



Mr Adam Petersen
Director
Australian Energy Regulator
GPO Box 922
Adelaide SA 5001

1 May 2018

By email: adam.petersen@ aer.gov.au

Dear Mr Petersen,

RE: Preliminary framework and approach: SA Power Networks Regulatory control period commencing 1 July 2020, March 2018

As the peak body for the health and community services sector in South Australia, the South Australian Council of Social Service (SACOSS) has an established history of interest, engagement and provision of proposed advice on the necessary market mechanisms and policy for essential services, including electricity. SACOSS would like to thank the Australian Energy Regulator (AER) for the opportunity to comment on the Preliminary Framework and Approach for the SA Power Networks (SAPN) regulatory control period commencing 1 July 2020 (F&A paper).

Introduction

The F&A paper is designed to determine some initial elements of the approach that the AER will take to regulation of SAPN, including the classification of services, the form of control, and the control mechanism. The final F&A paper in July 2018 will also set out the AER's expected positions on issues such as incentive arrangements, application of guidelines, and the AER's approach to depreciation in determining the opening RAB as at July 2020.

Service classification

The F&A paper proposes to change the classification of a range of ancillary services from negotiated or not previously identified to alternative control. The significance of this is that negotiated services are not price-regulated while alternative control services are subject to some form of price control, typically a price cap.

The proposed change in classification means that these ancillary services will, for the first time, become subject to some form of price control.

The F&A paper has identified the following ancillary services as services which it proposes to classify as alternative control:

- Connection application related services;
- Access permits, oversight and facilitation services;
- Third party funded network upgrade or other improvements;
- Network safety services;
- Rectification works to maintain network safety;
- Planned interruption – customer requested;
- Attendance at customers premises to perform a statutory right where access is prevented;
- Inspection services – private electrical installations
- Provision of training to third parties for network related access
- Authorisation and approval of third party service providers design, work and materials
- Security lights;
- Customer initiated asset relocations;
- Ancillary metering services (type 5 to 7 metering installations);
- Emergency maintenance of failed metering equipment not owned by DNSP (contestable metering);
- Meter recovery and disposal – type 5 and 6 (legacy meters);
- Third party requested outage for purposes of replacing meter;
- Non-standard connection services;
- Connection management services; and
- Public lighting.

The F&A paper states that a change in the AER's ring-fencing guideline in 2017¹ prompted the change in approach from SAPN. Previously, many of these services were negotiated between the customer and SAPN without any regulatory oversight. However, the new ring-fencing guideline required functional and legal separation of these ancillary services from direct control services, meaning that if the services remained as negotiated services they would need to be put into a separate company with strict division of personnel and accounts.

Alternative control is an appropriate classification of services where services are provided to specific customers and there is some element of monopoly control in their provision, for example through the requirement for access to network assets. Where the services are provided to multiple customers across the network, then they are generally classified as standard control services, which are paid for by all customers connected to the network. Where there is no element of monopoly control in the provision of the services then they can be considered contestable, for example type 1 to 4 metering.

Examining the above list of ancillary services, it would seem acceptable for them to be classified as alternative control as:

¹ AER, *Ring-fencing guideline electricity distribution, October 2017*; AER, *Electricity distribution ring-fencing guideline explanatory statement, October 2017*

- The services do seem to involve providing services to specific customers rather than to many customers.
- The services could not easily be provided without access to the network.

The possible exceptions in the list are: (i) network safety services; and (ii) rectification works to maintain network safety. In the F&A paper, network safety services are broken down into four sub-services.² Two of these sub-services - high load escorts and customer initiated outages – are clearly customer-initiated. However, there is insufficient information to judge whether the other two sub-elements - provision of traffic control and fitting of tiger tails and aerial markers - necessarily involve the provision of services to specific customers. It is also difficult to judge whether the service of ‘rectification works to manage customer vegetation defects or aerial mains where the customer has failed to do so’ is customer-specific. This assessment would depend on where the vegetation is and whether the customer has a specific responsibility for it.

One issue that arises is that SAPN would have been earning revenue on ancillary services for many years as unregulated services. At the same time, under the previous ring-fencing rules, there may have been less rigour in accounting for revenues earned on ancillary services compared with standard control services. This raises the question whether ancillary services benefited previously from some cross-subsidy or other advantage from their close link to network services. SAPN was granted a waiver from the new ring-fencing rules in relation to ancillary services, meaning that current accounts may not fully clarify the financial position between standard control services and ancillary services.³ In determining regulated revenues for SAPN’s standard control services, it will be important to create transparent accounts of the revenues and costs for both these ancillary services and for standard control services.

