

Response of the SAPN Customer Consultative Panel to SA Power Networks' Revised Proposal to the AER

Introduction

The SA Customer Consultative Panel ("the Panel") has been involved in the evolution of the SA Power Networks' ("SAPN") proposals to the Australian Energy Regulator ("AER") for the 2020-2025 regulatory period and has appreciated its on-going inclusion in their development and finalisation. Once again, a core group of the Panel has been involved in the development of this submission.

The key areas on which it seeks to comment at this concluding stage of the process are as follows:

- The customer/consumer engagement process and views of its effectiveness;
- Affordability;
- Proposed REPEX and AUGEX expenditure;
- Proposed ICT expenditure;
- Proposed property expenditure;
- Connections growth; and
- Tariff Structure Statement

The Panel's comments will also be made on a range of other matters included in SAPN's final proposal to the AER.

This submission was by necessity prepared as SAPN was finalising its Revised Proposal and accordingly it is largely based on the Panel's understanding of SAPN's final position.

The following summarises the Panel's understanding of the key elements of the SA Power Networks' Revised Revenue Proposal. The group's starting point has been to consider the AER's Draft Decision, in terms of bill impact for an average residential customer and to compare the Revised Revenue Proposal against this.

The AER's Draft Decision¹ said:

"This Draft Decision allows SA Power Networks to recover \$3905.3 million from its customers for the 2020–25 period. This is \$309.2 million less than the \$4214.5 million SA Power Networks proposed."

They also said, "We estimate that if this Draft Decision is implemented average residential customers and small business customers in South Australia will save, leading to a drop of \$20 and \$90, respectively by 2024–25."

¹ https://www.aer.gov.au/system/files/AER%20-%20SA%20Power%20Networks%202020-25%20-%20Draft%20decision%20-%20Overview%20-%20October%202019_2.pdf

The Panel understands that these impacts are projected for the final year of the regulatory period, whereas SAPN talks of reductions in the first year of the new regulatory period, \$62 for residential customers with reductions ‘front loaded’ to the start of the period, in line with consumer preferences. It is understood that the two different dollar values for price reductions are compatible, they just relate to different years.

The Panel understands that SAPN's Revised Revenue Proposal will provide for an estimated \$62.45 residential bill reduction, excluding potential impacts of the contingent project. This compares to the \$63 per year nominal residential bill reduction resulting from the AER Draft Decision - an overall increase of just \$0.55 per customer per year from the Draft Decision.

However, the Panel notes that this modest result is due to increases in SAPN's "controllable costs" in the Revised Revenue Proposal of \$3.85 per annum being largely offset by a \$3.30 per year reduction as a result of a lower weighted average cost of capital compared to the calculation at the time of the Draft Decision.

The main changes in SAPN's "controllable costs" are from a proposed \$3.00 per customer reduction in operating costs but increases in costs to customers for IT expenditure (excluding recurrent IT costs and cybersecurity requirements), increased replacement expenditure costs including the Assets and Work IT package and Connections Capex.

The Revised Revenue Proposal is for \$298m, nominal, less than the initial revenue proposal, a reduction of about 7%. The SAPN Revised Revenue Proposal is \$11m more than the AER Draft Decision.

SAPN provided the following data to the SAPN CCP just prior to finalising its Revised Revenue Proposal and is the basis of following comments.

Revenue and Expenditure (\$m)	SAPN Original Proposal	AER Draft Decision	SAPN Revised Revenue Proposal
Total Revenue Allowance (\$ nominal)	\$4,214	\$3,905	\$3,916
OPEX (\$ real)	\$1,530	\$1,466	\$1,442
CAPEX (\$real)	\$1,741	\$1,263	\$1,712

Source, SAPN as presented to the Panel, December 2019

As part of the Panel’s introduction to its submission, it draws attention to the following:

The Main Changes from SAPN’s Original Proposal

The SAPN CCP notes the following “headline” changes from the original proposal to the Revised Proposal from SAPN:

- reduced operating cost expenditure;

- maintenance of Capex costs proposal, specifically increases in replacement capital costs particularly when compared to the AER's Draft Decision;
- increasing connections costs;
- continuing high levels of IT expenditure, including the Assets and Work package; and
- a reduced focus on taxation matters.

