27 April 2018

Mr Chris Pattas
General Manager—Network Pricing, Policy & Compliance
Australian Energy Regulator

Submitted by email: AERinquiry@aer.gov.au

Dear Mr Pattas

AER Preliminary Framework and Approach paper

SA Power Networks appreciates the opportunity to comment on the AER's Preliminary Framework and Approach (F&A) for the 2020-25 distribution determination.[1] The AER's preliminary positions reflect our initial views as outlined in our October 2017 letter which initiated the F&A process, and therefore our reasoning is not detailed again in this submission.[2] We support the AER's positions, regarding the:

- application of the AER's various incentive schemes;
- approach to depreciation;
- classifications to apply to our services; and
- forms of control and formulae that should apply to our services.

Our submission raises some additional matters for the AER's consideration, including our views on:

- the form of the control and formulae to apply to our public lighting services, as these matters were not covered in our October 2017 letter;
- a required change to broaden the definition of demand management activities within our common distribution service;
- the treatment of market benefits under the capital and operating expenditure rules; and
- some inaccuracies in the terminology and descriptions that the AER is proposing to apply to our services. We have not submitted a marked-up version of the AER's service list and request that these relatively immaterial and detailed wording issues be discussed directly with AER staff.

If you wish to discuss any of our comments further, please contact Bruno Coelho on 08 8404 5676 or by email on: bruno.coelho@sapowernetworks.com.au

Yours sincerely

Richard Sibly
Head of Regulation

[1] AER, *Preliminary Framework and Approach—SA Power Networks regulatory period commencing 1 July 2020*, March 2018. Accessible on the AER's website: [http://www.aer.gov.au].

[2] SAPN, *Request to replace Framework and Approach*, 31 October 2017. Accessible on the AER's website: [http://www.aer.gov.au].

Application of the Expenditure Forecast Assessment Guideline

The AER's Preliminary F&A outlined its view on how the Expenditure Forecast Assessment Guideline will be applied in assessing expenditures that we will propose for the 2020-25 period. However, it has become apparent that an additional matter requiring AER confirmation is that National Electricity Market (NEM) wide benefits can be accommodated within the AER's expenditure assessments. This is noting that:

- The capital and operating expenditure (capex and opex) objectives and factors in Chapter 6 of the National Electricity Rules (NER) do not explicitly refer to consideration of the costs incurred and benefits derived via other parts of the NEM supply chain, i.e. market benefits.
- However, in our view market benefits are included in the scope of the capex and opex objectives and factors via the National Electricity Objective in the National Electricity Law, which refers to the national electricity system.[3]
- Our interpretation is also supported by the fact that in applying for incentives under the AER's new Demand Management Incentive Scheme (DMIS) and in undertaking a Regulatory Investment Test for Distribution (RIT-D), distribution network businesses can consider market benefits.
- There might be cases where a distribution business' initiative / investment made by means of, or in connection with, its distribution system, might derive greater benefits to the broader market than to the distribution network via avoided capex. For example, this could include a distribution business interacting with energy consumption, storage or generation devices connected to the distribution network, but with the aim of addressing a broader system security / market challenge for AEMO.

We have raised this issue in a separate submission to the AER's current review of the RIT-D application guidelines,[4] but consider that it warrants discussion in the F&A as it pertains to the AER's expenditure assessments within its distribution determinations.

Treatment of services

Service terminology and descriptions

The terminology and descriptions that the AER has applied to our services require further amendment to reflect the specific nature of the services we will provide over the 2020-25 period. In our view:

- There are some inaccuracies in the service list contained in Appendix B to the AER's preliminary F&A—particularly for 'Ancillary Services' pertaining to network safety, inspections and asset relocations. We propose discussing these detailed and relatively immaterial wording issues directly with AER staff.[5] Therefore, a marked-up version of our service list for 2020-25 has not been included in this submission.
- A more significant change required is to broaden the description of demand management in the list of example activities comprising our core 'common distribution service'. This activity should be reworded to be *'demand management for distribution or system reliability, efficiency or security'* noting that:
  - limiting the description of demand management to '*demand management for distribution purposes'* as the AER proposed,[6] might inappropriately constrain our ability to efficiently and prudently manage demand with a view to broader NEM impacts;
  - as described earlier in this submission, we consider that the intent of the NER and the AER's own mechanisms by way of the RIT-D and DMIS are for distribution network businesses to consider broader impacts arising from their actions, i.e. market benefits; and
  - our proposed wording fits with the definition of a 'distribution service' as it would be limited to activities / investments that we make by means of, or in connection with, our distribution system.

