

Attachment 1

Annual revenue requirement and control mechanism

2020-25 Revised
Regulatory Proposal
10 December 2019

This section outlines:

- › the proposed annual revenue requirement and control mechanism for SA Power Networks' Standard Control Services for the 2020-25 Regulatory Control Period.



Company information

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Disclaimer

This document forms part of SA Power Networks' Regulatory Proposal to the Australian Energy Regulator for the 1 July 2020 to 30 June 2025 regulatory control period. The Proposal and its attachments were prepared solely for the current regulatory process and are current as at the time of lodgement.

This document contains certain predictions, estimates and statements that reflect various assumptions concerning, amongst other things, economic growth and load growth forecasts. The Proposal includes documents and data that are part of SA Power Networks' normal business processes and are therefore subject to ongoing change and development.

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Note

This attachment forms part of our Proposal for the 2020-25 Regulatory Control Period. It should be read in conjunction with the other parts of the Proposal.

Our Proposal comprises the overview and attachments listed below, and the supporting documents that are listed in Attachment 18:

Document	Description
	Regulatory Proposal overview
<i>Attachment 1</i>	<i>Annual revenue requirement and control mechanism</i>
Attachment 2	Regulatory Asset Base
Attachment 3	Rate of Return
Attachment 4	Regulatory Depreciation
Attachment 5	Capital expenditure
Attachment 6	Operating expenditure
Attachment 7	Corporate income tax
Attachment 8	Efficiency Benefit Sharing Scheme
Attachment 9	Capital Expenditure Sharing Scheme
Attachment 10	Service target performance incentive scheme
Attachment 11	Demand management incentives and allowance
Attachment 12	Classification of services
Attachment 13	Pass through events
Attachment 14	Alternative Control Services
Attachment 15	Negotiated services framework and criteria
Attachment 16	Connection Policy
Attachment 17	Tariff Structure Statement Part A
Attachment 17	Tariff Structure Statement Part B - Explanatory Statement
Attachment 18	List of Proposal documentation

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1 Annual revenue requirement and control mechanism

1.1 Overview

SA Power Networks submitted its regulatory proposal for the 2020-25 regulatory control period (**RCP**) in January 2019 (**Original Proposal**). The Australian Energy Regulator (**AER**) published its draft decision on our Original Proposal on 8 October 2019 (**Draft Decision**).

The nominal smoothed revenue in our revised regulatory proposal for the 2020-25 RCP (**Revised Proposal**) is summarised in Table 1-1 below.

Table 1-1: Summary of nominal smoothed revenue at SA Power Networks' Original Proposal, AER's Draft Decision and SA Power Networks' Revised Proposal

Original Proposal	AER Draft Decision	Revised Proposal
\$4,214 million	\$3,905 million	\$3,916 million

1.1.1 Annual revenue requirement

Our annual revenue requirement (**ARR**) reflects the sum of the revenue building blocks – namely the return on capital, return of capital (depreciation), operating expenditure, revenue adjustments, and corporate tax allowance, for services classified as standard control services (**SCS**).

Our revenue requirement is calculated in accordance with the standard post-tax building block approach outlined in the National Electricity Rules (**NER**)¹, and the AER's Post-Tax Revenue Model (**PTRM**).

If accepted by the AER, our Revised Proposal will deliver residential customers an annual average \$62 reduction (nominal) in their distribution charges and small to medium businesses an annual average \$276 (nominal) reduction in their distribution charges from 1 July 2020.

1.1.2 Lodgement

In accordance with the NER, SA Power Networks is required to lodge its Revised Proposal by **10 December 2019**, being 45 business days after the publication of the AER's Draft Decision².

1.1.3 Cost allocation

The ARR relates to distribution services classified as SCS. All costs in relation to the provision of SCS have been attributed and allocated in accordance with SA Power Networks' approved Cost Allocation Method (**CAM**)³.

1.1.4 Presentation of numbers

In our Revised Proposal, unless stated otherwise, forecast and historical expenditure is expressed in real terms in June 2020 dollars, while the regulatory asset base (**RAB**) and revenue building blocks are presented in nominal dollars consistent with the AER's PTRM.

We note that totals presented in table rows and columns throughout this Revised Proposal may not necessarily add due to rounding.