Important continuing themes

- It is noted that the three core themes remain:
 1. keeping prices down;
 2. a managed transition to the new energy future; and
 3. maintaining safety and reliability
- The Panel views affordability as an essential objective, with South Australia's electricity costs continuing high by interstate and global comparisons. While there are opportunities for greater cost reductions in other parts of the "price stack", the Panel holds that it is still important that SAPN continues to look for every saving it can pass on to South Australia's long-suffering energy customers;
- It agrees with the maintenance of a strong focus on "future networks", recognising SAPN's international leadership in these areas
- The Panel supports the need for improved 'visibility' of the low voltage network

The Panel is also well aware of extensive interaction between the AER and SAPN technical staff on a vast majority of the issues that are considered in the Revised Revenue Proposal. While this active engagement has created extra work for both parties, we believe that detailed engagement before the lodgement of the Revised Revenue Proposal gives a much better chance of the proposal being accepted and consequently is in the better interests of customers.

The Consumer Engagement Process

The Panel commends SAPN on its continued pursuit of consumer engagement. The consultative journey has necessarily been one of learning, testing, discovery and moving on to the next stage as knowledge and confidence have grown.

In its early stages at the commencement of the RBP 2020 exercise, many members of the Panel had concerns about the effectiveness of the engagement process, largely centred on the complexity of the more technical information and difficulties associated with assimilating the details of the proposals and assessing their cost reasonableness. At the time, it acknowledged that SAPN had made great strides in this area since the previous regulatory process. In particular, it appreciated the substantial effort made with the Panel, other key stakeholders and customers in general to identify their concerns and requirements and that these were then encapsulated in the principles embodied in the work that followed. It was accompanied by extensive deep-dive workshop activity which addressed the major expenditure categories and the general approach built into the original Draft Proposal.

This process led to a substantial growth in the Panel's knowledge of the factors driving expenditure recommendations and decisions, but it was still difficult to ascertain whether some proposed areas could be said to be prudent, efficient and reasonable. This concern was built into the Panel's initial response to SAPN on the proposed Draft Proposal, resulting in further discussions between SAPN and the Panel and a second response from the Panel.

It would be fair to say that the consultative interaction between SAPN and its Customer Consultative Panel has at times been challenging and testing. However, the perseverance of all parties and a genuine commitment to continued discussion has led to a maturing of the relationship, heightened skills of all players and improved outcomes. Whereas in the early days, there was some confusion and indeed a broad gap between where the Panel and SAPN saw themselves on the IAP2 spectrum, the Panel believes that on-going and open involvement has built a stronger bridge between the parties, greater trust and a more acceptable final proposal – one that the Panel can live with. The Panel also expects that the Revised Revenue Proposal lodged with the AER is very unlikely to contain any surprises for it.

In particular, at this stage of the process, the Panel points to:

- Its participation in multiple subsequent workshops and site visits on key discussion points out of the AER's Draft Decision;
- The ready availability of technical experts who have shown themselves willing to break down the mystique of complex issues to build further understanding of how these factors contribute to customer benefits and cost outcomes;
- The provision of options and opportunities for the Panel to influence additional savings for customers;
- The stronger and more open questioning and discussion between the parties, demonstrating the worth of the consultation journey undertaken so far; and

- The prompt provision of follow-up information and explanation when required.

The Panel also notes that SAPN has recently reviewed the purpose, objectives and composition of its Customer Consultative Panel going forward and the current Panel is confident that the experience and lessons learned from the last two years will stand the new Panel commencing January 2020 and SAPN in good stead for the future.

In conclusion on this point, the Panel recognises the value of being involved in the long consultative journey to date. It has not always been an easy path, but the Panel believes that the maintained focus and a commitment to improved outcomes for customers and SAPN will further build long-term trust and effectiveness. Some continued movement along the IAP2 spectrum would be welcomed by the out-going Panel and would set up the incoming Panel for a constructive future.

