

11 October 2017

Mr Tony Weir
Australian Energy Regulator
Level 38, 360 Elizabeth Street
MELBOURNE 3000 VIC

By email: anthony.weir@aer.gov.au

Dear Tony

Draft AER 2017 Annual Benchmarking Report – Electricity distribution network service providers

Thank you for your 22 September email inviting comments on the AER's draft 2017 Annual Benchmarking Report for Electricity distribution network service providers (**DNSPs**). SA Power Networks has reviewed the draft report and provides comments in regards to the following:

- SA Power Networks' benchmarking performance;
- the impact of operating environment factors (**OEFs**);
- industry trends in productivity growth; and
- correction of minor errors.

SA Power Networks' benchmarking performance

The draft report acknowledges that SA Power Networks is one of the most efficient distributors in the National Electricity Market (**NEM**) in terms of Multilateral Total Factor Productivity (**MTFP**), second only to CitiPower. On a State-wide basis, for which the AER asserts that networks "*generally face similar regulatory and environmental factors*"¹, South Australia continues to outperform other jurisdictions.

SA Power Networks is therefore extremely disappointed that, despite relatively complimentary comments for other States' and Territories' TFP performance in the 2012-16 period, the AER conveys that "*The decline in South Australian opex and the improvement in TFP in 2016 was likely driven in part by the AER's 2015 final decision on SAPN's network determination for the 2015-20 regulatory period.*"². The report then highlights the reduction in opex from SA Power Networks' revised regulatory proposal forecast and the subsequent Australian Competition Tribunal (**Tribunal**) and Federal Court appeal processes.

¹ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 23

² AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 30

The AER's draft report comments fail to recognise firstly, SA Power Networks' sustained performance as one of the leading DNSPs in terms of benchmarking efficiency and secondly, our ongoing pursuit of continuous efficiency improvement. The comments present a negative, and we believe unfair, connotation on SA Power Networks' performance to the reader, and overlook the following:

- in the last round of determinations, the AER reduced the revised proposal opex for 12 of the 13 DNSPs in the NEM; and
- the opex amounts related to SA Power Networks' appeals represent less than 3 percent of our total opex allowance. This is of very low materiality in the context of the MTFP performance of SA Power Networks.

SA Power Networks requests that these comments for 2016 be removed from the final report to be issued in November. The report should instead refer to SA Power Networks' improvement in the past two years as being largely driven by reliability improvements, and lower emergency response expenditure and guaranteed service level (**GSL**) payments associated with normal weather years.

Impact of OEFs

We are aware that the AER is conducting a review of OEFs. The AER defines OEFs as factors beyond a DNSP's control that can affect its costs and benchmarking performance³. In this context, we note that SA Power Networks is unique in the NEM for having an uncapped jurisdictional reliability Guaranteed Service Level (**GSL**) scheme, a DNSP impost that is further amplified by the jurisdictional requirement that reliability **GSLs** apply for Major Event Days, unlike other DNSPs in the NEM. For example, we have incurred significant **GSL** payments in 2016/17 (in excess of \$25 million) due to severe weather days. This will be a factor in next year's benchmarking analysis but **we believe this expenditure should be adjusted for benchmarking purposes to enable more consistent and meaningful comparisons.**

As the purpose of the Annual Benchmarking Report is to inform customers about the relative efficiency of network service providers and to facilitate greater customer engagement and participation in network revenue decisions, **we also urge the AER to make OEF adjustments to normalise data sets before modelling rather than post modelling adjustments.** This was also the finding of the Tribunal in the recent NSW appeal process, where it found that OEF "*adjustments, where required, should be made before modelling, by normalising the data set, rather than ex post modelling.*"⁴

Also of concern are impacts upon MTFP performance driven by overhead capitalisation policies, which differ between distributors. Further, even more complexity arises due to some distributors having altered their policies since the commencement of the benchmarking measurement period (2006). However, with the aim of providing a consistent time series for the benchmarking model, the AER's consultant (Economic Insights) has in some instances amended distributors' actual data to align with the distributors' capitalisation policy in place at the commencement of benchmarking⁵, whereas in another jurisdiction it has required the DNSP to restate its data in accordance with its revised capitalisation policy⁶.

³ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 5

⁴ Australian Competition Tribunal | Re: Applications under s 71b of the National Electricity Law for a Review of Distribution Determination made by the Australian Energy Regulator in relation to Ausgrid pursuant to rule 6.11.1 of the National Electricity Rules | 26 February 2016, para 333

⁵ Economic Insights | Economic Benchmarking Results for the Australian Energy Regulator's 2017 DNSP Benchmarking Report | 6 September 2017, page 2

⁶ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, Table 2, Note 2, page 15



These adjustments result in benchmarking outcomes that misrepresent current performance. It would be much fairer and accurate for the AER to apply a consistent approach to overheads across all DNSPs. Capitalised overheads are currently reported in the Category Analysis RIN and it would be straightforward for the AER or its consultants to apply overheads consistently for all DNSPs over each year of the benchmarking period. **We would encourage the AER to apply consistency of overhead capitalisation to improve the accuracy and comparability of its benchmarking outcomes.**

A further consideration that supports this proposal is the reliance placed on benchmarking outcomes by investor/owner stakeholders, whose investment performance assessments may be compromised by the AER's inconsistent approach to efficiency measurement. This is particularly relevant to owners of multiple DNSPs whose capitalisation policies may in fact be aligned, but whose publicly reported benchmarking efficiency has been calculated on a different basis.

Industry trends in productivity growth

We note that the draft report states that industry-wide productivity has stabilised in the 2012-2016 period, and is showing a small increase in the annual average rate of 0.2 percent over that period⁷. We note that it is largely being driven by 'one-off' step-change efficiency reforms in NSW and ACT, and overhead efficiencies in Tasmania predominantly achieved from merging its transmission and distribution businesses, rather than ongoing continuous improvements. We believe that such efficiencies arise from specific events in some jurisdictions, and **it would be inappropriate for the AER to interpret this as a frontier shift in efficiency that might then be argued as supporting application of a productivity growth factor to allowances determined for more efficient DNSPs in other jurisdictions.**

Distributors are also continuing to absorb additional costs from multiple and material changes in regulatory policy such as metering contestability, ring-fencing and increased reporting requirements, and uncontrollable severe weather events will also continue to impact a distributor's ability to achieve ongoing annual efficiency gains as measured by the benchmarking models. Factors such as these must be considered by the AER to reduce the potential for inappropriate productivity factor application, driven by imperfect MTFP models.

Correction of errors

We have noted numerous typographical and numerical errors in the draft report. In particular, we note that the MTFP scores in Table 2⁸ differ slightly from those in Economic Insights' Table 3.1⁹ (we also note that Economic Insights' list of DNSPs is incorrect, e.g. CIT's results are shown against AND). Additionally, we note in the same table that SA Power Networks' 2015 to 16 change is shown as +5% (which we agree with), but Table 3¹⁰ erroneously shows SA's MTFP change for 2016 as 7.7%. Furthermore, the narrative relating to Figure E8, describing South Australia's very good performance refers to total costs per MW of maximum demand, rather than total cost per km of circuit line length.

⁷ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 20

⁸ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, pages 14-15

⁹ Economic Insights | Economic Benchmarking Results for the Australian Energy Regulator's 2017 DNSP Benchmarking Report | 6 September 2017, page 16

¹⁰ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 24



The above errors are minor and do not impact the overall benchmarking outcomes, but contribute to the report's quality and presentation and **we request that they be corrected in the final report**. We would also ask for consistency in reference to us as SA Power Networks. At different stages we are also referred to as SA Power¹¹ and SAPN¹² in the AER's text.

Please contact Trevor Gusling on 08 8404 4325 if you require any further discussion or clarification of the above.

Yours sincerely


Richard Sibly
A/Head of Regulation

¹¹ AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, pages 12,13

¹² AER | Draft Annual Benchmarking Report | Electricity distribution network service providers | November 2017, page 30

