Government of South Australia
Department for Energy and Mining

DEMC24/00556

Kris Funston
Executive General Manager
Australian Energy Regulator
Via email: SAPN2025@aer.gov.au

Dear Mr Funston

The Strategic Policy and Delivery Division (Division) of the Department for Energy and Mining (DEM) appreciates the opportunity to provide the following submission on SA Power Networks (SAPN) regulatory proposal (Proposal) for the period 1 July 2025 to 30 June 2030.

In considering SAPN's Proposal, the Division acknowledges the significant changes underway to the South Australian distribution network resulting from increasingly frequent significant weather events and the shift to a more technologically sophisticated and decentralised grid underpinned by rooftop solar and household batteries.

Similarly, the Division notes the age of South Australia's network compared to those in other states and territories, and the associated ongoing need for prudent scheduled expenditure on network asset refurbishment, replacement and augmentation.

Notwithstanding this, the Division recognises cost pressures placed on South Australian households and businesses from high retail energy prices. Since the September quarter 2022, retail electricity prices have grown by 26.3 per cent (or 16.8 per cent in annual terms).[1]

In its submission to SAPN's Draft Proposal of July 2023, the Division sought that SAPN reassess its forecast strong growth in capital expenditure (capex) and operating expenditure (opex) for 2025-30. The Division acknowledges the efforts taken by SAPN to re-examine each segment of expenditure from that presented in the Draft Proposal, however it notes that downward revisions applied incorporated into the Proposal are relatively minor and often offset or more than offset by rises elsewhere.

Unfortunately, with the Proposal indicating forecast capex growth of 22 per cent and forecast opex growth of 19 per cent, the Division considers that SAPN hasn't struck an appropriate balance between consumer costs and service levels.

[1] Derived from ABS, Cat No. 6402, Consumer Price Index, Table 7, Adelaide electricity series

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The Division acknowledges that SAPN's Proposal may lead to only modest annual increases of $10 (or 0.5 per cent) for residential customers and $24 (or 0.4 per cent) for small to medium business customers[2] and that the distribution network component makes up only a share of total bills. However, it considers that this regulatory proposal is a missed opportunity to place material downward pressure on energy costs for consumers while still providing for adequate expenditure to maintain and enhance the network for the energy transition.

The Division considers that such an opportunity to reduce distribution costs for consumers arises with SAPN's existing network assets becoming fully depreciated and its regulatory asset base declining. A greater emphasis on capital spending restraint has the potential to lower bills through passing on of savings arising from both a lower depreciation expense and a reduced return on capital applied to the existing smaller regulatory asset base. Not only does SAPN's Proposal more than offset these potential savings with strong growth in expenditure, but the proposed growth in capex, if approved, would be taking place in an environment of high interest rates and inflation, the extra cost of which would also be passed onto consumers.

<u>Proposed capital expenditure</u>

SAPN is proposing total capex of $2,379.2 million for 2025-30, representing a 21.9 per cent increase on SAPN's estimated expenditure for the 2020-25 period. In particular, the Division notes that SAPN is seeking replacement capex (repex) to grow by 32.6 per cent in real terms to $936.5 million and augmentation capex (augex) to grow by 48.8 per cent in real terms to $521.5 million.

Reinforcing the position taken in its submission to SAPN's Draft Proposal, the Division does not support this proposed scale of repex escalation and instead expects more measured growth across regulatory control periods consistent with the gradual replacement of long-life network assets. The Division encourages the AER to interrogate the robustness of the arguments made in the Proposal that these assets are expected to deteriorate to an extent where safety and reliability is compromised and that the increase in repex spending proposed for 2025-30 is commensurate with these risks.

More generally, the Division is concerned that the Proposal, with references to the adoption of new risk forecast modelling, appears to attempt to justify not only steep real increases in repex for the 2025-30 regulatory control period but also further material real increases over the longer term. While supportive that its "visibility of risk in 2020-25 vastly improved", the Division is disappointed that SAPN's reassessment of its network asset replacement schedule appears to be imposing an increased cost burden on the current generation of South Australian consumers.

The Division similarly supports the AER undertaking an in-depth review of the proposed augex, in particular the business case relating to the proposed $242 million of demand

[2] AER, Issues Paper: SA Power Networks' electricity distribution determination 2025–30, March 2024, p.5

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driven augmentation. While acknowledging the role of electrification in supporting future demand growth, The Division is cautious that the outcomes resulting from both introducing a probabilistic modelling approach and the incorporation of much higher AEMO modelled peak demand forecasts may combine to exaggerate the level of capacity augex required to support actual need for the 2025-30 period.

Regarding other components of augex, the Division is broadly supportive of the proposed expenditure on reliability augex that includes maintaining underlying reliability, improving CBD reliability, enhancing resilience via additional mobile generators, and enhancing regional reliability in the targeted areas of the South East, the Eyre Peninsula and the Upper North, and enhanced bushfire management.

The Division acknowledges the need for additional export capacity to resolve constraints arising from the continued growth in rooftop solar and batteries. While the Proposal implies a significant uplift in capex spending on customer energy resources (CER) integration to $92.7 million for 2025-30, the Division broadly supports the business case underpinning this item. The Division considers that an understanding of customer behaviour to changes in export service performance is still uncertain. In the future, it encourages SAPN to refine their “willingness-to-pay” approach that determined that the level of investment required should be based on achieving a 95 per cent level of export service for 90 per cent of customers.