A high level of genuine interaction and mutual exploration will also be critically important as the network of the future emerges and decisions are reached and implemented. The uncertainties in this are substantial and will require significant goodwill, understanding and trust in order to determine practical directions, relevant customer outcomes and an equitable cost-balance across generations of customers.

Moving along the IAP2 spectrum toward a genuine partnership with consumer advocates requires something further of a culture shift throughout SAPN as the organisation appreciates the benefits of external perspectives. This goes beyond seeking social licence and legitimacy for SAPN decisions by convincing stakeholders of the merits of each decision. When staff throughout SAPN and its owners can believe that better decisions are made by using the contributions of stakeholders – knowledge, values and perspectives on the future – then the next step toward stakeholders, including consumers, as partners can be made.

Accordingly, the Panel has highlighted to South Australia Power Networks the importance of ongoing engagement with it and other consumer interests over the coming period, in particular to problem solve the various “future network” issues that remain current, including the potential of a contingent project, driven by AEMO.

Affordability

The Panel was pleased to see that, following consistent feedback from consumers and their representatives, a concept of price restraint was built into the original principles (“keeping prices down”) to which SAPN has been working in the development of its draft and final proposals. However, as this principle was to be balanced against maintaining reliability and managing the transition to the network of the future, at times low prices can be lost in the outcomes proposed where there is an over-emphasis on ‘reliability’. Affordability remains the Number 1 issue with many South Australians but the compilation of the various proposals in apparent vertical streams at times rendered an overall view difficult to identify and assess.

The Panel is also acutely aware that the affordability /reliability trade-off is different for different customers. Perhaps at times SAPN has heard the loudest voices from those customers who place higher value on reliability and have less clearly heard the invariably more muted voices of low-income households with very limited ability to reduce their power bills, which are widely considered to be unaffordable.

The Panel still believes that a top-down review could be more firmly built into SAPN's methodology to better balance SAPN's operational and technical conclusions with the key customer imperative. The Panel remains concerned that this can be lost when such a strong sum of all parts, bottom up approach is taken.

Along with other commentators and customer advocates, the Panel notes that if external factors such as the WACC and tax adjustments were to be removed from the calculation, there would actually have been a price increase in the Draft Proposal.

However, the Panel is pleased to acknowledge that SAPN's final proposal would result in a further drop in customer prices, of which one half is due to SAPN's reconsideration of its CAPEX and OPEX plans. This evidence of price constraint is welcomed by the Panel.

The Panel appreciates the efforts of SAPN to identify the price impact to the customer of individual expenditure programs. The provision of waterfall graphs and their explanations have made more realistic the contributory elements in the Revised Proposal and have allowed for greater comparison between the benefits of individual programs.

REPEX

The Panel has appreciated the detailed explanations of SAPN's asset replacement and refurbishment needs which have continued in workshops post the Draft Decision. It considers that there has been a genuine attempt by SAPN to outline current asset condition, factors impacting on asset life and performance and the rationale used to develop the expenditure proposal. This was an area of significant concern to the Panel when the Draft Proposal was submitted as it was difficult for the Panel to reach a conclusion as to the reasonableness of the proposed bid.

It also recognises that the AER was unconvinced by some capex proposals in the initial revenue proposal, reducing the SAPN proposal by 20.2% from \$637.2m to \$508.5m, a reduction of \$128.6m.

In the Draft Decision, the AER said:

“There are number of factors contributing to our lower substitute capex forecast:

• Insufficient evidence to support the prudence and efficiency of SA Power Networks' forecast capex. We encourage SA Power Networks to address the issues we have identified in its revised proposal. In particular, we have not included an allowance for

a number of non-recurrent projects and programs, given the lack of detail and information in support of this proposed capex in SA Power Networks' forecast. We have engaged extensively with SA Power Networks on the reasons for our placeholder for these programs and projects and the evidence required to satisfy us on the prudence and efficiency of that expenditure."

The Panel is convinced that SAPN has accepted this feedback and has been diligent in its efforts to review, reassess and explain its capital expenditure proposals particularly for replacement capex. However, some uncertainty remains with the Panel, due to the technical nature of the assets. The Panel understands that the AER's Draft Decision in this area implies that the average asset life of important electricity distribution infrastructure would then be more than 200 years. The Panel struggles to feel that this AER position is reasonable and is especially concerned at the cost burden that may then be passed to future generations of customers.

