Hon Dan
van Holst Pellekaan MP

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CONSUMER COMMISSION
22 MAY 2019
CANBERRA

Government
of South Australia

MEM19V0517

Mr Warwick Anderson
General Manager
Networks Finance and Reporting
Australian Energy Regulator
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Dear Mr Anderson

Thank you for the opportunity to comment on the SA Power Networks' Regulatory Proposal for 2020-2025.

The SA Government acknowledges that the electricity distribution network within South Australia is transitioning from the traditional one-way flow to more renewable energy and consumer based distributed energy resources. As the owner and operator of the distribution network, it is prudent for SA Power Networks (SAPN) to assess and highlight issues which could impact the reliability and security of the State's power supply. The SA Government supports SAPN raising and seeking to manage the issue that South Australia's high penetration of rooftop solar PV is causing such as increased voltage issues, low daytime demand and other issues in their low-voltage distribution network.

This is a significant challenge facing South Australia, and requires a concerted approach from all parties. Government programs such as the Home Battery Scheme and the Virtual Power Plants will play a part in mitigating these emerging impacts and assist consumers to manage their electricity demand from the network.

To this end, the SA Government strongly supports the intent of SAPN's Future Network Strategy as well as the prudent expenditure on the Low-Voltage Management program to ensure all South Australian consumers benefit from distributed energy resources. More sophisticated integration of distributed resources would avoid negative impacts on consumers from alternatives such as blanket limits on distributed resources.

The SA Government has been a key stakeholder in the consultation process conducted by SAPN in the development of SAPN's regulatory proposal for 2020-2025 and lodged a submission to SA Power Networks' Draft Plan in September 2018. In that submission, the SA Government encouraged SAPN, in development of their regulatory proposal, to:

- provide greater details on proposed large expenditure items such as Information Technology, replacement and augmentation expenditure;
- fully articulate the reasons behind the actual and forecast underspends in this regulatory period;

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- find further savings and productivity growth; and
- identify more specific demand management strategies.

Unfortunately, SAPN's regulatory proposal does not adequately address many of the elements requested by the Government and other stakeholders during the consultation process, though I note the AER's recent decision to impose an annual 0.5 per cent productivity growth on distribution network service providers. While SAPN correctly identify the three key consumer concerns raised during their consultation, their Regulatory Proposal does not address other key underlying consumer and stakeholder concerns from their consultations. I note that, other than AER's final decisions on the rate of return and tax allowance in December 2018, SAPN's Regulatory Proposal only slightly varies from their Draft Plan in August 2018 with regards to total capital and operating expenditure. I encourage the AER to fully assess the issues raised in our attached submission to ensure that all SAPN's current period underspends and proposed expenditure in 2020-2025 is fully justifiable.

I trust that this submission assists the AER in determining a suitable outcome that meets the needs of SAPN to manage the transition underway in our electricity network and the needs of all South Australian electricity consumers for downward pressure on their electricity prices. I look forward to the AER's draft determination in September 2019.

Should you have any questions in relation to this submission, please contact Mr Vince Duffy, Executive Director, Energy and Technical Regulation, Department for Energy and Mining on [redacted].

Yours sincerely

[redacted]

Hon Dan van Holst Pellekaan MP
Minister for Energy and Mining

15 / 5 / 2019

Att: Government of South Australia Submission to the Australian Energy Regulator on the SA Power Networks' Regulatory Proposal 2020-2025

GOVERNMENT OF SOUTH AUSTRALIA SUBMISSION TO THE AUSTRALIAN ENERGY REGULATOR ON THE SA POWER NETWORKS' REGULATORY PROPOSAL 2020-2025

To assist the Australian Energy Regulator (AER) in its assessment of SA Power Networks' (SAPN) Regulatory Proposal for 2020-25, the Government of South Australia (SA Government) provides comments on the proposed capital and operating expenditure relating to:

1. Asset replacement
2. Network augmentation - strategic
3. Non network Capital expenditure for IT, Property and Fleet
4. Operating Expenditure - Corporate costs
5. Proposed step changes for operating expenditure
6. Distribution Licence Fee
7. Stakeholder Engagement

1 Capital expenditure - Asset replacement

In recognition that much of SAPN's network infrastructure was built in the 1950s and 1960s, the AER, and previously ESCOSA, have approved significantly increased allowances since the 2005-2010 regulatory period for asset replacement. For instance, the AER approved $239 million for 2010-2015 and increased this in 2015-2020 to $759.4 million ($2020).

