

19 February 2014

Mr Adam Petersen
Director
Australian Energy Regulator

By Email: SAelectricity2015@aer.gov.au

Dear Mr Petersen

Preliminary positions paper – Framework and Approach for SA Power Networks, Regulatory control period commencing 1 July 2015

SA Power Networks welcomes the opportunity to comment on the AER's preliminary positions with respect to the replacement Framework and Approach Paper (F&A) to be published by 30 April 2014. The F&A is an important first step in the determination process for the 2015-2020 regulatory control period (RCP) and will allow SA Power Networks to shape its Regulatory Proposal for that determination. Our Proposal will be lodged with the AER in October this year.

Our detailed comments on the AER's preliminary F&A positions are set out below. We generally support and agree with most of the AER's preliminary positions although, in some areas, we propose further refinement of the AER's positions as we consider these will be beneficial.

Changes to classification of distribution services

Public Lighting services

Summary

Public lighting services are currently classified as Negotiated Distribution Services (NDS) and the AER's preliminary position is to retain this classification.

SA Power Networks has been negotiating public lighting charges with the Local Government Association (LGA) and the Transport Services Division of the Department of Planning Transport & Infrastructure (DPTI) (public lighting customers) for many years, with the most recent round of negotiations commencing in 2010. These negotiations have become protracted and have imposed a significant burden on our resources. A successful negotiation is still to be concluded and may well require the AER to determine prices, should a formal dispute be raised. We note that the prices currently being charged to public lighting customers are prices independently approved by the Essential Services Commission of South Australia (ESCoSA) in 2010, escalated by CPI.

We therefore propose that it would be more efficient and appropriate for existing public lighting services to be reclassified as Alternative Control Services (ACS) with prices for the next RCP approved by the AER.

We also propose differentiating between existing and new public lighting services. For new public lighting services, potentially employing new lighting technologies or other service innovations, it would be more appropriate for these services to be negotiated and therefore remain classified as NDS.

Classification of services

Negotiations in respect of public lighting charges have been challenging since the advent of the NEM. ESCoSA has made two determinations as regulator, the first at the request of the Treasurer in 2001, and the second in 2010 to resolve a dispute raised by public lighting customers. In December 2013 we were advised by the LGA and DPTI that they intended to ask the AER to make a determination in respect of the current negotiations.

The primary issue in dispute is the return on and return of capital already invested in lighting infrastructure. Despite these costs being included as legitimate costs in ESCoSA's determination, public lighting customers are unwilling to accept their validity.

In these circumstances we consider that the negotiate/arbitrate model is not operating as intended and as such is inappropriate for existing public lighting services (**indicative price list public lighting services**). In contrast, we find that the negotiate/arbitrate model is working well for new, customer-initiated services such as recent LED lighting trials (**negotiated public lighting services**) and therefore propose these remain as NDS.

SA Power Networks considers that the appropriate form of control for public lighting services that are currently indicative price list services, where asset costs are nearly 50% of total costs, is to determine prices based on the building block and post tax revenue model. On this basis, we request that the classification for indicative price list public lighting services be changed to ACS. We also understand that nearly all public lighting services are classified as ACS in all other jurisdictions, and therefore such a change would contribute to national consistency.

Form of control

Whilst the overall price for existing public lighting remains in dispute, SA Power Networks has managed to agree an ongoing tariff rebalancing regime with public lighting customers. Public lighting tariffs have been progressively moving towards a more cost reflective structure (relative to one another) over the past three years. Public lighting customers have agreed to an annual process under which tariffs may be rebalanced such that no individual customer experiences a change in total costs of more than CPI plus 3%.

SA Power Networks recommends that the form of control for public lighting services classified as ACS be a weighted average price cap (**WAPC**). Under a WAPC, SA Power Networks would continue the move to more cost-reflective tariffs adopting a similar arrangement to that above.

Benefits

SA Power Networks believes that both customers and SA Power Networks will benefit from this change of regulatory classification and form of control. SA Power Networks acknowledges that there will be an administration cost to transition public lighting services from NDS to ACS, but believes that these would be minimal and that the benefits will outweigh such costs.

For new public lighting services, customers will continue to enjoy the full flexibility of negotiating an agreement that suits them, with the safety-net option of utilising indicative price list services, classified as ACS, as an alternative to a negotiated agreement.



