

28 April 2020

Mr W Anderson
General Manager Network Finance and Reporting
Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601

Email: AERInquiry@aer.gov.au

Dear Mr Anderson

Proposal to delay final decisions for SA Power Networks, Energex, Ergon Energy, Directlink and Jemena Gas Networks

I refer to the AER proposal to delay the 2020-25 final revenue determinations for SA Power Networks, Energex, Ergon Energy, Directlink and Jemena Gas Networks (Determinations) from 30 April 2020 to late May 2020 with a view to incorporating short-term inflation forecasts that are anticipated from the Reserve Bank on 8 May 2020. If forthcoming, these inflation forecasts are expected to provide a more accurate reflection of forecast inflation in years 1 and 2.

SA Power Networks supports any attempt by the AER to improve the inflation forecasts that are applied in the Determinations. We understand the AER is proposing that:

- the AER will provide each network provider with the allowed revenue for the first regulatory year of the 2020-25 regulatory control period using the February 2020 forecast of inflation from the Reserve Bank by 30 April 2020;
- each network provider will lodge an 'informal' annual pricing proposal to the AER within 15 business days of receiving that information from the AER (ie by 21 May 2020). This 'informal' proposal will apply the allowed revenue using the February 2020 forecast of inflation from the Reserve Bank and contain fixed prices for the first regulatory year;
- the AER will then update the allowed 2020-25 revenue using the May forecast of inflation from the Reserve Bank (if there is an update) and publish the Final Determinations by the end of May;
- each network provider will then lodge a formal annual pricing proposal by 1 June 2020. This proposal will contain:
 - the same fixed prices for the first regulatory year as the 'informal' proposal using the February 2020 forecast of inflation; and
 - indicative price paths for the subsequent regulatory years using the Final Determinations published by the end of May 2020. Any revenue 'true-up' between the 30 April and end May 2020 figures will be recovered in Years 2-5 of the regulatory period.

Subject to confirmation from the AER that our understanding is correct, we support this process so that network and retail businesses are able to put in place new retail prices from 1 July 2020.

However, we remain concerned that the AER's proposed delay will not improve its inflation forecast for years 3 to 10. In other words, the AER intend to only 'fix' part of a known error which is also highly material. Nor will it consider other adverse consequences of the COVID-19 pandemic and the associated material deterioration in economic and financial market conditions, as outlined in our 4 March 2020 letter to you. These impacts materially undermine the validity of key assumptions underpinning our revenue determination, which will be fixed for the next five years.

In these unprecedented economic and financial market conditions, it is more important than ever that the AER forecast of inflation is the best possible. The AER is currently forecasting inflation at 2.35% p.a. which is *materially* higher than any reasonable estimate. To the extent the AER over forecasts inflation, our revenue is reduced, and we are uncompensated for this error. Addressing the error in years 1 and 2 only partly addresses the issue. Even then it remains unclear as to whether the RBA will release new forecasts in May 2020 in which case the AER will revert to February 2020 forecasts for years 1 and 2, which are known to be no longer an appropriate measure of forecast inflation, and in doing so will thereby 'lock-in' the inflation forecast at 2.35%.

The fact that the AER has announced a formal review into its approach to regulatory inflation indicates that the AER itself is not confident that its 2.35% figure is the best possible estimate in the prevailing market conditions. However, any changed approach resulting from this review will not be applied retrospectively to our 2020-25 revenue allowance. That is, SA Power Networks will suffer the consequences for the next five years of using what are very clearly inaccurate estimates of forecast inflation.

Ultimately, however, the AER will be releasing a Final Determination which:

- has very limited regard or no regard (if the RBA does not release new inflation forecasts in May 2020) to the effects of COVID-19 and the associated dislocation in the financial markets; and
- is insufficient to allow for the recovery of our efficient costs.

Such a determination will inhibit efficient investment and is not in the long-term interests of consumers. It also seriously inhibits any further short-term relief packages we may wish to consider for our customers who have been and are adversely impacted by COVID-19.

We would be pleased to engage further with the AER on these and any other matters relevant to our final revenue determination. If you wish to discuss our submission further, please contact [REDACTED] on [REDACTED]

Yours sincerely

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