Consumer
Challenge
Panel

Submission to the Australian Energy Regulator

Preliminary framework and approach

South Australia Power Networks (SAPN)

Regulatory control period commencing 1 July 2020

Consumer Challenge Panel Sub-Panel 14

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1. Summary

This submission presents CCP14's views on the matters raised in the AER's Preliminary Framework and Approach for South Australia Power Networks (SAPN) for the regulatory period commencing 1 July 2020.

We acknowledge the feedback to date from a number of consumer bodies highlighting the high cost of energy in the state, and we support all activities that lead to the efficient operation of SAPN that focusses on lower costs for consumers.

The CCP notes the impact of the Ring Fencing Guidelines in influencing the classification of some services, in particular public lighting and non-standard connection services. Whilst supporting the proposal, we encourage the AER to work with distributors to identify opportunities that permit reasonable application of market forces, innovation and contestability in these areas whilst reducing the overhead, complexity and reduction in flexibility that arises from the need to consider these services as ACS.

In general, the CCP is supportive of the AER's proposal. We note two key issues to be considered.

1. The allocation of public lighting as an Alternative Control Service is supported, based on the complexities that exist in considering public lighting as contestable. The AER should encourage the distributors to remove any impediments to public lighting, particularly in greenfield situations, from being a fully contestable service with a view of reviewing the classification in the 2024-29 period and it potentially becoming an unregulated service. This should be announced as part of the final F&A to provide a guide to potential providers of competitive services in the 2024-29 period.
2. The allocation of the new distribution services - emergency recoverable works and mutual field support - as distribution services is supported. We believe that the distributors need to put measures in place to ensure all reasonable actions to recover the costs from the causer or beneficiary are taken.

The following table summarises our view of the proposal.

Preliminary F&A	CCP 14 Submission
1. Classification of distribution services	We note the proposed classification follows the AEMC rule change in December 2017 that gives more flexibility to the AER in its classification process. We agree with the proposed classifications in Figure 1 of the Preliminary framework and approach, and the benefits of consistency across jurisdictions. We support the initiatives noted in the proposal, including: - a 'service grouping' approach to allow greater flexibility as services change; - the adoption of the term 'common distribution service'; and - inclusion of the new activities 'support for another distributor' and 'emergency recoverable works' as standard control services. We note the concerns generally regarding the role of distributors as largely monopoly providers of public lighting to local councils, and acknowledge the steps taken by SAPN in improving the relationship between local councils and the utilities. Whilst a light level of regulation is preferable in an area where markets are emerging, especially in new lighting technology, the inefficiencies and nuances commensurate with maintaining the classification for public lighting as negotiated or unregulated are recognised. Against this background, the classification of public lighting as an ACS is supported, with the rider that SAPN should be encouraged to address any technical barriers that preclude the transition of public lighting, particularly in greenfield situations, to support it potentially becoming an unregulated service for the following 2024-29 period. We provide a similar comment regarding the transition of non-standard connection services.
2. Form of control	We agree with the proposed forms of control. We look forward to the current review of the Rate of Return guideline appropriately considering the impact of consumers bearing demand risk.
3. Incentive schemes	We support the application of all incentive schemes as proposed, providing that they start with an efficient base. Whilst supporting the application of the EBSS and CESS, we look forward to the AER ensuring that the base year chosen reflects the efficient level of costs. In reviewing the performance of the utilities in the areas of STPIS assessment, we would strongly support the application of the maximum factor of 5%. As with other states, we would encourage SAPN to proactively adopt internal performance measures that enhance the intent of STPIS and to report this performance to energy customers.

	We would also encourage the AER to continue to emphasise the importance of the recently updated DMIA and DMIS incentive schemes; noting the initiatives SAPN has already undertaken in this area.
4. Application of Expenditure Forecast Assessment Guideline	We agree with the AER's application of the Guideline.
5. Depreciation	We agree with the AER's proposed approach.
6. Consumer engagement	We support the framework as proposed and acknowledge the positive consumer engagement process that SAPN is undertaking as part of the regulatory reset.

Apart from these specific matters, CCP 14 would encourage the AER to consider the following:

A. Reviewing the use of revenue caps rather than price caps for standard control services

Grid power demand is undergoing dramatic changes as the level of distributed generation expands. The changing demand patterns influence the level of risk around the demand forecasts the revenue proposal is based on. Revenue cap regulation puts all the demand risk on to consumers. We hope that the full impact of consumers bearing this risk is reflected in the revised rate of return guideline currently being considered.