The Office of the Technical Regulator supports the new condition-based risk management model developed by SAPN. However, it is difficult for stakeholders to assess the validity of capital expenditure requested for this purpose. As asset replacement is 38.4% of the proposed capital expenditure and the forecast underspend of $89.8 (approximately 12% of the 2015-20 allowance), the SA Government encourages the AER to fully assess whether the proposed asset replacement expenditure is fully justifiable. The AER's assessment should consider whether it is reasonable to expect that SAPN can implement an asset replacement program of this value in the period with the other pressing issues SAPN has raised, such as addressing the transitioning distribution network.

2 Capital expenditure - Network augmentation – strategic

The SA Government is supportive of prudent capital expenditure by SAPN, as outlined in Supporting Document 5.18 LV Management Business Case. Given the high penetration of rooftop solar PV and forecasts of continued uptake, and the Government's Home Battery program and Virtual Power Plant programs, it is acknowledged that SAPN need to continue their work in reducing the impacts of solar PV on their distribution network (for instance, negative demand) while maximising the benefits of distributed energy resources for all consumers. This position is informed by evidence presented by AEMO and SAPN. As stated in the business case, the SA Government supports prudent investment in this area.

It is acknowledged, however, that this is an emerging issue and trials are underway to help inform the role of distribution network businesses, AEMO and other market participants. This makes determination of efficient costs for this work program difficult, but not a valid reason for rejecting or delaying this program. The SA Government encourages the AER to make specific enquiries with AEMO and relevant experts to assess the efficiency of the expenditure request.

The Government is supportive of SAPN's preferred option (option 2a) outlined in the business case as it is likely to be complementary with other initiatives for instance, AEMO's planned DER Register.

3 Capital expenditure – Non-Network

3a Information Technology

The 2015-20 IT allowance was a significant increase over the previous regulatory period and SAPN propose basically the same allowance for 2020-25. SAPN correctly identify the extent of their IT investment as a key customer concern during the Deep Dives in 2018. However, in response, the proposed IT expenditure increased from $261m in their Draft Plan to the proposed $285m. There is little justification for this 9% increase other than "vendor quotes received".

The SA Government is concerned that SAPN is seeking additional allowances for two key IT programs, the billing systems replacement and the assets and works project, which SAPN requested $63.6m and $63.9m respectively in 2015-20 period. These programs subsequently were delayed for other internal IT priorities. The SA Government trusts that the AER will fully consider whether the additional funds for these delayed programs ($25.5m and $40.8m respectively) are fully justifiable.

The SA Government strongly rejects the proposed expenditure ($3.8m) for SAPN's ring-fencing program. SAPN states that this expenditure "will address deficiencies identified following our 2018 ring-fencing compliance audit." Given the AER published its Final Ring-fencing Guideline on 30 November 2016 with distribution network service providers to be compliant no later than 1 January 2018, the SA Government is concerned that this expenditure should be have been undertaken in the 2015-20 regulatory period given the capital expenditure underspend for this period. Also, the SA Government queries why this expenditure should be paid for by SA consumers and added to the Regulated Asset Base. The AER has stated that ring-fencing obligations generally required the separation of the accounting and functional aspects of regulated distribution service from other services provided by the distribution network service provider. It ensures a level playing field for contestable services in competitive market by mitigating the advantage a distribution network service provider may have. Continued allowance of SAPN to recover costs associated with ring-fencing under the economic regulation process may undermine achievement of this objective.

While noting the importance of cyber security within the current threat environment, the SA Government seeks assurance that the proposed expenditures of $11.5m for general cyber security (a 69% increase on the previous period) and $5.0m for Operational Technology security are fully justifiable.

3b Property Expenditure

SAPN has underspent approximately 30% of the property allowance in 2015-20 with the stated primary reasons being "we have deferred some large property refurbishments to later in the current 2015-20 period (or into the 2020-25 period) until we have greater clarity and certainty of the use and function of some properties." For instance, the Supporting Document 5.31 Property Services states that for the Seaford depot "the design of this new southern depot is scheduled for 2019/20. The delay is due to wanting to learn from our design and approach at the Angaston depot prior to beginning work on the Seaford depot. The build is scheduled to commence in 2020/21."