Meter Provision and Maintenance, and Energy Data Management

Metering services – Type 5

We note that the AER's preliminary position is to retain the classification of Type 5 metering as NDS, largely because of its "non-standard" features. In the current environment, we support this position. However, late in January 2014 the South Australian Government released a draft policy document¹ for consultation recommending the installation of "smart ready" meters for all small customers requiring a new or replacement meter. There are approximately 40,000 new and replacement meters installed each year in South Australia. Under the proposed policy, customers could opt out and have a traditional accumulation meter installed instead.

Smart ready meters as defined by the policy could be seen as meters that would meet the requirements of Type 5 meter installations: capable of measuring and recording power usage over half hour periods and read manually. Implementation of this policy would see Type 5 metering become the new "standard" metering. Given this, the meter volumes involved each year and the homogeneous nature of the services involved, it would be more efficient for these meters to be classified as ACS and the AER to determine the charges. We also suggest that such a classification would better support the policy objectives of the South Australian Government.

If Type 5 meters remained classified as NDS, SA Power Networks would be obliged to first negotiate with each customer before it installed any Type 5 meters, or to develop a standard agreement in respect of this type of metering. The potential for customers to request a negotiation, or the requirement to educate customers in respect of a standard agreement and to administer such an agreement, would create an additional and unwarranted cost burden on SA Power Networks. Under the current Negotiating Framework, all of the additional costs would need to be reflected in the meter provision tariff, which, with the policy's option to opt out, we believe would adversely affect a broad acceptance of the new meters.

The benefits of such a policy accrue to customers much more as network users than as meter users, which further reduces the likelihood that such a policy would succeed where the meters were classified as NDS.

In the event that the policy as drafted is introduced, we recommend that Type 5 metering be classified as ACS.

Metering services – Type 6

SA Power Networks notes that the AER is proposing to reclassify three type 6 metering services (namely: energy data services except the quarterly meter read service, non-chargeable unscheduled metering and metering investigations) from Standard Control Services (SCS) to ACS. The key reason for this reclassification is the belief that this will enable an easier transition to future contestability in the provision of metering services. Only type 7 metering services would remain in SCS.

SA Power Networks supports costs directly attributed to reading meters and collecting meter data being classified as ACS. However, identification of such costs and the retention of other meter data management costs relating to provision of network services warrants further consideration.

SA Power Networks operates a large number of integrated work processes and information systems which receive and manage accumulation (Type 6 meter) data and other interval (Type 1-4 and Type 5 meter) data, provide this data to the market and issue network bills to retailers. Irrespective of whether SA Power Networks or external providers read the meters and undertake the data

¹ Government of South Australia, South Australian Policy for New and Replacement Electricity Meters Discussion Paper, January 2014.



forwarding role, we will still need these systems to receive data from the market and produce network bills.

With the proposed transfer of 'Type 6 meter data services' to ACS, some of the operating costs associated with these processes and systems are wholly related to the management of ACS metering data and can easily move to ACS. Other systems and capabilities would still be required by us even if SA Power Networks no longer undertook any meter provision services. These services should be classified as SCS.

Import and export metering

The AER has also stated its intention to retain the current NDS classification for type 6 import/export meters utilised to connect photo-voltaic installations, but asks for submissions as to whether a different classification is clearly more appropriate.

SA Power Networks advises that many of the metering services costs associated with these meters are currently not solely allocated to NDS. Import/export metering services costs are recovered through a combination of up-front charges and ongoing meter tariffs. The up-front charges generally recover the meter installation costs, which are allocated to NDS, and meter tariffs apply to recover asset costs and ongoing reading and maintenance costs, which are allocated to ACS.

The charges levied for import/export metering installation services differ depending on the number of phases of the meter, size of connection and whether it is a new or existing connection:-

- For a single phase, new basic connection (up to 63 Amps per phase) import/export meter, there is \$0 up-front charge and so all metering costs are allocated to ACS and recovered through the Type 6 meter tariff (currently \$30.70 per annum).
- For a three phase, new basic connection (up to 63 Amps per phase) import/export meter, a \$135 charge is levied up-front which reflects the approximate 'non-standard' cost differential between single phase and three phase meters and this is allocated to NDS. The remaining three phase meter costs are allocated to ACS and recovered through the Type 6 meter tariff (\$30.70 per annum);
- The installation of import/export metering at existing basic connections (below 63 Amps per phase) and all new and existing non-basic connections (greater than 63 Amps per phase) are non-standard services and the whole of the installation cost is treated as NDS. There are fixed up-front charges for single phase and three phase import/export meters to recover the (average) installation cost. All ongoing metering costs (asset costs, reading and maintenance) are recovered through the Type 6 meter tariff (either \$30.70 per annum for direct-connected meters or \$133.10 per annum if they are large consumption customers with current transformer-connected meters).