Nevertheless, we would encourage the AER to consider undertaking a review of whether the revenue cap is the best form of control to meet the NEO in this changing demand environment – and whether a price cap could be designed to prevent gaming. This review should be complete in time to take its conclusions into account for the next round of revenue resets from 2024/25.

B. Providing more specific incentives around the effectiveness of a networks consumer engagement

The recent moves by networks to engage in much earlier and more effective consumer engagement are certainly welcome. However, whether this engagement is good or not, does not result in any different decision-making process by the AER as it considers the network's revenue proposal. We would encourage the AER to give further consideration to more specific incentives around the effectiveness of a network's consumer engagement.

C. A review of the classification of services largely affected by the ring-fencing guidelines

We note that a number of services are transitioning from Negotiated or Unclassified to Alternative Control Service largely to address the impact of ring-fencing on the efficient provision of services. Many of these services do have some opportunity to be provided by a wider market. CCP will continue to encourage the AER to seek a longer-term solution beyond that of the 2020 reset period that will better reflect the emergence of innovative, transparent and customer-focussed commercial and technical arrangements related to many of these services.

2. Service Classification

CCP 14 supports the proposed classification as set out in Figure 1 on page 11 of the Preliminary Framework & Approach document. The CCP further supports the AER's objectives to provide improved clarity, consistency across jurisdictions as far as practicable, predictability in how new distribution services might be classified and service descriptions that better align with the services being provided.

We note that a number of services are translating from Negotiated or Unclassified to Alternative Control Service largely to address the impact of ring-fencing on the efficient provision of services that are largely monopoly but do have some opportunity to be provided by a wider market, including planning studies and technical analysis. We expect that many of these services will be offered as 'Price on Application'. The CCP will continue to encourage the AER to seek a longer-term solution beyond that of the 2020-24 reset period that will better reflect the emergence of innovative, transparent and customer-focussed commercial and technical arrangements related to many of these services.

The detail of the proposed classifications noted in Appendix B of the proposal are supported, with the following qualifications:

a) Emergency Works & Mutual Support

The CCP agrees that emergency recoverable works should be classified as common distribution services as these services are inherently part of the safe and reliable electricity supply to customers. However, some risks exist - largely around the incentive, processes and systems needed to ensure all reasonable efforts are taken to recover the costs from the causer or recipient of the services.

Also, the CCP would be concerned if the network distributors could recover twice for the provision of this service: once from consumers and again from the third party who caused the damage.

Regarding emergency works, current process is for distributors to aggressively pursue the recovery of what can be significant cost from a known or unknown debtor. An incentive exists for the recovery as the alternative is for the repair to be funded by the utility itself. The CCP questions whether the same effort to recover the cost would be made if the expense is already 'budgeted for' within the overall operating costs. We suggest further information be requested from SAPN on this issue.

The adoption of the costs to support other distributors in times of emergency as a common distribution service is also supported. Initial thinking is that such a facility would apply for major emergencies such as floods or cyclones, however it is conceivable that mutual aid could apply to meet 'business as usual' workload peaks across distributors' borders. We can see this as assisting the efficient use of resources, much like contractors. Once again however, the issue exists as to how consumers can be confident that there is no 'cross subsidy', and that fair and appropriate costs are appropriately recovered by the distributor providing the service from the receiver of the service.

Provided the AER can have confidence that the recovery of fair and reasonable costs by the service provider will occur, then allocation of this service as a Common Distribution Service is supported.

The CCP agrees with the AER's proposal to adopt this approach across all NEM jurisdictions.

b) Public Lighting

Public lighting in South Australia is currently classified as a Distribution Service, under Negotiated Service regulation. There is a case to continue to consider public lighting as a negotiated service on the basis that the allocation as a distribution service is largely consequential to the fact that the utilities own the pole to which the light is attached. Joint use facilities access agreements exist for other pole-mounted services, and public lights can be considered in a similar way.

Therefore, the CCP supports the view of public lighting being classified as *negotiated* as a goal in the classification of public lighting in the regulatory framework. However, we acknowledge that there are several impediments to such a classification in the short term, and as such support the current proposal to maintain the ACS classification.