¹ NER, chapter 6, part C.

² NER 6.10.3(a).

³ Version 4, approved by the AER in January 2018; available at: <https://www.sapowernetworks.com.au/public/download.jsp?id=309684>.

1.2 SA Power Networks' Original Proposal

1.2.1 Regulatory control period

SA Power Networks proposed that the next RCP should be for the five years commencing on 1 July 2020 and ending on 30 June 2025. This is called the '2020–25 RCP' in this Attachment.

1.2.2 Control mechanism for SCS

The AER is required to set out its proposed approach to the form of control mechanism and formula that gives effect to the control mechanism in its Framework & Approach (**F&A**) paper for a forthcoming distribution determination⁴. The AER decided in its final F&A for SA Power Networks for the 2020–25 RCP, that our SCS are to continue to be regulated via a revenue cap form of control⁵.

Annual revenue allowances will also be adjusted for outcomes of the various incentive schemes listed in clause 6.4.3 of the NER and may incorporate cost adjustments for pass through events.

Our reasons for accepting this form of control were set out in our submissions to, and considered during, the F&A process, which are available on the AER's website.

1.2.3 Annual revenue requirement

In our Original Proposal, we proposed an unsmoothed total revenue requirement of \$4,220.8 million (\$ nominal) for the 2020–25 RCP. We proposed an initial revenue reduction (P_0) in 2020/21 of 2.83%, with an X factor of 0.0% for each of the remaining years.

1.2.4 Revenue adjustments

Our Original Proposal included revenue adjustments totalling \$40.1 million (\$ nominal) for the 2020–25 RCP for the Efficiency Benefit Sharing Scheme (**EBSS**), Capital Expenditure Sharing Scheme (**CESS**), Demand Management Incentive Scheme (**DMIS**), Demand Management Innovation Allowance Mechanism (**DMIAM**) (applicable for the 2020–25 RCP) and shared asset cost reduction.

1.3 AER's Draft Decision

The AER determined in its Draft Decision that SA Power Networks could recover unsmoothed revenue of \$3,902.9 million (\$ nominal) from customers over the 2020-25 RCP.⁶ That was \$317.9 million (\$ nominal) lower than the amount proposed by SA Power Networks in our Original Proposal. The AER determined an annual expected smoothed revenue of \$3,905.3 million (\$ nominal), with an X-factor of 0.0%.

Table 1-2 below summarises the proposed and allowed revenues.

⁴ NER 6.8.1(b)(1)(i) and (2)(ii).

⁵ AER, *Final Framework and Approach—SA Power Networks regulatory control period commencing 1 July 2020, July 2018*, page 11.

⁶ AER, *Draft Decision on SA Power Networks Distribution Determination 2020-25, Attachment 1: Annual Revenue Requirement (Attachment 1)*, page 5.

Table 1-2: SCS Revenue for the 2020-25 RCP in our Original Proposal and the AER's Draft Decision (nominal, \$ million)

	Original Proposal	Draft Decision	Difference
Return on capital	1,276.6	1,053.7	(222.9)
Regulatory depreciation	1,233.3	1,187.7	(45.6)
Operating expenditure	1,670.8	1,585.1	(85.7)
Revenue adjustments	40.1	38.8	(1.3)
Net tax allowance	0.0	37.6	37.6
Annual revenue requirement (unsmoothed)	4,220.8	3,902.9	(317.9)
Annual revenue requirement (smoothed)	4,214.5	3,905.3	(309.2)

1.4 SA Power Networks' response to AER Draft Decision

SA Power Networks has reviewed the AER's preliminary determination in its Draft Decision on each of the building block components. We have set out our response to the AER's Draft Decision in relation to each of those building blocks in the attachments to this Revised Proposal.

We have summarised below our response to the AER's Draft Decision in relation to our ARR and the incentive schemes.

We have adopted the AER's preliminary determinations on revenue controls.

1.5 Revised Proposal

1.5.1 Annual Revenue Requirement

The Revised Proposal building block components and resulting ARR derived from the SCS PTRM are set out in Table 1-3 below.