While it appreciates that age is not the only factor influencing replacement and refurbishment schedules, the Panel believes that a reasonable prediction should be made which balances performance, future demands on and for the system, potential innovation benefits and any generational investment pass-through.

The Panel also appreciates that the average life of assets such as stobie poles can vary according to factors such as location and supports the use of an assessment which takes reasonable variables into account.

While the Panel hesitates to support a particular dollar investment amount, it understands that more detailed work has been undertaken by SAPN to support its Revised Proposal in this area.

The Panel believes that, with the appropriate research and supported argument, SAPN can make out a durable case for an increase from the REPEX amount outlined in the Draft Decision. In particular, the Panel acknowledges the vital importance of funding for the "bread and butter" of electricity infrastructure to customers, being poles, wires, transformers and associated equipment. With further and supported justification, it could support some additions to investment in this area.

The Panel also notes that while extra REPEX expenditure now does not have major impact on customer bills in the near future, there are impacts on the Regulated Asset Base, with some REPEX costs consequently being paid for, in part, by future customers.

The Panel believes that there is a need for a better shared view about what a sustainable amount of REPEX looks like for the next regulatory period and into the longer term. Intergenerational equity is a real aspect of the best, "long term interests of consumers".

ICT

The level of expenditure sought by SAPN for ICT investment remains of some concern to the Panel and it supports further careful scrutiny in this area.

The Panel has consistently found this to be a problematic area to assess. In particular:

- It is conscious that much of ICT is shrouded in technological mystique and is the domain of experts;
- The ICT world moves very quickly and it is difficult for those in the field and lay people to get a fix on the impact, risks and opportunities of the fast-moving changes and feel confident about proposed strategies and solutions (eg cyber security protections);
- It was of concern that only a limited number of benchmarks were offered in support of SAPN's initial proposals, but it is understood that further work has been done to develop the arguments further;
- The linkages between IT and other proposed areas for funding were not easily apparent in the Draft Proposal and it was difficult to identify and reconcile the trade-offs and savings that would flow from IT investments. The Panel understands that SAPN has now provided some further quantification of the benefits flowing from the original proposal which will be useful in determining the value of IT propositions and holding SAPN to account against the final outcome;
- With respect to the SAP \$ proposal, the Panel sought justification for continuing this level of investment. It expressed concern as to the limited options apparently available to SAPN and believes this is a serious nation-wide issue for infrastructure investment agencies and their regulators generally. It is understood that SAPN has done some further work on third party involvement to accompany its Revised Proposal;
- Again, the Panel was concerned that SAPN used a project by project, piecemeal approach in building up its ICT case and that made it hard to see the full picture; and
- On the other hand, the Panel supports in principle the continued development and roll-out of the Assets and Work strategy, believing it will have direct customer benefits and reduce operational costs and capital expenditure in the longer term. The Panel also notes that, with an investment in the Assets and Work program of the magnitude sought in the Revised Proposal, SAPN is confident that it can arrest future capital spend in this area.

The Panel appreciates that the rapidly changing role of the electricity distribution system will require greater visibility of the LV network, and is pleased to see that the AER is taking steps to progressively support this through investment. However, it believes that further consideration should be given by the AER of SAPN's revised business case where it allows for greater monitoring of the network and its customers.

The Panel is pleased to see that SAPN's review of its overall ICT proposal includes responses to the AER's questions and has resulted in a reduction in the dollars sought.

AUGEX

The Panel also was involved with a number of discussions regarding augmentation expenditure. It is aware of the AER's Draft Decision reductions of \$114 million to the proposed augmentation expenditure program and notes the Revised Revenue Proposal effectively "splits the difference" between the AER Draft Decision and the original SAPN proposal.

The Panel interprets a considerable amount of the dialogue it has had with SAPN as saying that REPEX expenditure is a higher priority than AUGEX - though these are not SAPN's words, they are the Panel's. Yet the Panel supports this view for the coming regulatory period, because minimising expenditure is the high priority.

