The Hon Tom Koutsantonis MP
Member for West Torrens

MMRE15D00485

Government
of South Australia

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Mr Sebastian Roberts
General Manager, Network Regulation
Australian Energy Regulator
GPO Box 520
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Dear Mr Roberts

On behalf of the Government of South Australia I would like to acknowledge the work of the Australian Energy Regulator (AER) with respect to SA Power Networks' revenue determination for the 2015-2020 regulatory period. I welcomed the preliminary decision which will provide South Australian residents with much needed relief from escalating electricity prices from 1 July 2015.

It was pleasing to see the high volume of stakeholder submissions made to the AER which highlight the community's overall concerns in relation to the impact of high electricity costs, a point which formed the basis of the Government's own submission.

The revenue determination process is a complex one with significant milestones, the next being SA Power Networks' revised proposal due on 3 July 2015. When assessing the revised proposal it is crucial that the AER remains mindful of stakeholder views presented to date and remains responsive to ensuring that South Australian customers see real reductions in electricity prices.

While the preliminary decision goes a long way to addressing the issues raised in the Government's submission on SA Power Network's regulatory proposal there are two items in particular that the Government asks the AER to reassess. Firstly, the operating expenditure (opex) associated with vegetation management and secondly, the opex associated with the implementation of the connections framework under the National Energy Customer Framework (NECF).

The Government strongly supports the AER's decision not to accept SA Power Networks' proposed step changes to the opex associated with vegetation management. However, the Government does not agree with the AER's conclusion that the 2013/2014 base year opex represents an efficient basis for vegetation management for 2015-2020.

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This is because the vegetation management expenditure for 2013/2014 is based on the allowance provided in the 2010-2015 revenue allowance, which contained an escalated amount to enable SA Power Networks to become compliant with the vegetation clearance requirements as well as a portion of the cost pass-through which was approved in July 2013, both of which the Government considers should be removed with a step change from the 2013/2014 base year.

The AER provides that its forecast of opex is based on total opex in a single year and while "vegetation management could be one category of expenditure that declines relative to 2013-2014 levels, there possibly will be other categories of opex that will increase"[1]. I am advised that the AER can determine a negative adjustment to a category of opex if it is satisfied that there has been a material change to the regulatory requirements or circumstances. By way of example, the AER correctly allows a negative adjustment to SA Power Networks' annual distribution licence fee which will reduce from 1 July 2015.

Review of the 2005-2010 and 2010-2015 revenue determinations indicate there was a significant increase in the vegetation management allowance for 2010-2015 despite the 2008/2009 base year occurring in drought conditions. Given the difficulty in establishing precise reasons for the changes in the vegetation management allowance over the last two regulatory periods, the Government requests that the AER assess the past decisions to determine whether the factors that contributed to the escalated expenditure were one-off events and whether a prudent and efficient network operator should continue to recover those costs.

For example, it appears that the vegetation management allowance from 2005-2010 to 2010-2015 increased significantly to enable SA Power Networks to undertake increased vegetation clearance activity in order to become compliant with its vegetation clearance requirements under the *Electricity (Principles of Vegetation Clearance) Regulations 2010* which it was not meeting. This suggests that the additional expenditure was provided to allow for a unique circumstance and once SA Power Networks reached compliance it is reasonable to assume that it would require less expenditure to maintain its ongoing requirements.

Furthermore, the AER's final decision for SA Power Networks' 2010-2015 revenue determination of May 2010, does not appear to take into account changes to the *Electricity (Principles of Vegetation Clearance) Regulations 2010* of February 2010 which provide for a more light-handed approach to vegetation clearance in Non Bushfire Risk Areas than in the previous regulatory period. Hence, just as consideration is given to step changes resulting from additional regulatory requirements, the AER should also closely consider whether the less stringent vegetation management requirements should result in a downward step change which was not included previously.

