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14 March 2024

Mr Grant Cox
Technical Regulation Manager
SA Power Networks
1 Anzac Highway
KESWICK SA 5035

By email: [REDACTED]

Dear Mr Cox,

Re: AER Determination – SA Power Networks River Murray Flood CPT Application

I am writing to advise you of the Australian Energy Regulator's (AER) assessment of SA Power Networks' cost pass through (CPT) application, submitted on 30 November 2023, in relation to the 2022-23 River Murray flood event (the flood event).

In accordance with clause 6.6.1 of the National Electricity Rules (NER), the AER has determined that a positive change event has occurred, and that SA Power Networks may recover incremental revenue of \$11.2 million (\$nominal, smoothed) from network users in the 2024-25 regulatory year. This is \$0.9 million higher than SA Power Networks' initial proposal of \$10.3 million (\$nominal, smoothed). The higher pass through amount is due to corrections made to SA Power Networks' proposed post-tax revenue model.

The approved pass through amount is estimated to incrementally increase the average annual bill of residential customers by approximately \$8 in 2024-25.

Details of the AER's assessment against the relevant factors in the NER are set out in following attachments. If you have any queries in relation to this matter, please contact David Monk at [REDACTED]

Yours sincerely

[REDACTED]

Arek Gulbenkoglou
General Manager
Network Expenditure

Sent by email on: 14.03.2024

Attachment A: Reasons for determination

1. Occurrence of a natural disaster pass through event

SA Power Networks' 2020–25 revenue determination defines a natural disaster pass through event as follows:^{1 2}

“Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2020–25 regulatory control period that increases the costs to SA Power Networks in providing direct control services, provided the fire, flood or other event was:

- a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or
- not a consequence of any other act or omission of the service provider.”

We are satisfied that the 2022-23 River Murray flood event (the flood event) meets this definition, and was not a consequence of any act or omission of SA Power Networks.

2. Positive change event

We are satisfied the flood event meets the definition of a “positive change event” in the NER as SA Power Networks has incurred materially³ higher costs in providing direct control services as a result of the event, as demonstrated in **Table 1**.

Table 1: AER – Materiality assessment (\$million, nominal)

Costs	2020-21	2021-22	2022-23	2023- 24	2024-25	Total
Approved CPT Opex	-	-	9.84	0.40	-	10.24
Approved CPT Capex	-	-	1.03	0.18	-	1.21
Total costs	-	-	10.87	0.58	-	11.45
AER approved unsmoothed revenues	-	-	802.77	823.35	-	1,626.12
Materiality (%)	-	-	1.35	0.07	-	0.7

3. Timing of SA Power Networks' Application

SA Power Networks' cost pass through (CPT) application in relation to the flood event was due on 30 March 2023, 90 business days after 21 November 2022, the date on which the SA Government State Coordinator declared a Major Emergency in respect of the flood event.⁴

On 17 March 2023, SA Power Networks submitted an extension request⁵ citing the difficulty in assessing and quantifying the effects of the flood event. The AER extended the timeframe for SA Power Networks to submit an application in relation to the flood event until 30 November 2023. SA Power Networks submitted its application on that day.

¹ Cl. 6.6.1(a1)(5) of the NER.

² [Final decision - SA Power Networks distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

³ As defined in Chapter 10 of the NER (Glossary)

⁴ [Declaration of a Major Emergency - River Murray Flood Emergency](#).

⁵ Cl. 6.6.1(k) of the NER

4. Assessment of the pass through amounts

In assessing SA Power Networks' CPT application, the NER requires the AER to consider a number of factors⁶ to determine whether the proposed level of costs are prudent and efficient. To assist our review, we sought additional, more detailed information on the break-down of incurred costs, which SA Power Networks provided. Our assessment found that:

- the proposed pass through amount reflects only the incremental costs incurred as a consequence of the flood event, and not business-as-usual costs, or costs associated with increasing the scope of network services.
- SA Power Networks' decisions and actions in responding to the flood event were efficient, and the scope of works undertaken appears reasonable in the circumstances.
- SA Power Networks had not taken any action which had increased the magnitude of the pass through amount, or failed to take action that could reasonably have been taken to reduce the magnitude of the pass through amount.

Internal labour costs

Our analysis of SA Power Networks' application identified that internal labour accounted for the majority, around 53 per cent, of total flood response expenditure. We met with SA Power Networks and sought additional information to confirm the identified internal labour costs were incremental, and not already funded through existing revenue allowances.

SA Power Networks explained that expenditure on internal labour primarily related to overtime and allowances for non-local staff who were used to assist the flood response. SA Power Networks also incurred additional costs in back-filling for resources reallocated from existing maintenance and capital programs to the flood response, and provided documentation and declarations to support these claims.

We are satisfied that the identified expenditure on internal labour was for activities that were additional to those funded through the existing AER approved revenue allowance for the 2020-25 regulatory period.

5. Approved pass through amount

Our determination is to approve total incremental costs of \$11.5 million (\$nominal, smoothed), comprising \$10.2 million (\$nominal) in operating expenditure (opex) and \$1.2 million (\$nominal) capital expenditure (capex) as shown in **Table 2**.