More generally, with the changes in service classifications, it will assist stakeholders for distributors to present accounts showing how changes in services classifications affect revenues both historically and going forward. For example, if a service is proposed to be carved out of the common distribution service for RP 2020-25, then it would help to see how that service contributed historically to the common distribution service in RP 2015-20 and how removing it from the common distribution service affects costs in both the common distribution service and in the new category of services that has been carved out.

Public lighting

SACOSS supports the reclassification of public lighting from negotiated to alternative control.⁴ The reclassification aligns SA with States such as NSW and Queensland and recognises that SAPN has an element of monopoly control in the provision of this service, since the installation and maintenance of most streetlights requires access to SAPN’s poles.

Form of control

The F&A paper proposes to use a revenue cap as the form of control for standard control services.⁵ Other choices open to the AER include price caps and hybrid revenue/price cap arrangements.

² F&A paper, Appendix B, p. 76

³ F&A paper, p. 10

⁴ F&A paper, p. 31

⁵ F&A paper, p. 35

Under revenue caps, networks are awarded a set amount of revenue per year for standard control services. Under a price cap, this revenue is then converted into a price cap of some form by estimating total demand and then determining a price that delivers the total revenue across this estimated demand. Under a revenue cap, networks are relatively indifferent to demand, while under a price cap, networks gain if more units of electricity are sold than estimated but lose if less units of electricity are sold than estimated.

There has been a strong trend towards revenue caps in recent years. However, there needs to be more debate about the form of control. This is because price caps can provide incentives for electricity networks to reveal their demand forecast and associated capital spending requirements. Under a revenue cap, networks have an incentive to overstate demand, so that they can justify higher capital spending programs. There is significant evidence historically of this problem, particularly around 2010-15 when demand across many networks in Australia turned down for a variety of reasons.

Price caps, on the other hand, may tend to encourage networks to understate demand, as they can then profit from any increase over forecasts. However, if networks understate demand too much, there is strong chance that their augmentation capital spending will be cut, as augex is based on forecast future demand. The benefit of a price cap therefore, is that it is more likely to provide the right mix of incentives for networks to reveal expected future demand.

Price caps have been criticized on the basis that they may give incentives for networks to expand overall demand. However, with the separation of networks from retailers, it is not clear that networks have strong influence over the final demand for electricity. The exception may be where networks can choose non-network alternatives for the supply of electricity. However, the AER has introduced stronger incentives under the new Demand Management Incentive Scheme published in December 2017 to encourage networks to adopt non-network alternatives.⁶ In addition, the RIT-D test somewhat constrains networks from building network where non-network alternatives are more efficient.

SACOSS considers that the AER should take steps to more fully investigate the choice between price caps and revenue caps; both through this F&A process and through a broader process across the NEM. Ideally, this issue should be debated prior to finally determining whether to apply a price cap or a revenue cap for SAPN in the 2020-25 regulatory period.

Incentive arrangements

STPIS

A service target performance incentive scheme (STPIS) provides a mix of rewards or penalties where a network exceeds (or undershoots) performance thresholds across a range of service quality metrics.

SACOSS supports a STPIS to provide incentives for SAPN to maintain service quality.

However, SACOSS does not support maintaining the revenue at risk at ± 5 per cent, which is the level that it was set at for the 2015-20 regulatory period and which the AER proposes to keep for RP 2020-25.⁷

⁶ See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/demand-management-incentive-scheme-and-innovation-allowance-mechanism>

⁷ F&A paper, p. 53

A STPIS set at ± 5 per cent is relatively high-powered and can result in higher prices for customers where the network is able to raise reliability standards above the threshold. The problem is that customers may prefer lower prices at lower reliability/service quality levels.

SACOSS considers it may be preferable to set a STPIS at ± 2 per cent, or alternatively set penalties for not achieving threshold service quality levels without providing rewards for exceeding the threshold. These forms of the STPIS are likely to more closely reflect consumer preferences.

There has been a strong focus by AER on encouraging networks to engage with customers to find out what customers want, and only accept increases in costs where those cost increases are solidly supported by customers. SACOSS considers that the AER should let that process play out in RP 2020-25 by letting SAPN test with customers whether they are prepared to pay up to 5 per cent more for improvements in service quality above current levels. That is preferable to the proposed approach of continuing the STPIS at ± 5 per cent.

We thank you in advance for consideration of our comments. If you have any questions relating to this submission, please contact Jo De Silva via jo@sacoss.org.au or 08 8305 4211.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'RWomersley', with a stylized flourish at the end.

Ross Womersley
Chief Executive Officer