Notwithstanding these comments, the Panel recognises that the AER accepted the low-voltage management program, an important component of future DER management. It is also generally supportive of the low-voltage transformer monitoring program which has been amended for the Revised Revenue Proposal. The Panel is happy with the intent of this program and also happy to look to AER's expertise in assessing the most cost-effective options for achieving the low-voltage transformer monitoring outcomes.

The Panel has valued the significant efforts of SAPN to inform it over the last two years on the rapidly changing demands on and for the network as consumers move into more distributed energy systems and solutions. Improved efficiency of and new DER equipment are driving increased consumer interest and implementation. The Panel accepts that this trend is not going to flatten off and that steps must be taken to ensure that the network can support and balance the demands facing it.

Voltage performance raises significant performance and safety issues and the Panel believes that SAPN's revised business case deserves closer scrutiny by the AER, with a view to increasing the allowance from the Draft Decision. In particular, the Panel is keen to ensure that any new investments supported by the AER incorporate clear labour and work management trade-offs.

The Panel is aware of the often long-standing problems faced by customers on low reliability feeders. SAPN's customer research and engagement have highlighted several key areas of concern and performance has been tracked for many years which supports its conclusion that some further investment is required in these areas.

The Panel has noted the views of several communities in regional and remote South Australia and accepts that significant performance-related disadvantages are felt by these worst served customers. The Panel appreciates that the STPIS scheme is part of the balancing consideration that is required in this area, but it is conscious that a small but targeted investment on these low reliability feeders can make a significant difference to the customers involved. In conclusion, with a more detailed business case, the Panel supports an increase in funding to improve reliability for SA's worst served customers, mainly for equity reasons.

However, the Panel has mixed views as to the proposal with respect to hardening the network, with its significant focus on the Adelaide Hills. While it is understood that the cost impact per residential customer is around 20 cents in total over the 2020-2025 period, questions arise as to whether all customers should be asked to bear the cost of actions taken largely in the Adelaide Hills to reduce the length of outages, in the face of other priorities.

The Panel has viewed the conditions in a few of the CBD substations and can see some merit in the continuation of a staged funding program to improve safety and work impacts and to move towards compliance with current standards.

Property

The Panel noted that, in its Draft Decision, the AER did not commit to a future investment in SAPN's property holdings and reduced SAPN's draft proposal for future fleet expenditure. It believes that, while the \$0 placeholder for property gave SAPN the time and opportunity to better make out its case, there is a need for investment in this area, especially in some of the proposals.

However, it believes that it would be constructive if SAPN were to develop a detailed asset register for its properties, the plant and equipment they contain and their surrounds. This register would detail the specific age and condition of the various elements in these assets and could apply established and accepted industry standards (including costs) for their maintenance, upgrading and replacement. This would ensure that an objective and professional approach was taken to expenditure on property in the future.

With this approach implemented, the Panel could support a level of investment that would allow for SAPN's ageing property holding at Marleston North to be brought to a more serviceable and safe, although not plush, operating condition, one which renders the location fit for purpose. Again, the responsibility is on SAPN to make an improved case here, including consideration of other potentially more efficient options to achieve the functions currently performed at Marleston North.