For administrative expediency and to limit cost allocation errors, SA Power Networks considers it would be appropriate to clarify the definition of ACS Type 6 metering services, to make clear that they include the standard component of import/export meter services.

Small customer – meter transfer fees

Over the next RCP, it is increasingly likely that Retailers or other meter service providers will seek to replace our small customers' Type 6 metering with smart meters (perhaps Type 4 or Type 5). This is consistent with the national energy policy and the proposed State Government policy referred to above.



From the time a small customer churns to another meter provider, they will no longer pay our metering fee. If metering fees are established by the AER with an insufficient allowance for meter churn we would under-recover Type 6 metering costs.

This risk could be mitigated by introducing a new meter transfer fee on small customers. We currently have exit fees for large customers with a Type 6 meter. However, the introduction of an individual meter transfer fee on small customers may be seen as a more significant barrier to meter churn and hindering the State Government's desire for innovative service offerings to customers. We would welcome the opportunity to discuss with the AER alternatives that would simplify the administration and costs of transfer away from existing accumulation meters and ensure that these costs to SA Power Networks' customers are appropriately and efficiently managed. Possible options include:

- 1) The AER provide an explicit cost allowance for small customer Type 6 meter churn to cover this risk. This cost could be allocated either to ACS or SCS.
 - a) If allocated to ACS, costs would be recovered under meter tariffs paid by SA Power Networks' remaining meter customers.
 - b) If allocated to SCS costs would be recovered from all customers through distribution tariffs.

SA Power Networks suggests that an allocation to SCS would be preferable and have a very minor impact on network tariffs. In either case this would require the AER to either determine forecast meter churn to establish an appropriate allowance or make annual adjustments to allowed revenues / pricing based on actual churn. This latter approach would impose more administrative costs.

- 2) Classify all existing Type 6 meters as SCS and accelerate their depreciation. This would allow SA Power Networks to recover the major portion of metering costs in a shorter time frame, with minimal increase in distribution tariffs and avoid the need to forecast meter churn, make annual revenue/price adjustments, or administer and collect meter transfer fees for these meters.
- 3) Classifying all standard meter provision as SCS. If another metering services provider installed a new meter, then the customer would receive a rebate.

Control mechanisms

Standard control – revenue cap

SA Power Networks notes the AER's proposal to alter the form of control on SCS from a WAPC to a revenue cap for the 2015-2020 RCP. We consider this form of control is appropriate for the next RCP and reinforces incentives for SA Power Networks to undertake demand side management projects to reduce total costs. However, we also note that beyond the next RCP circumstances may change whereby greater certainty in demand response by customers and clarity around the introduction of cost reflective tariffs would support a return to a WAPC or the use of another form of control.

Under a revenue cap, SA Power Networks expects any over or under recovery of actual revenue will be held in an 'overs/unders' account which will be used to adjust the Maximum Allowed Revenue in the next year. The AER has indicated the potential use of a tolerance mechanism on this overs/unders account to manage potential price volatility.

The AER has used different approaches to overs/unders accounts in Tasmania and Queensland. As a principle, any tolerance mechanism should seek to allow the recovery of allowed revenue for a RCP in that RCP and should not be designed in a way that revenues are deferred well into the subsequent RCP. We expect the AER will liaise with SA Power Networks to develop a pragmatic and workable



arrangement before any decision is made at the determination stage. In any case, deferral of revenue recovery should be indexed using the weighted average cost of capital to allow for recovery of the time value of money.

Alternative control – price cap

SA Power Networks notes the AER's proposal to alter the form of control on ACS from a WAPC to a pure price cap. ACS currently includes metering services only – predominantly Type 6 meter provision and quarterly reading services.

The costs to provide metering services include both fixed components (for example to establish and operate service contracts and information systems) and variable components (transaction costs related to provision and reading of individual meters and management of data from those meters). The fixed costs are independent of meter volume whereas the variable components are directly volume dependent.

