ABN 14 725 309 328
136 Greenhill Road
Unley SA 5061
Telephone 08 8300 0000
Fax 08 8300 0001
Email customerservice@business-sa.com
www.business-sa.com

BusinessSA
South Australia's Chamber of Commerce and Industry

3 July 2015

Mr Sebastian Roberts
General Manager – Networks Branch
Australian Energy Regulator
GPO Box 520
MELBOURNE VIC 3001

Dear Mr Roberts

I write in relation to the AER's preliminary decision on SA Power Network (SAPN)'s Regulatory Proposal for 2015-20.

**Executive Summary**

Business SA welcomes the price relief which should eventuate from the AER's preliminary decision on SAPN's regulatory proposal, a 9.8% cut to electricity bills for both residential and small business customers. The clear message from our members is that price rises since 2009 are hurting business, particularly manufacturers and irrigators but also small business more broadly. In a competitive environment, businesses often cannot pass back these costs to customers and the result is internal cost cutting, including on staff. Businesses also hold back from expanding under such circumstances and this limits economic growth more broadly.

While Business SA supports the AER's rationale in paring back many aspects of SAPN's capital and operating expenditure (capex and opex) programs over 2015-20, the reality is that base year opex has been accepted as is without recognition of the significant step change between the 2005-10 and 2010-15 and whether or not the factors which drove that change are still relevant for 2015-20. Furthermore, while rate of return considerations are quite important, Business SA is deeply concerned about the rate of increase in the value of SAPN's regulatory asset base, 34% over the next five years, which is even higher than the increase over the past five years. Once the economy returns to a more normal growth trajectory and interest rate environment, if the AER does not address this anomaly, the price impact on consumers will be severe. The AER is primarily bound to act in the long term interest of consumers and we see this scenario as presenting the single biggest obstacle to the long term affordability of electricity in South Australia.

Finally, Business SA stands by its member survey which showed that 87% of businesses want reduced electricity prices rather than having increased spending on measures to improve reliability, bushfire mitigation, car accidents involving stobie poles and customer service.

**Background**

We provide the following background regarding the extent to which our key issues are addressed in the AER's preliminary decision:

1. Business SA supports the AER's decision not to depart from its rate of return guideline. With respect to return on equity, we reiterate our initial concerns over SAPN's arbitrary selection of weights to apply to each financial model with an apparent bias towards those models which produce higher estimates.

2. Business SA agrees that there are few changes to the operating environment facing SAPN during 2015-20 with respect to risk or regulatory obligations. This is particularly important in so far as justifying the AER's decision to reject SAPN's discretionary spending on bushfire mitigation and road safety and we support the AER's conclusion that 'SAPN has proposed to recover more revenue from its customers than is necessary for the safe and reliable operation of its network.'

3. Business SA supports the AER's preliminary decision to reject a significant portion of SAPN's proposed IT spending which should be able to fund itself through efficiencies. Furthermore, we reiterate that while customers may express a preference for certain services, it does not necessarily mean that an increase in total forecast operating or capital expenditure is required.

4. We acknowledge the AER's comments that historically, SAPN has been a relatively efficient distributor, but we highlight the significant step change in operating expenditure between 2005-10 and 2010-15. We are not convinced the AER has adequately demonstrated that the factors which drove that change are necessarily relevant to allow SAPN to continue such levels of opex across 2015-20.

   We are also concerned that the AER's decisions made in relation to both opex and capex over 2015-20 are inconsistent with accepting SAPN's base level of opex. For example, the AER has correctly rejected the high level of forecast labour cost growth, but the existing enterprise bargaining agreement began in 2014 which is in the current regulatory period. Consequently, how can the base level of operating expenditure be accepted on this premise alone?

5. Business SA's recent submission to the AER highlighted the impact of rising electricity prices since 2009 on South Australian business, particularly for manufacturers and irrigators. During this period the regulated asset base (RAB) for SAPN grew in value by 32% between 2010/11 and 2014/15.