However, in SAPN's revised proposal for the 2015-20 period, SAPN stated "we need to, as a minimum, construct a new depot at Seaford and a larger depot at Nuriootpa. These projects will be undertaken in the first half of the 2015-20 RCP at a forecast cost of $8.8m (June 2015 $m) and $7.9m respectively. This expenditure is a material cost that we will need to be incurred in the 2015-20 RCP in order to comply with our regulatory obligations and requirements."

From SAPN's proposal, they are seeking approximately $7m to build the Seaford depot and the Nuriootpa property is to be sold in 2020-25. This raises questions regarding their previous justification for this property expenditure. The SA Government would like further information justifying the need for the Seaford depot to allow stakeholders to assess whether this is efficient expenditure for the 2020-25 period. The SA Government also encourages the AER to examine this apparent deferral of SAPN's regulatory obligations and requirements and the significant underspend in this capital expenditure in their assessment of SAPN's property proposed capital expenditure.

The SA Government has been advised that the AER is seeking clarification on some discrepancies within the Attachment 5 – Capital Expenditure (Tables 5.46 and 5.47) and the Supporting Document 5.31 Property Services (Tables 3 and 10) for both the 2015-20 and 2020-25 periods and encourages the AER to seek clarity around the actual underspend in 2015-20.

3c Fleet

SAPN's proposal outlines a $41.7m (31%) underspend for fleet capital expenditure in the 2015-20 period. This underspend includes a $11.035m underspend in 2019-20. The SA Government queries whether SAPN should be replacing its trailers now, using some of the forecast underspend in 2019-20, given the stated "increasing number of trailers being replaced due to poor condition and safety concerns". The AER should request SA Power Networks to reduce its fleet capital expenditure for the 2020-2025 period and move forward with some of its proposed program in the current period noting SAPN is highlighting safety concerns which should be managed as a priority and in a timely manner.

Also, the SA Government questions whether the proposed 2020-25 forecast expenditure should be above the current actual/forecast expenditure for the 2015-20 particularly given the stated reasons for the underspend in 2015-20 – that is, a highly competitive supply market, better procurement contracts, and vehicle selection. It is unlikely that these conditions will deteriorate in the 2020-25 period and therefore the allowance should be reset to take into account these conditions.

As for the proposed Property expenditure, the SA Government has been advised that the AER is seeking clarification on some discrepancies between the Attachment 5 – Capital Expenditure (Table 5.51) and the Supporting Document 5.30 Strategic Fleet Plan (Table 7) for the 2020-25 period.

4 Operating expenditure

4a Corporate costs

The SA Government notes that SAPN, unlike many other DNSPs, do not capitalise any of their corporate costs, and as a result, corporate costs are a larger percentage of operating expenditure. However, the SA Government is concerned that there appears to be a significant increase in forecast corporate costs from 2019-20 to 20-21 (approximately $5m or 6.6%) followed by smaller increases in subsequent years. This results in an increase in corporate costs over the period of approximately $10m or 13.5%. In the absence of a stated reason within the proposal for this increase, the SA Government suggests that the AER should fully question this proposed increase in corporate costs.

4b Proposed step changes

The SA Government understands that the AER will fully examine each of the proposed step changes. In particular, the AER should consult with the Critical Infrastructure Centre within the Australian Department of Home Affairs to fully understand the implications of the *Security of Critical Infrastructure Act 2018* on SAPN's annual operating costs.

4c Productivity growth

During SAPN's consultation deep dives and on its Draft Plan in 2018, almost all attendees queried the lack of forecast productivity growth for operating expenditure. In our submission to SAPN on the Draft Plan, I urged SAPN to identify some productivity growth in preparing their formal proposal. However, SAPN notes in its proposal that it has remained strongly opposed to any productivity growth despite this consistently strong feedback from customers and key stakeholders.

As the AER published its final decision on forecasting productivity growth for electricity distributors on 8 March 2019, the SA Government notes that SAPN's proposed operating expenditure will now be subject to an annual 0.5% productivity growth rate.