The CCP is aware that there is a degree of frustration among local Councils on three main aspects of public lighting. Firstly, the general nature of public lighting agreements tends to lead to inconsistent performance levels given to some customers. This generates a level of dissatisfaction with the performance of the utilities regarding price, billing accuracy and maintenance priority. This is exacerbated by public lighting being outside the STPIS and formal GSL framework.

Secondly, due to monopoly ownership of most support structures (poles) and exclusions from standard wiring codes, contestability for the operation, maintenance and upgrade of existing lights and the provision of new suburban lighting in areas supplied by overhead lines is unlikely in the current regulatory environment.

Finally, most councils approach public lighting as 'non-core business' and are keen to outsource the responsibility for the lighting. With this approach comes a responsibility to ratepayers of fair, accurate and transparent pricing, efficient service and the progressive and cost-effective adoption of new technology. Ensuring such a regime when the supplier is viewed as a monopoly is not optimum.

We do however acknowledge the steps being taken by SAPN in improving the relationship between local councils and the utilities.

It is also clear that efficiencies that exist in the installation, operation and maintenance of a significant proportion of public lighting when it remains a regulated distribution service and outside the constraints of ring-fencing.

The CCP believes that the approach by the AER to regulate the price being charged by distributors for public lighting as an Alternative Control Service is a necessary but ultimately insufficient response to this issue. A 'light' level of regulation is preferable in this area where markets are emerging, especially in new lighting technology, however the issues noted above highlight the requirement to implement a level of oversight that will address the many aspects of public lighting that are not clearly contestable.

Against this background, the continued classification of public lighting as an ACS is supported as an interim position for this upcoming period, with the rider that SAPN should be encouraged to address any technical and commercial barriers that preclude the transition of public lighting to potentially becoming an unregulated service for 2024-29 period, particularly for greenfield locations.

3. Form of Control

The AER propose to apply the following forms of control:

- standard control services— revenue cap
- alternative control services— caps on the prices of individual services.

CCP 14 supports these proposed forms of control.

One area the CCP will focus on is the payment arrangements for non-standard connections. We agree with it being classified as direct control/alternative control given the SAPN distribution licence and the AER's view that SAPN possesses significant market power in the provision of connection services. Our particular interest is around:

- whether SAPN makes any capital contribution to the costs of non-standard connections, and
- does the prices charged reflect the full costs of providing the services – which is not just the capex but the opex over the life of the specific assets

ie whether other users subsidise the provision of these services in some way. So, for example:

- if the non-standard connection is dedicated to the exclusive use of the major customer at the time of installation and there is no reasonable likelihood that the network extension will be used to supply another customer or customers within the time period set out in SAPN's connection policy, do the regulated prices mean that the full costs ie capex and opex are recovered from the major customer over the life of the asset? What happens if the only customer goes into liquidation before the end of the contractual period? Who takes this customers credit risk? Does the residual stranded asset value go back into shared RAB?
- if SAPN considers that there is a reasonable likelihood that the network extension will be used to supply another customer or customers within the time period set out in their distribution policy, but no other customer/or insufficient customers eventuate to fully utilise the asset in that time period, does any part of the original assert cost, not covered by the original customer, end up in the RAB to be recovered from all customers?

We believe that the cost of connections for customers seeking non-standard connection, should, as much as possible, be causer/user pays. It should not be an opportunity for a network to make a capital contribution that increases the RAB for all consumers. It should not be an opportunity for a large consumer seeking a specialised connection to have that connection cross-subsidised by all users.

At a broader level we encourage the AER to consider undertaking a review of whether a revenue cap form of control is the best form of control in the changing demand environment in the National Electricity Market for the next cycle of resets in 2025-30.

4. Incentive schemes

Incentive schemes encourage network businesses to manage their networks in a safe, reliable manner that serves the long term interests of consumers. They provide network businesses with incentives to only incur efficient costs and to meet or exceed service quality targets.

The AER's proposed position is to apply each of the available incentive schemes to SAPN:

- Service Target Performance Incentive Scheme (STPIS)
- Efficiency Benefit Sharing Scheme (EBSS)
- Capital Expenditure Sharing Scheme (CESS)
- Demand Management Incentive Scheme (DMIS) and Innovation Allowance Mechanism (DMIA).