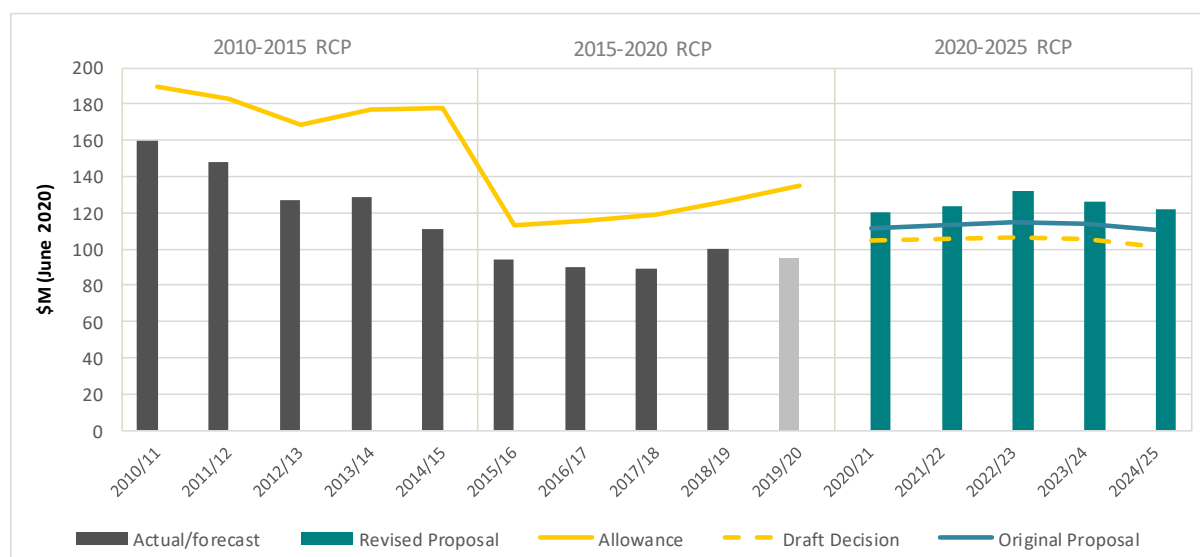
The Panel has consistently suggested that SAPN uses industry investment standards or benchmarks in proposing additional upgrading and improvements to its property holdings. It has been advised that SAPN has used an independent quantity surveyor to prepare its cost estimates.

Connections Growth

Connections capital expenditure comprises 'Gross' expenditure forecasts and customer contribution forecasts to arrive at a forecast of 'Net' capex. SA Power Networks originally proposed a forecast Net Connections Capital Expenditure of \$198.4m. The AER's Draft Decision was to include a substitute forecast of \$167.6m (a reduction of 30.8m). The Revised Proposal however contains a forecast that is higher than both of these at \$276.8m.

We understand the increase is a function of increased expectations for major projects and a reduction in customer contributions as a result of the lower WACC.

The revised forecasts only arrived late in the consultation period (early December) and hence there have been limited opportunities for engagement or scrutiny. The Panel acknowledges the difficulty in forecasting future connections, even with the input of skilled consultants. However, it is aware that historic Gross Connections allowances have consistently over estimated actual expenditure. The following chart was provided to the Panel by SA Power Networks:



Connections gross capex trend (June 2020, \$ million)

Accordingly, the Panel expects the AER to establish a high level of confidence in the forecasts, so that customers are not unfairly burdened by the eventual allowance.

Tariff Structure Statement

SAPN has shown a thoughtful approach to balancing tariffs and cost allocations across different customer groups and across the five-year timeframe. The contention about demand-based tariffs has been appeased and the solar sponge is welcomed as a price signal that should, hopefully, serve both SAPN and its customers.

While the Panel still has some concerns about the level of creativity built into the tariff proposal, this work has been a strong and successful example of developing an approach in close consultation with customers and other stakeholders. The 'solar sponge' proposal is excellent leadership in responding to the network challenges of more supply through rooftop PV than aggregate demand.

In addition, the Panel is aware of the difficulty in securing retailer commitment to adopting the tariff proposals in practice and commends SAPN's efforts to engage pro-actively with retailers, including through hosting a workshop with retailers in Melbourne.

Conclusion

The Panel acknowledges that SAPN has considered genuinely and in detail the AER's feedback and has responded with explanations, revised business cases or restructured elements of its Draft Proposal. It has found beneficial its close involvement in the further work and exploration it has had with SAPN in the finalisation of its proposal. It considers that the higher level of transparency and trust that has evolved between SAPN and the Panel is a valuable additional outcome of the regulatory process and the Panel looks forward to its continued growth.

However, while it is more comfortable with the Revised Proposal, it is still looking to the AER to be confident that the dollars spent in the end reflect the long-term interests of consumers, are "capable of acceptance" and are efficient and prudent. It also seeks reassurance that the final decision represents a reasonable balance between justified investment and cost restraint and that it takes into account the changes emerging in the electricity market and the longer-term impact on future generations of customers.

SAPN Customer Consultative Panel

23 December 2019