Using a price cap approach to recover these costs, the AER must approve the forecast volumes for individual metering services over the next RCP. To the extent that actual meter volumes retained by SA Power Networks are below forecast (for example if meter churn to alternative metering service providers is greater than expected), SA Power Networks will under-recover its fixed metering services costs through the prices approved by the AER.

We submit that a revenue cap (consistent with the form of control proposed for standard control services), or to a lesser extent a WAPC mechanism would ameliorate this risk by providing more flexibility to adjust prices within the different metering services offered. A pure price cap approach does not have this flexibility.

Noting our previous comments recommending existing public lighting services be classified as ACS, we submit that a WAPC form of control would also be appropriate for public lighting services classified as ACS.

Control formulae

SA Power Networks notes the proposed formulae to give effect to the revenue cap on SCS include certain adjustment mechanisms. The allowable adjustments will be decided at the determination stage. SA Power Networks believes the SCS control formulae are appropriate but reiterates the previous comments that any deferral of revenue recovery must include appropriate adjustments for the time value of money.

SA Power Networks notes the proposed formulae to give effect to the price cap on ACS also include an adjustment mechanism. SA Power Networks believes the proposed ACS control formulae are appropriate for metering services classified as ACS.

The formulae would also be appropriate for existing public lighting services, should these be classified as ACS.

Service Target Performance Incentive Scheme

SA Power Networks notes and supports the AER's proposed changes to align the Service Target Performance Incentive Scheme (STPIS) for SA Power Networks to the national scheme and increase revenue at risk from $\pm 3\%$ to $\pm 5\%$. We also note and support the intention to retain the Guaranteed Service Levels determined by the ESCoSA in the STPIS.



The alignment to the national scheme will alter which days are classified as Major Event Days (MEDs). Under the current STPIS applying to SA Power Networks (as detailed in the AER's 2010-2015 Distribution Determination) the number of MEDs is approximately 5 days per annum. Under the national scheme, the number of MEDs will be approximately 2.5 days per annum - around half the number of days currently determined.

The change in how a particular day is classified as a MED will create transitional issues when calculating targets for not only the next RCP, 2015-2020, but also the subsequent RCP, 2020-2025. This is because the targets set for the upcoming RCP are based on the most recent five years actual performance. These five years span both the current and previous RCPs².

Section 2.6 of the STPIS Guideline details the factors that the AER will take into account when determining the appropriateness of the proposed transitional arrangements. Clause 2.6(d) of the Guideline states:

- (d) *The AER shall decide on the appropriateness of the arrangement to address a transitional issue on the basis of:*
 - (1) *materiality of the issue*
 - (2) *reasonableness and fairness to the DNSP and customers*
 - (3) *consistency with the objectives as set out in clause 1.5.*

SA Power Networks submits that in moving to the national STPIS scheme, transitional arrangements are necessary to ensure that SA Power Networks is not advantaged nor disadvantaged and that those arrangements mimic the outcome (revenue at risk) that SA Power Networks received in each regulatory year of the current 2010-15 RCP. This requires recalculating the actual performance of each year of the 2010-2015 RCP using the national scheme's method for calculating MEDs and adjusting each year's performance by an amount which achieves the equivalent revenue at risk that would otherwise be provided by the current STPIS regime.

The final Framework and Approach Paper should acknowledge that transitional arrangements will apply to the STPIS regime from the 2010-15 to the 2015-20 RCP and that such arrangements will be finalised as part of the determination.

Efficiency Benefit Sharing Scheme

SA Power Networks notes and supports the continuing application of the Efficiency Benefit Sharing Scheme (EBSS) applying in the next RCP. We also note changes with the proposed EBSS to limit adjustments and exclusions from the scheme. SA Power Networks will work with the AER to reach agreement on appropriate exclusions from the EBSS at the determination stage.

Capital Expenditure Sharing Scheme

SA Power Networks notes and supports the application of the new Capital Expenditure Sharing Scheme (CESS) applying in the next RCP. The CESS and EBSS provide appropriate and balanced incentives for efficient expenditure.

² That is, STPIS targets for the 2015-2020 RCP are likely to be based on actual performance of three years from the 2010-2015 RCP and two years from the 2005-2010 RCP. Targets for the 2020-2025 RCP will be based on performance of three years from the 2015-2020 RCP and two years from the 2010-2015 RCP.