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[1] AER Preliminary Decision SA Power Networks Determination 2015-2016 to 2019-2020, Attachment 7 – Operating Expenditure, page 7-102

Finally, but perhaps most importantly, it is understood that the 2013/2014 base year contains a portion of the $35.1 million cost pass-through allowance which the AER approved in July 2013. This additional allowance, which the AER determined resulted from uncontrolled and unexpected vegetation growth following the break in the drought, was approved for a one-off circumstance which should not apply in the new regulatory period. Therefore, the 2013/2014 base year should see a downward step change representing the portion of the cost pass-through allowance.

In addition, the Government is disappointed with the AER's preliminary decision to accept a $1.3 million step change in opex relating to the full implementation of the connection charging framework under the National Energy Customer Framework. The Government's initial submission provided that SA Power Networks is already applying the substantial requirements from the NECF in its Connection Policy 2013-2015 and that the calculations under the AER's Charging Guideline are not too dissimilar to the current connection charging regime. Given that this concern was not addressed in the AER's preliminary decision, the Government would welcome any evidence to support that a step change is in fact necessary.

An additional matter not previously addressed in the Government's submission relates to SA Power Networks' proposed step changes for customer service programs and specifically consumer education about the electricity industry and changes in the industry. The AER's position is that this is not the role of SA Power Networks[2]. While the Government agrees with the AER's general decision that such activities are discretionary and not required by regulatory obligations, noting the pending transition to cost-reflective network pricing, the Government sees the role of consumer education as a joint one to be shared by various organisations including Governments and network businesses.

Having outlined the Government's concerns with the preliminary decision, the Government is pleased to see that many of the concerns raised in our submission to the Regulatory Proposal have been addressed by the AER. In particular the Government supports the AER's preliminary decisions with respect to:

- Reducing SA Power Networks' proposed capital expenditure on asset replacement;
- Not accepting SA Power Networks' capital expenditure proposal to underground or relocate power lines in 20 targeted traffic black spots;
- Not accepting SA Power Networks' capital expenditure relating to improving network reliability given SA Power Networks' high performance and customer satisfaction with current reliability levels;
- Not accepting SA Power Networks' proposed expenditure and approach to metering and tariffs ahead of the pending regulatory changes relating to the competitive framework for advanced metering; and

[2] AER Preliminary Decision SA Power Networks Determination 2015-2016 to 2019-2020, Attachment 7 – Operating Expenditure, page 7-103

- Not accepting the general nominated pass through event.

The Government also welcomes the AER's preliminary position to accept SA Power Networks' proposed capital expenditure to ensure a secure electricity supply to Kangaroo Island. As submitted previously, the South Australian Government supports SA Power Networks' proposal to install a new undersea cable that supplies Kangaroo Island to ensure that the island's residents have a secure long-term power supply and to avoid the risk associated with the cable failing. The Government also notes the application of the Regulatory investment test for distribution (RIT-D) which applies to all network investment planning decisions of which the estimated cost exceeds $5 million. The Government's priority for Kangaroo Island is to minimise the risk of cable failure and any additional costs being incurred should the cable fail early. Therefore, the Government is confident that the RIT-D process will achieve the most appropriate solution and any savings achieved will be shared with customers as required under the regulatory framework.

On a final matter, the Government notes the AER's preliminary decision not to accept SA Power Networks' proposed rate of return of 7.62 per cent but instead decided that a rate of 5.45 per cent in 2015-2016 was more reflective of the current financial environment. The Government also notes the many views expressed by stakeholders and a subsequent further reduction in the cash rate in May 2015, and is confident the AER will take these factors into account when forming its final decision.

Should you have any questions in relation to this submission, please contact Mr Vince Duffy, Executive Director of the Energy Markets and Programs Division, Department of State Development on (08) 8226 5500.

Yours sincerely

Tom Koutsantonis

Hon Tom Koutsantonis MP
Minister for Mineral Resources and Energy

30th June 2015