We support in principle the application of all the incentive schemes if the network is showing it is efficient. In particular we look forward to the SAPN proposals for both DMIS and DMIA, and adoption of the capital/operating cost trade-offs considered in the new DMIS. Given the distributed resources potential of South Australia and the demand management measures already initiated by both networks, we see a great opportunity for non-network solutions and the application of the revised schemes. We make the following comments on EBSS and CESS.

Efficiency Benefit Sharing Scheme (EBSS)

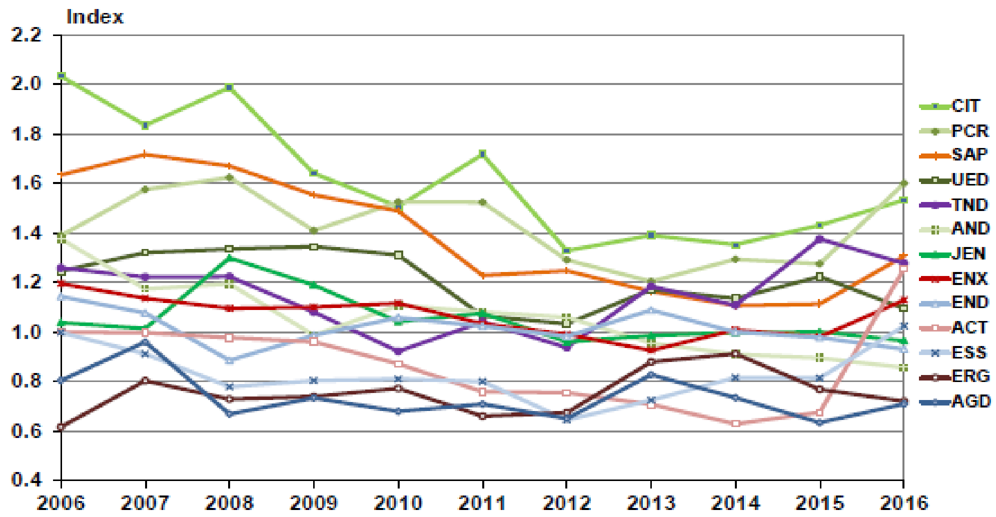
The AER notes (p.58):

> *"We intend to apply the EBSS to SA Power Networks in the 2020–25 regulatory control period if we are satisfied the scheme will fairly share efficiency gains and losses between the distributors and consumers. This will occur only if the opex forecast for the following period is based on the distributors' revealed costs."*

CCP 14 supports the application of EBSS when the revealed costs in the proposed base year (2017/18) are shown to be "efficient". The latest productivity data for 2015/16 show that SAPN is reasonably well placed in comparison with other distribution networks in the NEM in 2015/16.[1]

[1] AER Annual Benchmarking Report Electricity distribution network service providers November 2017 p. 37 https://www.aer.gov.au/system/files/AER%202017%20distribution%20network%20service%20provider%20benchmarking%20report.pdf

Figure 17 Opex multilateral partial factor productivity (MPFP), 2006–16



However, it also shows a significant reduction in SAPN's trend opex productivity over the 2006-16 period. It may be one of the best in 2015/16, but the best in 2015/16 are somewhat less productive and less efficient that the best in 2006 and 2007. The significant rise in opex in 2016/17, to back near the level of 2014/15, will probably reduce the productivity improvement in 2016/17 back towards the rate in 2014/15 which was ~35% below the 2007 performance.

Further we would question the AER's assumption of a zero productivity change over the reset period. While this is based on a view that a zero assumption is an improvement on fall in productivity over the last 10 years, in the current environment network business customers are under continual pressure to improve their productivity to stay in business. Most residential consumers, particularly vulnerable consumers, are not receiving real increases in their income. We see no reason why networks should be treated any differently from their customers. This means that the efficiency frontier at the end of the reset period is higher than the base year.

What this history and expected future indicates is that the AER should exercise caution in accepting revealed costs in any year of the current period (SAPN have indicated that it is likely to be 2017/18) as an acceptable base year for 2020-24. One approach it could consider is to use 2017/18 (after adjustments) as the starting point and then reducing that by a productivity factor implicit in CPI-X regulation eg 1-2% to get the base year opex number.

It is only when SAPN achieves lower than this should it receive an EBSS benefit. The EBSS should reward the network for improving its efficiency above what is an efficient level at the start of the regulatory period. It should not reward a network for getting from an inefficient level to an efficient level.