Demand Management Incentive Scheme

We note and support the AER's preliminary position to continue with the demand management incentive allowance (DMIA) in the next RCP. We will include an appropriate DMIA amount in our Regulatory Proposal.

We note the AER's comments that the Commonwealth and State Governments' Standing Council on Energy and Resources (SCER) is considering proposed rule changes by the Australian Energy Market Commission (AEMC). These rule changes, when implemented, could result in a new demand management incentive scheme. We plan to follow these developments closely and will consider any new proposals when they eventuate.

Small-Scale Incentive Scheme

SA Power Networks notes that the AER has not developed any new small-scale incentive scheme. SA Power Networks has also been considering whether any matters could be addressed in a potential small-scale incentive scheme (SSIS) and has had preliminary discussions with the Australian Energy Market Operator and the AER (Wholesale Markets Branch) on this topic. However, at this stage, we are not proposing any scheme. If this position changes we will notify the AER and include any scheme in our Regulatory Proposal to be lodged in October 2014.

Application of Expenditure Forecast Assessment Guideline

SA Power Networks notes that the AER intend to use all the assessment tools in the Expenditure Forecast Assessment Guideline, including:

- Models for repex and augex;
- Benchmarking;
- Methodology, governance and policy reviews;
- Predictive modelling and trend analysis; and
- Cost benefit analysis and detailed project reviews.

Further specific guidance on how the AER will use these tools and the relative weightings that the AER will apply to each should be made clear by the AER.

Depreciation Basis for RAB roll-forward

SA Power Networks notes the AER's position to use forecast depreciation to establish the 1 July 2020 opening value for the Regulatory Asset Base.

Jurisdictional derogation – side constraint on supply charge – and distribution pricing reform

SA Power Networks notes the AER's position and supports an approach to distribution pricing that allows for cost reflective pricing to be implemented, which is consistent with outcomes from recent national reviews. Accordingly, jurisdictional arrangements that may inhibit more efficient pricing should be removed. We also note that distribution pricing is being further considered under the AEMC's Power of Choice Review and we are participating in those consultation processes.



SA Power Networks considers that four elements enable an increase in the efficiency of network pricing:

1. A desire by the utility to amend tariffs;
2. Metering, systems and retailer support to enable new tariffs to be implemented;
3. An opportunity for tariff amendment; and
4. No barriers from rule makers to the new tariff.

SA Power Networks also considers that we have made progress in transitioning customers to more efficient tariffs over recent years.

High Voltage connected customers have been on demand tariffs for some years. For other medium to large customers (those consuming more than 160 MWh per annum), the availability of interval metering has enabled many of these business customers to move to efficient agreed demand tariffs.

The number of Low Voltage connected (LV) business customers on demand tariffs has also steadily increased due to tariff rule changes implemented by SA Power Networks³.

With respect to residential customers, SA Power Networks has been conducting the North Adelaide Trial where approximately 3500 residential customers have had new generation metering installed and some of these customers have been involved in trials of residential demand tariff structures with in-home displays to feedback real time energy demand.

We continue to examine and analyse future options for cost-reflective pricing structures that suit South Australian market conditions.

Dual function assets

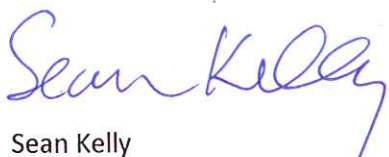
As defined by the National Electricity Rules, dual function assets are assets owned, operated or controlled by a Distribution Network Service Provider, which operate at voltages between 66 kV and 220 kV, to support the higher voltage transmission network.

SA Power Networks confirms it does not own or operate any such assets. The AER's position, to not make any determination in respect of these assets, is therefore appropriate.

Other matters

SA Power Networks has not identified any other matters which it believes the AER should address in the F&A.

If you wish to discuss any of the issues raised in this submission or require any further information, please contact Richard Sibly on 08 8404 5613.



Sean Kelly
General Manager Corporate Strategy

³ Business single tariff was closed in July 2010 to new customers. Business 2-rate became the default tariff. The inclining blocks of business single tariffs were used to properly recover more costly load characteristics from those larger business customers who elect to remain on the closed tariff. Customers requiring over 100 amps (nearly 80 kVA or more) from new or amended supplies have been required to be on demand tariffs since July 2010. Many customers in the 80 to 250 kVA range who have good load characteristics have also been transferred to the demand tariff.