[3] NEL, Section 7, National Electricity Objective.

[4] SAPN, *Review of the application guidelines—Regulatory Investment Tests,* 6 April 2018.

[5] AER staff have informally advised us that this approach is preferable.

[6] AER, *Preliminary Framework & Approach—SA Power Networks period commencing 1 July 2020*, March 2018, pp.73-84.

Classification of services

We agree with the AER's service classification positions, set out in Figure 1, as being consistent with our initial views and reasoning contained in our October 2017 letter. We only comment further on two matters.

Figure 1: Current and new classifications (preliminary views)

Primary service grouping	2015-20	2020-25 (preliminary positions)
Common distribution services	SCS	SCS
Ancillary services	NDS	ACS
Metering services	ACS – (type 5 & 6)	ACS – (legacy type 5 & 6 cost recovery, reading, data services, ancillary metering)
	NDS – (type 1 to 4; special reads)	Unregulated – (type 1 to 4)
	SCS – (type 7)	SCS – (type 7)
Public lighting	NDS	ACS
Connection services	SCS (standard connections)	SCS (standard connections, contributions on standard connections)
	NDS (non-standard connections; disconnections / reconnections; contributions on standard connections)	ACS (non-standard connections; connection management services)[7]**
Unregulated distribution services	Not listed	4 services listed (non-exhaustive)

Connections services

At the AER's F&A public forum some parties appeared unclear on the interaction between the proposed classifications for connection services and the limited contestability existing in SA. In our view the proposed classifications are appropriate and will not impede contestability noting that:

- Contestability for connection services in SA only pertains to discrete and limited circumstances, in contrast to NSW where connection services are fully contestable and subject to an independent service provider accreditation scheme;
- SA Power Networks' Connection Policy allows some limited contestability in connection services. Contestability does not depend on a connection service being standard (to be classified as SCS) or non-standard (to be classified as ACS). Rather it depends on whether there are third-parties (i.e. developers) who wish to build / self-fund greenfield connection assets in isolation of our distribution network.
- Classifying standard connections as SCS as the AER proposes, will not hinder these limited circumstances where third parties seek to self-fund / self-construct a greenfield connection asset. Where a third party opts for this option and then wishes to integrate these assets into the shared distribution network, our Connection Policy would apply such that any connection charge payable by the developer / customers recognises the funds that have already been paid.[8]

Public lighting services

We accept the AER's position to reclassify public lighting from Negotiated Distribution Services (NDS) to Alternative Control Services (ACS). This is noting:

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7 As discussed in our letter of October 2017, we want to confirm that the treatment of contributions on connections as SCS will not hinder our ability to recover our efficient costs, that is, that there will not be any revenue shortfall to SA Power Networks. The AER's preliminary F&A is not conclusive on these contributions. Discussions with AER staff suggest these matters are to be confirmed in the distribution determination process.

8 SAPN, *Connections Policy for 2015-2020*, June 2015.

- an ACS classification would be consistent with the treatment of public lighting in other jurisdictions where the AER has consistently considered that this classification matches the market characteristics of public lighting, including due to market power issues;
- discussions with our public lighting customers reveal that some customers might value additional oversight via the AER's 5-yearly distribution determinations. It was evident from our recent workshop with our public lighting customers that the pros and cons of a NDS vs ACS classification are not entirely apparent to our customers. This is noting that:
  - there was some general acceptance that direct negotiations between us and our customers under an NDS framework over recent years has enabled responsive and tailored service provision;
  - however, there is no reason why an ACS framework will not work for customers. We seek an ACS approach that maintains our ability to tailor service offerings and ensures no downside change in service provision to customers. As such, the pros and cons of the classification decision ultimately depend on whether customers value some additional regulatory oversight by the AER.

