribunal) require of the AER’s Decisions. The regulator has historically been very lenient on the networks in assessing their claims and the evidence backing those claims. I hope that this round of determinations sends a strong signal to the networks that the era of exploitation is over.

If the AER accepts invalid arguments from SAPN and other networks, it creates a regulatory bias which violates the National Electricity Objective. This is due to the ability of the networks to appeal only parts of their decisions. The AER has the new power to make an overall revenue decision which is not strictly based on the building blocks. This means that it can now account for uncertainties without assigning precise numbers, instead balancing factors subjectively. The ability of the AER to use subjective judgment on its revenue decision can be considered superior to the strict building-block method because it results in less regulatory costs for what would be a similar overall outcome. Rigorous analysis of individual pieces may not be useful, especially when the variables being evaluated are complex and not easily quantified. For example, the AER may leniently accept inflated demand forecasts, but offsets its concern with a conservative estimate of efficient CAPEX. SAPN can appeal its CAPEX allowance without bringing up the demand forecasts which balanced the regulator’s decision. If the appeal is granted, a bias is introduced. The final decision can still be prudent and efficient despite what may be called errors in the component analysis which was appealed.

The new Decision process implies that making a case that the regulator has erred in one component of its decision should not automatically mean that the network is entitled to a change in overall revenue. The appeals process exhibits a risk of the network being awarded bonus revenue based on the process and the complexity which the network itself created, which is an inefficient outcome according to the National Electricity Objective. The best way for the AER to ensure that the correct result is reached on appeal is simply by applying its best efforts wherever it can. I believe that it has done well in this case, and I hope that this level of analysis continues.

On appeal, the AER’s decision should never be held to a level of economic rigor which would create a regulatory burden. Given the size and complexity of the Proposal, I would say that the AER has already taken on more burden than would have been efficient.[[3]](#footnote-3) SA Power Networks should not be rewarded for making a cumbersome proposal, hoping to benefit from unrecognized inefficiencies and a potentially biased appeals process. Instead, SA Power Networks should be penalized, sending a message to others that there is a limit to the complexity necessary to manage, regulate and plan an electricity distribution network. A regulatory proposal should be clear and clean, providing only accurate and unbiased facts and forecasts. I can only guess how many hours of work were wasted preparing the current Proposal. Not only has this wasted the Regulator’s time, but that of stakeholders and the public as well.

The NSW networks have apparently appealed their determinations based on some very technical statistical issues. Given that their revised proposals contained more complaints than revisions, I expect SA Power Networks will change little in its revised Proposal. This is unfortunate, and absolutely unjustified. It is clear that the AER’s methods are not perfect, but they do appear to strike a balance between rigor and parsimony, noting the significant resource constraints facing the regulator. The NSW networks appear to know a great deal about economics and statistics when criticizing the regulator, yet overlook (or actually inject) very basic problems which have biased their own results. Having read the AER’s full Decision on SAPN’s Proposal, I can find no place where it has objectively made an error. This is in stark contrast to my view of The Proposal itself, which is riddled with bias, insincerity, and fallacious arguments.

I’m sure many others are better positioned to explore the numbers that guided the regulator to its Preliminary Decision. I believe that SAPN has injected so much bias into its arguments that they should not be taken seriously, and that every piece of work submitted in the future be examined closely for signs of corporate profit being put above the long-term interest of customers. I wish to thank the AER for its excellent work, and I am confident that the quality is sufficient to be upheld on appeal. Please feel free to contact me if there is anything I can do to elaborate further, or to assist in the noble and enormous task of regulating SA Power Networks.

Best regards,

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1. For example, the Pricing Principles in 6.18.5. The illusion of protection is worse than no protection at all. [↑](#footnote-ref-1)
2. For example, see the Standalone Cost methodology in the 2013/14 proposal. [↑](#footnote-ref-2)
3. Does SAPN claim that its work on The Proposal is efficient expenditure? [↑](#footnote-ref-3)