We are quite concerned that despite the AER's cuts to SAPN's proposed revenue recovery over the next regulatory period, the value of its regulated asset base will still rise by 34% which is even higher than the period in which the most significant step changes were passed back to business. Considering return on capital and depreciation comprise the majority of SAPN's revenues, Business SA recommends the AER review each consideration within its overarching decision to ensure the future impost on consumers is minimised over subsequent regulatory periods.

Notwithstanding the AER's move to a trailing average approach for debt financing, considering interest rates are likely to return to more normal long term levels by 2019/20, if the forecast RAB growth is not adequately addressed now, electricity consumers will face a considerable rise in electricity prices in following regulatory periods. Business SA's members cannot afford this and will not be subject to a repeat of the price rises passed down since 2009.

6. The AER has not addressed Business SA's independent engineering expert analysis of the efficiency of SAPN's pole replacement program, more specifically:

*The cost per pole average replacement cost appears to reflect the stated unit rates of between $7,600 and $14,500 per unit with a minimum cost of $650 for pole plating (reflecting the reasonably low proportion of pole plating compared to pole replacement). However, the expenditure on conductor appears to be, on average, significantly higher than the stated unit rates. Indeed, the average cost is 1.5 times higher than the highest unit rate. We have not identified any explanation for this material disconnection.*

*Based on our understanding these average costs are at the upper end of unit costs for this work and would more accurately reflect small programs of work with high proportions of mobilization and project management costs. These costs do not appear to be reflective of a well-planned large scale program capturing economies of scale. This position would appear consistent with the approach taken to establish the unit rates that uses previous project data to establish the unit rates.*[1]

In general, it seems there is an overarching theme in the preliminary decision to discount some specific considerations of SAPN's operating efficiency on the basis that on balance, it is within broader benchmark efficiency parameters.

The role of external consultation is to highlight where stakeholders believe efficiency improvements can be made, regardless of where a network distribution company like SAPN may sit relative to other companies, which we might add are not necessarily models of efficient businesses. We acknowledge that the benchmarking of SAPN is required, but the AER also needs to use judgement and rely on expert analysis where there may be micro level improvements despite the aggregated level of efficiency.

[1] Business SA, Submission to SAPN Regulatory Proposal 2015-20, P26

7. Business SA disagrees with the notion that 'As operating expenditure is largely recurrent and predictable, opex in one period is often a good indicator of opex in the next period.' All our members have to keep becoming more efficient in order to compete, particularly those exposed to international markets. The AER should ensure it exposes network distribution companies such as SAPN to a shadow competitive environment which entails a constant drive to improve efficiency. As the AER states, 'To the extent that SAPN incurs costs above efficient levels, they should be borne by SAPN's shareholders and not its customers.

8. There is no evidence that the AER has considered Business SA's analysis of how stand alone power systems (SAPS) could be considered wherever augmentation or replacement of low density feeders is required as an alternative to traditional network solutions, more specifically:

   *As SAPN notes in its submission, it is the lowest density network in the NEM. With alternative technologies such as embedded generation and energy storage maturing, we would expect these solutions should be cost effective in South Australia first. We are seeing that they are being successfully used elsewhere (e.g. WA), but there is only one small trial on a single feeder of a token $2.8M contained in this proposal.*

   *For both augmentation and replacement of low density networks, we consider that the use of Stand Alone Power Systems (SAPS) may already offer a viable alternative, and has not been adequately considered. In addition, rapid developments in technology and economies of scale from increased global demand and manufacturing volumes mean the cost of these systems is falling rapidly – there is an option value in deferring expenditure until alternative technologies mature.*

   *We do not consider that SAPN has sufficiently explored questions such as "Is Like for like" replacement of a 100yr old network design the best approach?" or "Will the current network model be fit for purpose for the next 50 years?"*[2]

   *'There is considerable scope for cost reductions in SAPS systems over the next 5-10 years, with much analysis predicting a "tipping point" where they will become cheaper than grid supply within this time horizon. With uniform tariffs across South Australia, we expect there are many feeders within the SAPN network where the true cost per customer is already above the cost of SAPS. Additional investment in traditional network solutions in these instances is inefficient, locks in old technology that is unlikely to be fit for purpose in 40 years, and prevents SAPN from gaining experience in emerging technologies that are likely to become mature in a short timeframe.'*[3]

