

17 October 2018

Mr Evan Lutton
Australian Energy Regulator
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MELBOURNE 3000 VIC

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

Dear Evan

Draft AER 2018 Annual Benchmarking Report – Electricity distribution network service providers

Thank you for your 27 September email inviting comments on the AER's draft 2018 Annual Benchmarking Report for Electricity distribution network service providers (**DNSPs**). SA Power Networks has reviewed the draft report and provides comments in regard to the following:

- SA Power Networks' relative efficiency;
- the impact of operating environment factors (**OEFs**);
- category specific partial performance indicators (**PPIs**);
- correction of minor errors; and
- productivity 'decline' and industry transformation.

Matters to be addressed to ensure consumer confidence

1. The draft report should acknowledge that SA Power Networks' productivity improved in the two years before 2016/17, before severe, uncontrollable weather events unfavourably impacted both reliability and opex. In contrast, it appears that a major contributor to improved Victorian outcomes for 2017 has been favourable weather.
2. AER should amend incorrect statements in the final report that CitiPower, Powercor and United Energy are the three most efficient DNSPs.
3. The AER's review of OEFs has failed to consider the impact that capitalisation policy has in measuring the relative opex efficiency of distributors.
4. The Sapere-Merz report does not address the OEF relating to jurisdictional GSL schemes. This has had a material effect on SA Power Networks' 2017 benchmarking outcomes.
5. We are pleased to see the inclusion of category specific PPIs in the report, but believe that the measurement of emergency response costs per interruption is misleading, and contend that cost per kilometre is more appropriate.
6. We believe the AER's benchmarking needs to acknowledge the significant impact that distributed energy resources and the wider industry transformation is having on SA Power Networks (and other DNSPs) comparative performance.

SA Power Networks' relative efficiency

The draft report acknowledges that SA Power Networks has consistently been amongst the most efficient service providers in the NEM across all benchmarking measures¹. The report focuses on our declining opex productivity since 2006 and that our productivity was the lowest it has been over 2006-17, as measured by opex MPFP². SA Power Networks believes that the AER should include some acknowledgement that SA Power Networks' productivity had improved in the two years before 2016/17, before severe and uncontrollable weather events unfavourably impacted both reliability and opex costs.

SA Power Networks experienced an unprecedented nine major weather events in the 2016/17 regulatory year. Whilst major event day (**MED**) outages are excluded for reliability measurement, the residual effects from severe storms will continue to impact reliability for a period after the event. From a cost perspective, emergency response costs and guaranteed service level (**GSL**) payments to customers are not excluded for MEDs and will have a detrimental impact to overall opex. Unlike many other jurisdictions, GSL payments on MEDs continue to apply in South Australia. Consequently, SA Power Networks incurred more than \$25m of GSL payments on MEDs in 2016/17, representing around 10% of opex.

We note that the improvement in productivity across the NEM in 2017 was largely driven by decreasing opex and improved reliability³. We also note that a major contributor to the outcome for the biggest improver in 2017, AusNet Services, was favourable weather conditions⁴ (we presume it is reasonable to expect that this would apply to other Victorian DNSPs also). This highlights the impact that uncontrollable weather events can have on annual benchmarking results. TasNetworks, whose productivity fell by 8%, also identifies that its performance was detrimentally impacted by increases in uncontrollable expenditure (including GSL and emergency response costs) resulting from major weather events⁵.

Further, SA Power Networks requests the AER correct statements in the draft report asserting CitiPower, Powercor and United Energy as being the "... three businesses that (sic) been the most efficient DNSPs over the 2006-17 by opex MPFP (as well as MTFP and supporting econometric modelling)." ⁶ This is clearly incorrect. Whilst the above three businesses "have been consistently among the most efficient in the NEM" ⁷, the above statements do not recognise that SA Power Networks is the second ranked DNSP in terms of MTFP and third in opex MPFP.

Impact of OEFs

We reiterate our concerns that the discussion on OEFs does not include any assessment of capitalisation policy. SA Power Networks is disadvantaged in regard to opex MPFP in comparison to many other DNSPs due to its policy of expensing all corporate overheads. We acknowledge that this is an internal management decision, but that it impacts the relative opex benchmarking measurement for factors other than efficiency. We believe that this is inconsistent with a stated aim in the report of providing "consumers with useful information about the relative efficiency of the networks that distribute electricity to their door." ⁸

¹ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 24.

² AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 24.

³ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 7.

⁴ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 31.

⁵ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 32.

⁶ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 12. A very similar statement is repeated on page 24.

⁷ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 31.

⁸ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 6.



If SA Power Networks capitalised corporate costs by 30% (average across all DNSPs), our opex would reduce by around \$15 million, which would have a significant impact on our benchmarking outcomes. We are further concerned that the AER adjusts the opex of other DNSPs for benchmarking purposes who have adopted a similar capitalisation policy to SA Power Networks, and believe that it is imperative that the AER apply consistency across all distribution businesses in regards to capitalisation to truly reflect relative outcomes.