Capital Efficiency Sharing Scheme (CESS)

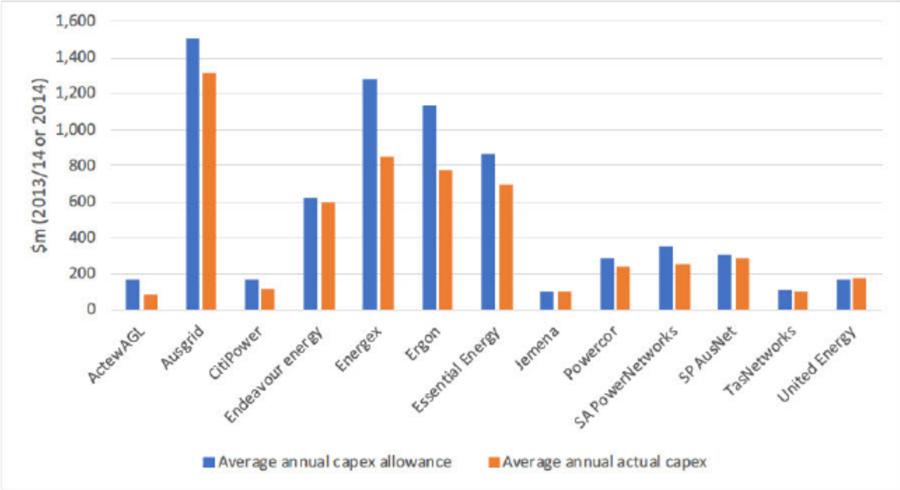
The intention of CESS is to provide an incentive to networks to improve their capex efficiency. In our view this means capex underspend because the networks capital evaluation process concluded either that:

- It is more efficient to defer a capital project to the next period, or

- A lower cost capex solution or non-network solution was found

The recent analysis by the Centre for Efficiency and Productivity Analysis (CEPA) of periods prior to CESS's introduction showed, apart from Jemena and United, consistent underspend of allowed capex, including SAPN.[2] SAPN's forecast spend in the current 2015-2020 period is ~19% lower than the AER allowance.

Figure 3.1: DNSP total average annual real allowed and actual net capex[52]



Source: CEPA analysis of AER determinations and annual RINs

CEPA cited three reasons for this underspend:

- Lower actual demand than forecast, therefore augmentation projects were deferred or avoided
- DNSP's actively seeking to reduce the need for capex
- Improvements in risk management that led to a reduced volume of works

CCP14 members' work with several DNSPs has also highlighted other reasons for underspending capital allowances, including:

1. Inefficient allocation of the network's resources due to being diverted by other activities eg for SAPN reasons advanced are the uncertainty on the regulatory allocation in the early part of the period and the storms in 2015/16 led to resources being diverted form capital project evaluation and implementation,
2. Continued over-forecasting of demand growth or network needs in a rapidly changing environment, driven by a traditional conservative approach to risk, and
3. Simply not devoting sufficient resources to the work.

CCP 14 does not see these reasons or the failure of forecast demand to materialise as legitimate reasons for the network to share in the CESS benefits. Consumers should not pay for networks not properly resourcing their capex evaluation and implementation activities they sought as necessary to meet their obligations at the time of submitting their proposal. While consumers take demand risk once an asset is built, we do not see why consumers should share 30% of the demand risk with networks when an asset is not built because of the forecast demand growth does not eventuate.

[2] CEPA "Incentives Faced by Network Service Providers" Report to AEMC 16 April 2018 Draft Report pp34-5 https://www.aemc.gov.au/sites/default/files/2018-04/CEPA%20AEMC%20CapexBias%20Report%20DRAFT.pdf

So, rather than an automatic application of CESS to SAPN, we would encourage the AER to carefully examine the reasons for the capital underspend to assess whether there should be an adjustment for deferral of capex as provided for in the CESS Guideline[3].

Service Target Performance Incentive Scheme (STPIS)

We support the application of all incentive schemes as proposed. In reviewing the performance of the utilities in the areas of STPIS assessment, we would strongly support the application of the maximum factor of 5%. The current review of the GSL scheme in SAPN is noted.