While Ancillary Services are requested and charged on a once-off basis, public lighting involves long-lived capital investments, contracts / agreements, and tailored service options. We want to ensure ACS allows for continued service tailoring to customers. In addition to ongoing bilateral discussions, we hosted a large workshop (17 April 2018) with customers to gauge views on current and any new service offerings required for 2020-25. An issue emerging from these discussions requiring AER consideration, is how to treat cases where customers want price certainty beyond the 5-year regulatory period. In our view:

- It was evident from the workshop discussions that some of our public lighting customers might value the certainty provided by having either the capital or operating and maintenance components of their contract / agreement price with us fixed for longer than the regulatory period. For example, some of our agreements to date have provided customers with price components fixed for up to 20 years.
- Under ACS, prices are only fixed for the regulatory control period, with the length of price certainty depending on the year in which any agreement / contract with us is made.[9]
- To balance regulatory oversight and price certainty for customers, we want to offer two options:

  Option 1: ACS prices to serve as the base price (i.e. a reference price) that is fixed for the regulatory control period—we would be required to offer this price to all customers;

  Option 2: If some customers seek additional price certainty for longer time periods (e.g. up to the 20-year expected life of public lights), and enter on this basis, into a contract with us in good faith then:
  - prices for these agreements would be permitted to last for the term of that agreement; and
  - services and prices pursuant to such an agreement would be treated as an ACS. The physical service does not differ depending on whether a customer opts for option (1)—pricing for 2020-25, or option (2)—pricing for a longer term. Further, options for longer term agreements in an ACS framework provides some of the benefits of the current NDS framework while avoiding unnecessary and inefficient cost implications of ring-fencing, where customers willingly opt for option (2) in good faith.
- Our proposed approach would provide the following benefits:
  - It provides us flexibility to offer additional price certainty / term options to our customers in line with our experience over recent years under an NDS framework. Our public lighting customers (local councils and the SA Government Department of Planning, Transport and Infrastructure) are typically very well informed and able to evaluate the business case for longer terms.
  - It would provide a reference or 'fall back' price overseen by the AER but not otherwise limiting additional options for customers. As noted above, our recent workshop revealed that some customers value regulatory oversight but this did not appear to be a universally shared view.
  - If customers have concerns over time with the long-term agreements, they could apply to the AER to arbitrate, or revert to the reference price (option 1) via fair break-out provisions (to be determined).

[9] For example, an agreement made in year 4 of the 2020-25 regulatory period will only be in place for 1 year.

Forms of control

We accept the AER's positions on the forms of control, as listed in our Appendix 1. In our view:

- SCS remain appropriately regulated via a revenue cap. This maintains the balance in the treatment of network spends and demand management alternatives, as explained in our October 2017 letter.
- All of our ACS should be regulated via price caps by way of 'caps on the prices of individual services'. These services are specific in nature and therefore individual prices should apply.

In Appendix 1 we outline our proposals as to which of our ACS should be regulated on either a 'fee' basis or 'quoted' basis under a price-cap approach. The precise list of fee and quoted services will be set out in our regulatory proposal due to the AER at the end of January 2019.[10]

Tariff streams and control formulae

We agree with the AER's positions on the formulae to give effect to the forms of control to apply to our regulated services, excluding our public lighting services which we discuss below. We support the following formulas set out in the AER's preliminary F&A:[11]

- for SCS, the revenue cap formula set out in the AER's Figure 2.1; and
- for ACS (excluding public lighting), the price cap formulae set out in the AER's Figures 2.2 and 2.3.

New services arising during 2020-25

We agree with the AER's position to regulate on a 'quoted' basis, any new services arising during 2020-25 which fit one of the service groupings in our service list (to be decided in the distribution determination). This appropriately balances flexibility to offer new versions of regulated services as circumstances evolve over the course of 2020-25, while maintaining AER regulatory price oversight.

Public lighting

As outlined earlier, we have been engaging with our customers on the scope of our current service offerings and new offerings customers require for 2020-25. Our proposal on how to translate into an ACS framework, offerings that we believe our customers value, is as follows:

1. LED lights—offer six key streams of service choices based on LED lighting assets, as outlined in Figure 2;
2. Defined Legacy Luminaires—offer customers the option of remaining on tariffs for old lighting assets (HID lighting) up to a period of time that will be advised.