We also note that the AER has included Total Overheads in its measurement of cost category PPIs. It describes the reason for this as “We have used total overheads allocated to both capex and opex to ensure that differences in a DNSP's capitalisation policy does not affect the analysis. It also mitigates the impact of a DNSP's choice in allocating their overheads to corporate or network services.”⁹ We applaud this approach, but consider that it should also be acknowledged in measuring relative benchmarking efficiency.

SA Power Networks is also concerned that Sapere-Merz does not include consideration of differences in the obligations and value of payments under GSL schemes in different jurisdictions in its final report, other than to acknowledge that it requires further investigation. The impact of GSL costs on SA Power Network's opex and consequently benchmarking outcomes in 2016/17 (10% of opex as described above) is a clear indication of the materiality of this OEF.

Category specific PPIs

SA Power Networks is pleased to see the inclusion of cost category PPIs in the report. During our customer engagement process for our 2020-25 Reset, we have frequently been requested to provide more bottom-up analysis of opex. We provided internally generated benchmarking information, based on data provided in RINs, and inclusion of similar information in the AER's Annual Benchmarking Report provides a level of independence that should provide additional comfort to electricity customers.

The AER's comparison of vegetation management and maintenance costs per kilometre of line (route and circuit), and the measurement of total overheads on a per customer basis is appropriate. However, the measurement of emergency response costs as spend per interruption is misleading. Interruptions are reported on a feeder type basis, and emergency response spend per interruption for rural feeders will be adversely impacted by the increased travel and fault locating times associated with longer lines with fewer customers. Further, SA Power Networks only records interruptions greater than one minute rather than the 0.5 second specified in the guideline for the CA RIN, which may mean that data is not comparable across DNSPs.

Emergency response costs per circuit kilometre would provide a more appropriate comparison of emergency response performance. This is consistent with the approach to other network opex categories, and would compensate for any potential differences in a DNSP's classification of costs between maintenance and emergency response categories.

Correction of errors

We have identified a number of minor typographical errors in the draft report that we would assume would be corrected in the AER's final benchmarking report. Aside from the aforementioned incorrect reference to CitiPower, Powercor and United Energy as the three most efficient businesses, the only material error we note is that the dialogue below Figure 4.3 refers to measurement of capital MPFP over the 2013-17 period (rather than 2006-17).¹⁰ We would also recommend that the AER revert to consistency of colours across jurisdictions in benchmarking diagrams in the final report, as it has applied previously.

⁹ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 48.

¹⁰ AER | Annual Benchmarking Report | Electricity distribution network service providers | September 2018, page 27.



Productivity 'decline' and industry transformation

The AER would also be aware that the electricity industry is undergoing a significant transformation. The traditional model of centralised generation being transmitted and distributed 'one-way' to consumers is changing rapidly with a significant amount of solar, and increasingly batteries, being connected at the distribution level.

SA Power Networks is at the forefront of this change. More than 1000 MW of solar generation capacity is now connected to our network and significant programs by the South Australian Government and Virtual Power Plant proponents are underway which will accelerate the take-up of more solar and battery systems. Enabling more solar generation and batteries to connect to our network offers substantial benefits to customers and the wider community, including by helping to put downward pressure on wholesale electricity costs for all electricity customers in South Australia.

The installation of solar generation on our network commenced around 2010/11 and has contributed to a reduction in our ratcheted maximum demand and energy delivered through our distribution network. These outcomes contribute significantly to the decline in our productivity performance as measured by the AER's modelling.

Nearly one in three customers on our network are now embedded generators, yet the AER's benchmarking model does not recognise the number of embedded generators, nor their customer-exported energy as outputs.

These new generator connection and energy export services enabled by DNSPs are clearly valued by customers as evidenced by the ongoing rapid uptake of distributed energy resources in South Australia and across most other jurisdictions.

Enabling these outputs has been a significant driver of our business since 2010/11. Further operating and capital investment will soon be required by SA Power Networks to enable more distributed energy resources to connect to our network. Investing in these additional inputs will contribute to a further decline in productivity, as currently measured. This is misleading to customers and other stakeholders looking to assess and compare industry productivity.

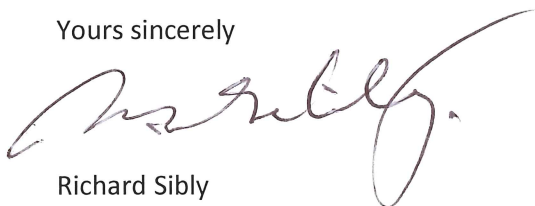
We believe the AER's benchmarking needs to take into account the significant impact that distributed energy resources and the wider industry transformation, now well underway in South Australia, is having on SA Power Networks (and other DNSPs) comparative performance.

We would be pleased to work with the AER on approaches to incorporating these outputs into future reports. For this year's report, we consider it would be appropriate to at least acknowledge the impact that this industry transformation is having on benchmarking results, leading to reductions in SA Power Networks' productivity as currently measured by the AER.

Inclusion of generator connection and energy export services by the AER in its Annual Benchmarking Report would be seen as recognition of the distributed energy transformation occurring across Australian distribution networks.

Please contact Trevor Gusling on 08 8404 4325 if you require any further discussion or clarification of the above.

Yours sincerely



Richard Sibly

Head of Regulation