The work being undertaken by the AER in the proposed amendment to the Service Target Performance Incentive Scheme is noted, and incorporation of an enhanced scheme into the SAPN regulatory reset is to be encouraged. In addition, customer service aspects of the STPIS should be enhanced to reflect new and high-impact ways that utilities interact with customers and communities.

As with other states, we would encourage SAPN to proactively adopt internal performance measures that enhance the intent of STPIS and to report this performance to energy customers.

Demand Management Incentive Scheme (DMIS)

We note the application of the previous DMIS regime by SAPN in addressing the changing load factor as a result of the high penetration of distributed energy resources.

As with other states, the CCP is keen to support strong action by distributors to seek non-network solutions to the emerging challenges of falling network utilisation factors, changing energy use and aging assets. In addition, we would expect to see the impact of tariff reform initiatives being considered in moderating or otherwise changing demand growth.

We support the application of the DMIS.

We would also encourage the AER to emphasise the importance of the recently updated DMIA and DMIs incentive schemes to the SAPN proposal, in particular the opportunity for operating cost trade-offs to capital investment in long-lived assets.

5. Application of Expenditure Forecast Assessment Guideline

We agree with the AER's proposed application of the Expenditure Forecast Assessment Guideline.

We believe that the application of this guideline, particularly around the use of benchmarking (within the context of the Tribunal and Federal Court decisions on the NSW distributors) and the recent enhancements in the repex modelling to take account of different scenarios around unit costs and asset lives must underpin a comprehensive evaluation of the SAPN proposal.

We note that SAPN is yet to receive formal advice from the Essential Services Commission of South Australia (ESCoSA) on the reliability and minimum service standards that are to apply to the 2020-25 period.

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[3] See AER 'Capital Expenditure Incentive Guideline for Electricity Network Service Providers" Section 2.5 p.9 https://www.aer.gov.au/system/files/AER%20capital%20expenditure%20incentive%20guideline%20-%20November%202013.pdf

6. Depreciation

The AER's preliminary position is to use depreciation based on forecast capex (or forecast depreciation) to establish the opening RABs as at 1 July 2020. In combination with the AER's proposed application of the CESS, this approach will maintain incentives for the distributors to pursue capex efficiencies. These improved efficiencies will benefit consumers through lower regulated prices.

We note that some networks are seeking to have the AER apply accelerated depreciation to some assets e.g. legacy metering assets subsequent to the implementation of the Power of Choice reforms form December 2017. If SAPN propose to take this approach they will need to persuade both the AER and their customers that any change to a straight-line depreciation methodology is in the long-term interests of consumers.

7. Consumer Engagement

The AER rightly highlights the growing importance of consumer engagement in the development of network proposals. We note the positive feedback from a number of major stakeholders, such as Business SA, who recognise the open and constructive manner taken by SAPN as part of this reset engagement. Our hope is that that this engagement continues past the reset itself, and indications to date from SAPN is that there is a commitment to such an outcome.

The CCP considers the SAPN consumer engagement to date reflects many aspects of robust, informed and collaborative engagement, and that SAPN should be congratulated on their approach to the engagement for the reset so far.

The 'Deep Dives' to date have generally been well managed and appropriate, however the CCP will continue to encourage SAPN to publish their draft proposal, along with expected commercial requirements, soon in order to continue the informed public debate.

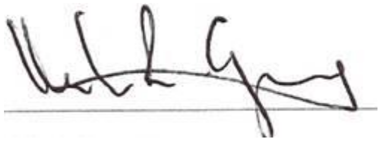
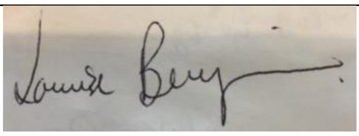
CCP 14 has observed SAPN utilising effective CE methods including:

- An effective structure for their Consumer Consultative Committee (CCC);
- Single and multiple day long deep dives on specific aspects of their developing proposals e.g. capex and opex and tariff structure statements with both consumer and AER representatives participating
- Focussed day long forums on the network of the future and how they might utilise the DMIS incentives
- One-on-one discussions with their major customers in addition to the general reset meetings
- Provision of numbers for key parts of their proposal (numbers or at least ranges for capex/opex/price path/RAB) prior to the publication of the Draft Proposal, to inform discussion

We look forward to further deep engagement with stakeholders following their Draft Proposal publication and prior to their AER submission

CCP 14 look forward to continuing our productive working relationship with the AER and SAPN in this process.

Signed

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