Figure 2: Proposed service offerings and tariff streams for 2020-25

Service offering stream	Choices
1. Activity package– offer choices on activities we undertake for customers	a. Energy Only (EO): street light out services b. Customer Lighting Equipment Rate (CLER): operating and maintenance of lights on customer infrastructure, and EO. c. SA Power Networks (SAPN): lights on SAPN infrastructure, operating and maintenance, and EO
2. Asset risk / responsibility— offer choices on luminaire capital funding and replacement	a. SAPN: we fund luminaire capital and assume capital risk (i.e. we fund replacements) b. PLC: the customer funds the luminaire capital and assumes capital risk. c. TFI: a hybrid where the customer funds the luminaire capital but SAPN assumes luminaire capital risk

10 Each of our services (e.g. asset relocation) will have multiple service variants (e.g. specific to the asset being relocated). All of these service variants and their respective fee or quoted based approach to prices will be set out in our regulatory proposal.

11 AER, *Preliminary Framework and Approach—SA Power Networks*, March 2018, pp.45-51.

Service offering stream	Choices
3. Asset technology and information	We will offer some choice on the lighting technology that is to be used, and services pertaining to tailored information provision
4. Price certainty / term length—we intend (as covered earlier) to offer choices as to the term of agreements / contracts	a. For new luminaire capital annuities—a fixed rate for 2020-25 and the option of a rate fixed for up to 20 years (the expected asset life); b. For luminaire systems and operating and maintenance—a fixed rate for 2020-25 and the option of a rate fixed for up to 20 years; c. For public lighting infrastructure capital, operating and maintenance and administration—a fixed rate for 2020-25.
5. New / emerging public lighting services	▪ This stream will reflect any new services particularly using emerging technologies that might arise during 2020-25, but which cannot be defined at this time. ▪ Our customers are increasingly enquiring as to new services using emerging technologies. This includes those pertaining to 'smart lighting' technologies that can provide customers (or us on behalf of customers) with greater control over public lights (e.g. to dim lights in certain locations to minimise energy use).
6. Regional bulk luminaire replacement projects	▪ To better reflect the costs of undertaking bulk luminaire replacements in regional areas, we propose including a charge to reflect staff travel expenses, either as: (1) an upfront charge; or (2) a part of an ongoing tariff to allow the customer to amortise the cost over the time of the agreement or some other term as requested by a customer.

The public lighting service offerings set out above then translate into building blocks that comprise an overall price for customers. These building blocks will vary depending on the offerings that customers choose, as summarised in Figure 3 below.

The fee and quoted elements summarised in Figure 3 will all use the AER's formulae as set out in its Preliminary F&A, with the exception of the following:

- Defined legacy luminaires—for ongoing services pertaining to old lighting technology (HID) we propose that the fee based price-cap contain an annual adjustment factor based on inputs which we intend to agree with the AER at the time of its distribution determination. This is to account for changing asset failure rates over the course of the 2020-25 period.
- Regional bulk luminaire replacements—this quoted charge will be based on 'travel + away' costs, to cover costs of field crews travelling to the location of an upgrade and to be accomodated away from home.

Figure 3: Public lighting price components

Price =	Luminaire capital asset provision +	Luminaire operating & maintenance (O&M) activities[12] +	Infrastructure & administrative (I&A) activities[13] +	Adjustment factor (cost pass throughs-new requirements)
SAPN				
SAPN	Annuity for new luminaires (fee based). Includes 2 payment options for travel + away costs of regional bulk luminaire replacements: (1) over the agreement's term (quoted basis) (2) upfront / once off charge (quoted basis)	O&M charge (fee based)	I&A charge (fee based)	Applicability depends on nature of obligations / requirements that might emerge during 2020-25.
TFI	Annuity for future luminaire replacement (fee based). Upfront charge for luminaire provision & installation (quoted basis) Includes 2 payment options for travel + away costs of regional bulk luminaire replacements: (1) over the agreement's term (quoted basis) (2) upfront / once off charge (quoted basis)	O&M charge (fee based)	I&A charge (fee based)	
PLC	Upfront charge for luminaire provision & installation (quoted basis)	O&M charge (fee based)	I&A charge (fee based)	
CLER	Not applicable	O&M charge (fee based)	I&A charge (fee based) – charge varies to that for SAPN option as service will be on customer lights.	Applicability depends on nature of obligations / requirements that emerge.
EO	Not applicable	Not applicable	I&A charge (fee based). Charge varies to that for SAPN & CLER to reflect different share of costs associated with EO	Applicability depends on nature of obligations / requirements that emerge.
Defined legacy luminaire[14]	Not applicable	O&M charge (fee based: 1st year specified with subsequent years	I&A charge (fee based)	Applicability depends on nature of obligations /