---

[2] Business SA, Submission to SAPN Regulatory Proposal 2015-20, P21
[3] Business SA, Submission to SAPN Regulatory Proposal 2015-20, P22

9. The AER has not explained whether or not electricity consumers are liable for the additional 1% of superannuation and $700 electricity distribution rebates for SAPN employees as part of their most recent enterprise bargaining agreement. As we previously stated in our original submission, we consider such benefits to be beyond what is efficient and above the norm for other sectors of the South Australian economy. Furthermore, if SAPN wants to incentivise its employees to reduce costs for the overall business, why are they being rebated their electricity distribution charges?

10. Business SA wishes to reiterate the concerns we had with SAPN's customer willingness to pay survey:

*'We are very concerned by the use of the customer engagement process as a primary means of justifying significant expenditures, including some $221M for bushfire safety and $77M for road safety.*

*Whilst we appreciate SAPN's efforts to better engage with its customers, the fact that the outcome of this process (significantly increased expenditure and higher energy prices) is directly opposed to the views of business consumers (87% have "reduced prices" as their highest priority, while only 4% have reducing bushfire or traffic risk as their highest priority) indicates to us that the process has not effectively captured the overarching views of customers.*

*In particular, we note the following areas we consider as flaws in the process, or the use of the outcomes as a basis for justifying expenditure:*

- *"Willingness to pay" analysis was used offering a number of benefits for small annual costs. The structure of the questionnaire was such that customers were asked about multiple discreet "benefits" in a series of questions, with no visibility of the totality of their "commitments", or the ability to choose between different benefits. The effect is that multiple "benefits" can be supported, resulting in a "pan caking" of programs and costs that do not reflect the overarching concerns of customers or their total willingness to pay.*
- *The "man on the street" is not a policy analysis expert. Considerations such as whether the "benefits" proposed could be achieved by other means (e.g. traffic lights) at lower cost, and what tradeoffs are being made through increased energy costs, were not considered and would generally not be in the minds of those completing the survey.*
- *While the benefits are societal, the costs are effectively borne by electricity consumers. There is no evidence that other funding mechanisms, government co-funding etc have been considered or pursued.*
- *Representation of business consumers was small compared to their share of energy consumption (and total cost to be borne by the business sector).*

*In summary, we do not consider the results of the customer engagement process provide sufficient justification for bushfire or traffic safety initiatives proposed.*[4]

Furthermore, Business SA would like to emphasize that our survey had 167 business respondents and our understanding is that SAPN had less than 60. While Business SA does not have several hundred thousand dollars to undertake sophisticated statistical analysis of the impact of rising energy costs on business, the fact is that we understand what is important to business and what their relative priorities are. When we asked our members to rank issues in terms of importance including reducing prices and spending on measures to improve reliability, bushfire mitigation, car accidents involving stobie poles and customer service, 87% selected reduced electricity prices as their highest priority. In a separate question, only 1% of businesses were willing to pay for improved reliability while just 10% were willing to sacrifice some reliability for lower prices.

While we recognise and encourage SAPN for their efforts to better engage customers to understand their preferences, they also need to acknowledge the reality that price is the overarching consideration for businesses that operate in a competitive environment and have already had to absorb significant price rises since 2009.

**Who we are**

As South Australia's peak Chamber of Commerce and Industry, Business SA is South Australia's leading business membership organisation. We represent thousands of businesses through direct membership and affiliated industry associations. These businesses come from all industry sectors, ranging in size from micro-business to multi-national companies. Business SA advocates on behalf of business to propose legislative, regulatory and policy reforms and programs for sustainable economic growth in South Australia.

Should you require any further information or have any questions, please contact Rick Cairney, Director of Policy, Business SA on (08) 8300 0060 or rickc@business-sa.com.

Yours sincerely

**Nigel McBride**
**Chief Executive Officer**

[4] Business SA, Submission to SAPN Regulatory Proposal 2015-20, P20