5 Operating expenditure - Distribution Licence fee

The SA Government charges SAPN an annual licence fee which for this regulatory period, 2015-2020, is $2,257,600.

In accordance with the *Electricity Act 1996*, as the Minister for Energy and Mining, I am responsible to fix the level of electricity industry licence fees from time to time, including distribution licence fees. I expect to set the annual electricity distribution licence fee around $ 2,935,000 per annum for the 2020-25 regulatory period.

6 Proposed Tariff Structure Statement

The SA Government supports the move to cost-reflective pricing as a means to equitably recover distribution network costs from those customers that impact the distribution network and incentivise all customers to minimise their load requirements. Further, the SA Government supports SAPN's intention for the new tariffs to shift loads from the traditional peak demand periods into the middle of the day when there can be surplus solar PV energy within the network. Without appropriate price signals to incentivise operation of solar PV and energy storage in a manner which benefits the customer and the system as a whole, network security issues are likely to increase over the period.

The SA Government expects SA retailers to offer these price signals to customers and to fully explain to residential customers how they can manage their electricity costs on such tariffs. This will be particularly important for those residential customers identified in **Figures 17.45** and **17.46** of Attachment 17 who have greatest power consumption in peak periods. Government programs such as the Home Battery Scheme and the Virtual Power Plants provide the opportunity for customers to take greater control of their electricity use and manage it to reduce their electricity costs. The Government will also be undertaking demand management trials which will assist customers to respond to time of use tariffs.

The proposed changes for small business, particularly where these are increasing, will need to be fully explained and any opportunities for reducing these increases through tariff change, will need to be communicated with the SA business community.

The SA Government welcomes the removal of the Critical Peak Pricing option given the complexity of that proposal.

7 Stakeholder engagement

The SA Government welcomes the extensive consultation processes that SAPN developed and conducted for the preparation of their 2020-25 regulatory proposal. The lengthy process covered metropolitan and rural areas; included well-organised specific issue reference/consultative committees; a series of facilitated, targeted Deep Dives; and was strongly supported by SAPN senior executives and staff. The SA Government attended most of the Deep Dives and several of the reference committees during the consultation period.

It should be noted however, that particularly at the facilitated deep dives, not all expenditure items could be fully explored and discussed. Often the amount of information provided at these sessions could be over-whelming and time constraints may have led to balancing the levels of knowledge of the participants in the session with the overarching consumer/stakeholder concerns, particularly reducing overall SAPN prices to the consumer. The SA Government encourages the AER to consider the feedback provided to SAPN on its Draft Plan as similar sentiments could be likely in submissions to the Regulatory Proposal.

SAPN has accurately reported the three overarching issues relayed by consumers and stakeholders during the consultations: that is, keeping prices down, maintaining a safe and reliable network, and transitioning to the new energy future.

However, underlying these overarching issues were other issues that are not appropriately reflected in SAPN's proposal. These include:

- A better articulation of the reasons for the significant underspends in the 2015-20 regulatory period particularly in capital expenditure
- The need for productivity growth following periods of declining efficiency within the broader DNSP community
- Better description of the customer benefits of the ongoing, large Information Technology capital expenditure, and
- The expectation that SAPN would reduce capital and operating expenditure in 2020-25 rather than proposed a predominantly business-as-usual proposal.

In addition, whilst SAPN has proposed a flat tariff over the five year period, SA Government feedback from consumers is that they would see greater benefit from a profile more akin to the previous period, with a larger drop in the first year followed by incremental increases over the regulatory period.

While SAPN state that capital expenditure has reduced by $109m since the Draft Plan, much of this is due to regulatory decisions outside of SAPN's control for instance, the AER's final decisions on the rate of return and tax allowance in December 2018 together with a reduction of regulatory superannuation. Effectively, this is reflected by the capex-opex trade-off for cables and conductor repairs ($70m) and a regulatory adjustment for superannuation ($38.3M). This results in minor changes – increases and decreases in other expenditure items with little or no clear explanation for any of the increases.

From the SA Government's experience of the consultation process, SAPN tried to cover all of the diverse concerns expressed during the process but has failed to deliver greater price reductions probably expected from the consultation process.

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