12 O&M of luminaires (e.g. replacing components of luminaires, testing output of luminaires, washing luminaires).

13 Non-luminaire infrastructure assets (e.g. brackets, dedicated poles and cables); O&M of non-luminaire assets (e.g. inspecting dedicated poles and repairs to cabling); systems, administration and corporate activities (e.g. interface with customers, shared corporate functions); recovery of legacy luminaire assets (HID prior to 1 July 2018).

14 This legacy charge stream will only apply up to the certain date, still to be confirmed and advised.

		annually adjusted via agreed inputs)		requirements that emerge.

Incentive schemes and depreciation

With respect to the other matters covered in the AER's Preliminary F&A, we support the AER's positions to apply the following:

- the current approach of using forecast depreciation to establish the regulatory asset base at the commencement of the following regulatory period, consistent with the CESS guideline, when the CESS mechanism is in place, as we consider should be the case for 2020-25.
- the AER's existing incentive schemes including: the Efficiency Benefit Sharing Scheme (EBSS) for operating expenditure, the Capital Efficiency Savings Scheme (CESS) for capital expenditure, and the revised Service Target Performance Incentive Scheme (STPIS) when the AER concludes its current review;
- the AER's new Demand Management Incentive Scheme (DMIS) and Demand Management Innovation Allowance Mechanism (DMIAM).

Appendix 1: Service classification and forms of control for 2020-25

Primary service group	Secondary service group	Classification	Form of control
Common distribution services		SCS	Revenue cap
Ancillary services	Connection application related services	ACS	Price cap – fee & quoted
	Access permits, oversight and facilitation services		Price cap – fee & quoted
	Third party funded network upgrades or other improvements		Price cap – quoted
	Network safety services		Price cap – fee & quoted
	Rectification works to maintain network safety		Price cap – quoted
	Planned interruptions – customer requested		Price cap – quoted
	Attendance at a customer's premises to perform a statutory right where access is prevented		Price cap – quoted
	Inspection services – private electrical installations		Price cap – fee & quoted
	Provision of training to third parties for network related access		Price cap – fee & quoted
	Authorisation and approval of third party service providers' design, work and materials		Price cap – fee & quoted
	Security lights		Price cap – fee & quoted
	Customer initiated asset relocations		Price cap – fee & quoted
	Customer requested provision of electricity network data		Price cap – fee & quoted
Metering services	Type 1 to 4 metering services	Unregulated	N.A
	Types 5 and 6 meter installation and provision	ACS	Price cap – fee
	Type 5 and 7 meter maintenance, reading and data		Price cap – fee & quoted
	Ancillary metering services (type 5 to 7 metering installation)		Price cap – fee
	Emergency maintenance of failed metering equipment not owned by the DNSP (contestable metering)		Price cap - fee
	Meter recovery and disposal – type 5 and 6 (legacy meters)		Price cap - fee
	Third party requested outage for purposes of replacing meter		Price cap – fee & quoted
	Type 7 metering services	SCS	Revenue cap

Primary service group	Secondary service group	Classification	Form of control
Connection services	Standard connections	SCS	Revenue cap + contributions
	Non-standard connection services	ACS	Price cap – fee & quoted
	Connection management services		Price cap – fee & quoted
Public lighting services	Public lighting services	ACS	Price cap – fee & quoted
Distribution asset rental		Unregulated distribution service	N.A
Contestable metering support roles			
Type 5 and 6 meter data management to other electricity distributors			
Provision of training to third parties for work not associated with common distribution services nor network services			