Finally, the Division does not support the proposed $20 million Innovation Fund. Noting SAPN’s previous success in developing new network solutions and adopting new technologies for the benefit of South Australian consumers, the Division expects that initiatives that are likely to return long-term customer benefits should continue to be incubated through existing business segments and resourcing.

<u>Proposed operating expenditure</u>

The Division notes that SAPN is proposing total opex of $1,983.7 million for 2025-30, representing an 18.8 per cent increase on SAPN’s estimated expenditure for the 2020-25 period. The Division recognises that economy-wide input cost pressures may justify larger than trend increases of some opex categories such as insurance premiums. Additionally, the Division accepts that the energy transition is resulting in additional costs to support the uptake of CER, cyber security, the rollout of smart meters, and new regulatory obligations.

Nevertheless, given it represents almost $150 million in total, in assessing SAPN’s proposed opex for the period 2025-30 the Division requests that the Australian Energy Regulatory (AER) review the proposed opex step changes to ensure they are correctly categorised as step changes and that the costs proposed are economically efficient. The Division is concerned that normalising significant expenses by permitting them to be categorised as step-changes over multiple regulatory control periods may undermine the “base-step-trend” approach to forecasting opex and also reduce transparency.

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The Division also supports the AER undertaking a targeted review of the reasonableness of the $84.7 million adjustment to base year costs, including an additional $13.9 million compared to the Draft Proposal, resulting from the change in accounting standards associated with “Software-as-a-Service”.

While the Division notes that opex spending on cyber security has reduced since the Draft Proposal, based on SAPN adopting a “risk-prioritised approach”, it appears that the combined capex/opex spending on cyber security outlined in the Proposal is largely unchanged. Given the material $50 million SAPN have proposed for cyber security, the Division supports an AER targeted review of this item, including verification of SAPN’s estimate that this spending would result in a positive net present value of $124 million over 10 years.

Reflecting the Division’s concerns with the scale of SAPN’s proposed capex, it holds similar concerns regarding the proposed $18 million of network uplift expenditure (comprising additional corporate support and ICT spending) intended to accompany this capital spending. The Division supports the AER’s intended review into this item and additionally expects that, should the AER not approve the scale of SAPN’s capex program, then this network uplift spending be proportionally reduced.

Finally, the Division notes that SAPN is proposing opex productivity improvements of 0.5 per cent each year over the 2025-30 regulatory period, identical to annual productivity growth approved for the current 2020-25 period. Given the notable escalation in proposed capex and opex compared to the current regulatory control period, the Division would expect additional savings to consequently flow because of efficiency gains.

Proposed tariff structure

The Division considers that the tariff structures outlined in the proposal were developed with an appropriate consideration of cost reflectivity, customer energy usage patterns and trends, fairness and equity, and an intent to maximise the utilisation of the distribution network. The Division supports the one hour expansions of the Solar Sponge and Off-Peak windows for residential time of use customers and encourages SAPN to continue innovating, via the use of trial tariffs, to improve understanding of consumer energy usage and incentives when interacting with CER.

The Division supports the proposed introduction of small business tariff sub-categories as a way of providing more realistic price incentives for South Australian small and medium-sized operations. The Division encourages SAPN to ensure price structures for these proposed tariff sub-categories are equitable at the margin for relevant businesses consuming around 40 megawatt hours per annum.

Export tariffs

The Division recognises that the provision of export services allows for the more efficient provision and use of the network and a more equitable allocation of costs and benefits.

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Complementing the Division's support for additional expenditure on CER integration as well as SAPN's previous work undertaken on flexible exports and enhanced voltage management, it similarly supports the proposal to introduce a modest export tariff structure to recover the costs of this expenditure from customers with the ability to export into the distribution network and who can expect to receive most of the benefits from reducing network congestion.

The Division supports the measured and equitable design characteristics of the proposed export tariff structure including:

- an export free level and roll over mechanism that means that most of a residential customer's exports should not attract an export charge.
- that export charges are not dependant on meter type and equate to less than $10 per year for most residential customers.
- that the average export charge for vulnerable customers is lower than the state average.

While supporting the introduction of export tariffs from 1 July 2025 the Division acknowledges that this, together with the closing of the Solar Feed-in Scheme during the 2025-30 regulatory period, will impact consumers with renewable energy systems connected to the grid.

Acknowledging the discussion presented by SAPN in the Proposal, the Division reinforces that, should the proposal for export tariffs be accepted by the AER, SAPN should genuinely engage and provide clear and comprehensive guidance for customers, retailers, government, and other market participants well in advance of the start date. This guidance should highlight the bill impacts for a range of relevant customer types, including for vulnerable customers and those without rooftop solar. The guidance should also show how different customer types may benefit by shifting their network use in response to price signals.

Should you wish to further discuss any aspects of this submission, in the first instance please contact Andrew Schultz on [redacted]

Yours sincerely

[redacted]

Rebecca Knights
EXECUTIVE DIRECTOR, STRATEGIC POLICY AND DELIVERY

16 / 05 / 2024

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