Table 2: AER approved incremental capex and opex for the 2022–23 River Murray Flood (\$million, nominal)

Costs	\$million
Operating expenditure	10.2
Capital expenditure	1.2
Total costs	11.5

Note: Numbers may not add due to rounding.

⁶ Cl. 6.6.1(j) of the NER.

The incremental revenue associated with these costs (the approved pass through amount) is detailed in **Table 3**.

Table 3: AER approved incremental revenue resulting from the 2022–23 River Murray Flood (\$million, nominal)

\$million (nominal)	2020-21	2021-22	2022-23	2023- 24	2024-25	Total
Return on capital	-	-	-	0.0	0.1	0.1
Return of capital (regulatory depreciation)	-	-	-	-0.0	-0.0	-0.0
Operating expenditure	-	-	10.0	0.4	-	10.4
Revenue adjustments	-	-	-	-	-	-
Net tax allowance	-	-	-0.1	-0.0	0.0	-0.2
Incremental annual revenue requirement (unsmoothed)	-	-	9.9	0.4	0.1	10.3
Incremental annual expected revenue (smoothed)	-	-	-	-	11.2	11.2

Note: Numbers may not add due to rounding.

Calculation of pass through amount

SA Power Networks' CPT application included a post-tax revenue model (PTRM). Our analysis of SA Power Networks' PTRM identified a number of modelling issues.

- SA Power Networks did not use the latest published return on debt updated PTRM in calculating the incremental revenue. Instead, it calculated incremental revenues using a PTRM template containing no opening Regulatory Asset Base (RAB) nor existing capex and opex, resulting in an incorrect estimate of the tax building block.
- Total actual opex and capex costs were de-escalated to real \$2019–20 terms using inflation assumptions that are inconsistent with the annual pricing process. This inconsistency resulted in the nominal costs, as calculated in the PTRM, that are to be recovered from consumers being different to the actual nominal costs incurred by SA Power Networks.
- SA Power Networks assumed nominal costs to be in end-of-year terms, which is inconsistent with the AER's recognition of nominal capex and opex in mid-year terms. As a result, the real \$2019–20 costs as per SA Power Networks' proposal PTRM were incorrectly input as December 2019 amounts, rather than in June 2020 terms as required by the PTRM.
- Proposed capex amounts for input into the PTRM were rounded to the nearest dollar, whereas we expect all inputs to be unrounded.

In response to an information request on the above issues, SA Power Networks agreed to all our modelling corrections. This included:

- Using the 2023–24 return on debt updated PTRM and including the cost pass through expenditure in addition to the existing forecast capex and opex as approved for the 2022–23 Emergency Standards cost pass through decision on 16 September 2022.⁷

⁷ [SA Power Networks - Cost pass through - Emergency standards 2021–22](#)

- Applying an inflation de-escalation consistent with the annual pricing process. This meant using expected inflation as per the PTRM for the first year and actual inflation 18 months lagged for all other years to convert nominal expenditure figures to real June 2020 terms.
- Applying a half-year CPI to convert nominal mid-year costs to real end-of-year.
- Using the exact (unrounded) capex amounts as inputs in the PTRM.

6. Timing of cost pass through recovery

SA Power Networks proposed to recover the incremental revenue arising from its cost pass through application in 2024-25, the remaining year of its 2020–25 regulatory control period.

We are supportive of SA Power Networks' proposal and determine that SA Power Networks recover the approved pass through amount in 2024-25. We are satisfied that the recovery of the pass through amount in 2024-25 will allow SA Power Networks to recover its efficient costs in a timely manner, without materially increasing volatility in revenue recovered from consumers.

This is estimated to incrementally increase the annual bill of residential customers in the 2024-25 year by approximately \$8.

Attachment B: Requirements for determining a positive change event has occurred

Requirement of the NER	Our consideration
Is the pass through event a regulatory change event, service standard event, tax change event, or retailer insolvency event? ⁸	No.
Does the pass through relate to any other event specified in SA Power Networks' 2020–25 distribution determination as a pass through event for that determination? ⁹	Yes. We consider that the 2022-23 River Murray flood event (flood event) is a natural disaster pass through event as specified in SA Power Networks' 2020–25 distribution determination. ¹⁰
Was the pass through event a consequence of acts or omissions of SA Power Networks?	No. There is no evidence that SA Power Networks' acts or omissions caused the flood event.
Did the pass through event entail SA Power Networks incurring materially higher costs in providing direct control services than it would have incurred but for the event? ¹¹	Yes. The additional costs incurred by SA Power Networks as a result of the flood event were material. The cost of responding to the flood event in 2022-23 was \$10.9 million or 1.35% of SA Power Networks' approved \$802.8 million revenue for that year.
What is the date on which the positive change event occurred? ¹²	SA Power Networks identified that the flood event occurred from 21 November 2022 to 9 February 2023. These dates align with the SA Government State Coordinator declaration of a Major Emergency in respect of the flood event. ¹³ We agree the event extended over this period.
Did SA Power Networks submit a written statement within 90 business days of the positive change event occurring? ¹⁴	Yes. In response to SA Power Networks' request, the AER provided an extension to submit a cost pass through application by 30 November 2023. SA Power Networks submitted its application on that day.
Did SA Power Networks specify details of the positive change event, including the date on which the event occurred, in its written statement? ¹⁵	Yes. SA Power Networks' application (written statement) included details of the positive change event, including the date on which the event occurred.
Did SA Power Networks specify in its written statement the eligible pass through amount, the proposed positive pass through amount, and the amounts proposed to be recovered from customers in each regulatory year? ¹⁶	Yes. SA Power Network proposed a positive pass through amount of \$10.3 million (\$nominal) to be recovered from consumers in 2024-25, the last year of the current regulatory control period.
Did SA Power Networks specify in its written statement evidence of the actual and likely increase in costs that occurred solely as a consequence of the positive change event? ¹⁷	Yes. SA Power Networks' pass through application sets out the costs incurred as a result of the flood event, as well as how it calculated its proposed pass through amount. ¹⁸
Is the pass through amount, in whole or in part, in respect of expenditure for a restricted asset? ¹⁹	No.