Table 1-3: Proposed SCS Revenue for the 2020-25 RCP (nominal, \$ million)

	2020/21	2021/22	2022/23	2023/24	2024/25	2020-25 RCP
Return on capital	208.9	209.3	209.7	209.3	208.6	1,045.7
Regulatory depreciation	220.8	235.2	249.4	258.3	255.3	1,219.0
Operating expenditure	292.6	301.7	311.8	321.8	332.1	1,560.1
Revenue adjustments	27.7	(3.3)	24.5	18.5	16.6	84.1
Net tax allowance	1.1	0.8	2.0	3.3	3.3	10.5
Annual revenue requirement (unsmoothed)	751.1	743.7	797.5	811.2	815.9	3,919.4
Annual revenue requirement (smoothed)	759.4	771.1	783.0	795.1	807.3	3,916.0
Revenue P₀ and X-factors	11.40%	0.80%	0.80%	0.80%	0.80%	

The P₀ revenue reduction and X-factors proposed in Table 1-3 are SA Power Networks preferred approach to reducing price volatility, in line with Australian Energy Market Commission pricing policy objectives. This approach results in the final regulatory years smoothing revenue being 1.0% below the building block revenue for that regulatory year, which is within the 3% target band that the AER has applied in other

determinations⁷. The AER’s standard smoothing approach would see more volatile prices with a P_0 reduction of 12.26% and subsequent annual real revenue decreases of 0.30%. This risks real price increases in 2020/21 onwards if actual sales continue to decline at the rate they have done in recent years. We discuss this further in section 17.2.6 and Figure 17B-14 of Attachment 17 – Tariff structure statement, Part B.

The proposed X-factor results in Year 5 revenue at a level halfway between the building block total and the building block excluding revenue adjustments. The latter building block reflects the likely starting point for our 2025-30 RCP.

1.5.2 Revenue Adjustments

A summary of adjustments is shown in Table 1-4 below.

Table 1-4: Revenue adjustments for the 2020-25 RCP (nominal, \$ million)

	2020/21	2021/22	2022/23	2023/24	2024/25	2020-25 RCP
EBSS	12.6	(18.8)	8.7	2.3	-	4.8
CESS	15.6	16.0	16.4	16.7	17.1	81.8
DMIS and DMIAM	0.8	0.8	0.9	0.9	0.9	4.3
Shared assets	(1.3)	(1.3)	(1.4)	(1.4)	(1.4)	(6.8)
Total revenue adjustments	27.7	(3.3)	24.5	18.5	16.6	84.1

1.5.2.1 EBSS

The AER applied the latest version of the EBSS (version 2) to SA Power Networks for the 2015-20 RCP.

We forecast a carry-over EBSS payment of \$4.8 million (\$4.6 million in \$June, 2020) as shown in Table 1-4 above.

The AER determined in its Draft Decision to apply version 2 of the EBSS to SA Power Networks for the 2020-25 RCP.⁸

Full details in relation to the application of the EBSS to this Revised Proposal and the 2020–25 RCP are contained in Attachment 8 – Efficiency benefit sharing scheme.

1.5.2.2 CESS

The AER applied CESS (version 1) to SA Power Networks for the 2015-20 RCP.

We forecast a carry-over CESS payment of \$81.8 million (\$76.3 million in \$June, 2020) as shown in Table 1-4 above.

The AER determined in its Draft Decision to apply the CESS to SA Power Networks for the 2020-25 RCP.⁹

Full details in relation to the application of the CESS to this Revised Proposal and the 2020–25 RCP are contained in Attachment 9 – Capital expenditure sharing scheme.

⁷ See, for example, AER, *Draft Decision: TasNetworks Distribution Determination 2019 to 2024, Attachment 1- Annual revenue requirement, September 2018, page 1-12*. Similarly referred to in AER, *Draft Decision: Evoenergy Distribution Determination 2019 to 2024, Attachment 1- Annual revenue requirement, September 2018, page 1-14*.

⁸ AER, *Draft Decision, Attachment 8: Efficiency benefit sharing scheme, page 6*.

⁹ AER, *Draft Decision, Attachment 9: Capital expenditure sharing scheme, page 6*.

1.5.2.3 Service Target Performance Incentive Scheme (STPIS)

The AER applied STPIS (version 1) to SA Power Networks for the 2015–20 RCP.

The AER determined in its Draft Decision that it would apply STPIS (version 2.0) to SA Power Networks for the 2020-25 RCP.¹⁰

The revenue cap formula in the final F&A contains an S-factor to account for any revenue increments or decrements resulting from the application of the STPIS. There is no ex-ante allowance for STPIS. Any revenue adjustment will be made through the control mechanism.

Full details in relation to the application of the STPIS to this Revised Proposal and the 2020–25 RCP are contained in Attachment 10 – Service target performance incentive scheme.

1.5.2.4 DMIS and DMIAM

In December 2017, the AER introduced its new DMIS and DMIAM. Our Original Proposal was to apply the new DMIS and DMIAM for the 2020–25 RCP, consistent with the AER’s proposed position as set out in its final F&A.¹¹ The AER, in its Draft Decision, approved the application of the DMIS and DMIAM to SA Power Networks for the 2020-25 RCP without any modification.¹²

As shown in Table 1-4 above the DMIAM revenue proposed for the 2020-25 RCP is \$4.3m (\$ nominal) revenue. The final DMIAM amount will be updated in the AER’s final decision for the 2020-25 RCP, due to the DMIAM’s dependence on the AER’s allowed total revenue for the 2020-25 RCP.

There is no ex-ante allowance for DMIS. This will be sought by way of the application criteria as potential projects arise. Any revenue adjustment will be made through the control mechanism.

1.5.2.5 Shared Assets

Clause 6.4.4 of the NER requires the AER to have regard to the shared asset principles and the Shared Asset Guideline (**SAG**) in determining shared asset cost reductions.

The SAG requires that regulated customers share a proportion of revenue earned from regulated assets to earn unregulated revenue, subject to a materiality threshold. We proposed a \$6.8 million (\$6.3 million in \$June, 2020) revenue adjustment in our Original Proposal.

In its Draft Decision, the AER applied a \$6.8 million (\$6.3 million in \$June, 2020) revenue adjustment, albeit calculated using a slightly different method.¹³ We have included this amount in our Revised Proposal revenue adjustments as shown in Table 1-4 above.

We note the AER’s decision in its Draft Decision to reduce fleet capex by \$8.0 million (\$June, 2020) to apply proportional use of fleet assets at time of acquisition.¹⁴ We have not accepted this decision in our Revised Proposal capex (refer to Attachment 5 - Capital expenditure). However, if the AER does apply the reduction to fleet capex, that will reduce the shared asset revenue earned from the use of vehicles, and our shared asset revenue adjustment will reduce by \$0.4 million to \$6.4 million (\$6.0 million in \$June, 2020).

¹⁰ AER, *Draft Decision, Attachment 10, page 6.*

¹¹ AER, *Final Framework and Approach—SA Power Networks regulatory control period commencing 1 July 2020, July 2018, page 75.*

¹² AER, *Draft Decision, Attachment 11, page 5.*

¹³ AER, *Draft Decision, Attachment 1, page 13.*

¹⁴ AER, *Draft Decision, Attachment 5, page 79.*

Shortened Forms

AER	<i>Australian Energy Regulator</i>
ARR	<i>Annual revenue requirement</i>
Attachment 1	<i>AER, Draft Decision for SA Power Networks Distribution Determination 2020 to 2025, Attachment 1: Annual Revenue Requirement</i>
CAM	<i>Cost Allocation Method</i>
CESS	<i>Capital Expenditure Sharing Scheme</i>
DMIAM	<i>Demand Management Innovation Allowance Mechanism</i>
DMIS	<i>Demand Management Incentive Scheme</i>
Draft Decision	<i>AER, Draft Decision—SA Power Networks Distribution Determination 2020 to 2025</i>
EBSS	<i>Efficiency Benefit Sharing Scheme</i>
F&A	<i>Framework and approach</i>
NER	<i>National Electricity Rules</i>
Original Proposal	<i>Regulatory Proposal for the 2020-25 RCP</i>
PTRM	<i>Post-Tax Revenue Model</i>
RAB	<i>Regulatory asset base</i>
RCP	<i>Regulatory Control Period</i>
Revised Proposal	<i>SA Power Networks 2020-25 Revised Regulatory Proposal</i>
SAG	<i>Shared Asset Guideline</i>
SCS	<i>Standard control services</i>
STPIS	<i>Service Target Performance Incentive Scheme</i>