⁸ NER, cl. 6.6.1(a1)(1) through 6.6.1(a1)(4); and chapter 10.

⁹ NER, cl. 6.6.1(a1)(5).

¹⁰ [Final decision - SA Power Networks distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

¹¹ That is, does it meet the definition of a "positive change event" as defined in chapter 10 of the Rules.

¹² NER, cl. 6.6.1(c)(2).

¹³ [Declaration of a Major Emergency - River Murray Flood Emergency](#)

¹⁴ NER, cl. 6.6.1(c).

¹⁵ NER, cl. 6.6.1(c)(1) and 6.6.1(c)(2).

¹⁶ NER, cl. 6.6.1(c)(3), 6.6.1(c)(4), and 6.6.1(c)(5).

¹⁷ NER, cl. 6.6.1(c)(6).

¹⁸ [SA Power Networks - Cost Pass Through Application - Attachment B - PTRM - Expenditure+Summary tab.](#)

¹⁹ NER, cl. 6.6.1(c1) and (d2).

Attachment C: Relevant factors under cl. 6.6.1(j)

Requirement of the NER	Our consideration
We must take into account the matters and proposals set out in SA Power Networks' written statement. ²⁰	This decision sets out how we have considered the matters and proposals in SA Power Networks' pass through application (written statement).
We must take into account the increase in costs in providing direct control services resulting from the pass through event. ²¹	We are satisfied that the expenses incurred by SA Power Networks in providing direct control services in response to the flood event were incremental to existing costs.
We must take into account the efficiency of SA Power Networks' decisions and actions in relation to the risk of the event. ²²	We are satisfied that the decisions and actions taken in responding to the flood event were efficient, and the scope of works undertaken is reasonable in the circumstances. There does not appear to be any action that SA Power Networks has failed to take to reduce the magnitude of the flood response cost, or that it took or omitted to take which has increased the magnitude of these costs.
We must take into account the time cost of money. ²³	To account for the recovery of the pass through amount in 2024-25, we have used the nominal rate of return, as determined in SA Power Networks' 2020-25 distribution determination, reflecting the most recent return on debt update in the approved PTRM.
We must take into account the need to ensure that the pass through amount reflects only costs incurred solely as a consequence of the flood event. ²⁴	We are satisfied the costs included in our approved pass through amount were solely incurred because of the flood event. SA Power Networks has taken an appropriate approach to identify flood related costs and exclude non-incremental costs from its application.
The AER will have regard to whether SA Power Networks has insurance against the event, and whether it is the level of insurance that an efficient and prudent network operator would obtain? ²⁵	SA Power Networks does not have insurance covering poles, wires and related network infrastructure due to prohibitively high costs for the limited coverage options commercially available. The premiums required to eliminate risks to poles and wires would result in higher customer charges inconsistent with efficient network operation. We are satisfied it was prudent and efficient for SA Power Networks to not obtain insurance for its poles and wire assets. This approach to is generally consistent with comparable peer networks including those impacted by other natural disasters.
We must take into account whether the costs of the event have already been factored into SA Power Networks' annual revenue requirement for the current regulatory control period or will be factored into annual revenue for the next regulatory control period. ²⁶	We do not consider the costs that SA Power Networks is proposing to recover have been factored into SA Power Networks' annual revenue requirement for either the current or following regulatory control periods.
We must take into account the extent to which SA Power Networks' costs have already been funded by previous pass through determinations. ²⁷	We consider that the costs to be recovered by SA Power Networks due to this pass through event are solely attributable to the incremental costs associated with SA Power Networks' response to the flood event.

²⁰ NER, cl. 6.6.1(j)(1).

²¹ NER, cl. 6.6.1(j)(2).

²² NER, cl. 6.6.1(j)(3).

²³ NER, cl. 6.6.1(j)(4).

²⁴ NER, cl. 6.6.1(j)(5).

²⁵ [Final decision - SA Power Networks distribution determination 2020-25 - Attachment 14 - Pass through events - June 2020](#)

²⁶ NER, cl. 6.6.1(j)(7).

²⁷ NER, cl. 6.6.1(j)(7A).