SA Power Networks

25 October 2012

Mr Richard Khoe
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Richard,

Reference: ERC0134/ERC1035/GRC0011

SA Power Networks[1] welcomes the opportunity to provide comments on the Australian Energy Market Commission (AEMC) *Consultation Paper on Savings and Transitional Arrangements* dated 14 September 2012 that will apply to the new rules proposed in the draft rule determination dated 23 August 2012.

SA Power Networks has engaged in discussions with the AER on the *Consultation Paper,* the associated draft rules released by AEMC officers and the AER paper entitled *AER Staff working paper – DNSP Discussion Version, 18 October, Transitional Arrangements for Chapter 6.*

SA Power Networks supports the 12 month delay in finalising the next determination, having a streamlined process for the establishment of a smoothed placeholder revenue in the first year of the next regulatory control period and a true-up process for year 1 revenues.

We have arrived at this position after consideration of AEMC's key criteria of having the earliest possible uptake of the new rules by Network Service Providers (NSPs), ensuring an adequate period of stakeholder consultation, allowing for the recovery of NSPs' efficient costs and minimisation of AER resourcing constraints. We also consider our proposed approach will be more efficient for both stakeholder groups and network service providers as it will allow a primary focus on the full 5 year regulatory proposal and outcomes.

This submission details SA Power Networks' positions, and amendments to the AER proposals, in the interest of developing a workable process for the next South Australian Distribution Network Service Provider (DNSP) determination.

Options Available for Transition

On 14 September 2012, the AEMC issued a consultation paper on the transitional arrangements for implementation of the draft Chapter 6 and 6A Rules. The AEMC consultation paper outlined that the upcoming round of revenue determinations would be delayed by 1 year, with a transitional determination required to set revenue for the first year following the current regulatory control period.

[1] Previously ETSA Utilities. ETSA Utilities changed its trading name to SA Power Networks in September 2012.

During the course of the consultation period, four alternative models for the 1 year transitional period have been contemplated and discussed by market participants, the AER and the AEMC as follows[2]:

1. AEMC Consultation Paper
2. TransGrid/AER Proposal
3. Mechanistic Approach
4. Hybrid Model

While each of the options have their merits SA Power Networks has a strong preference for those options which avoid multiple review processes and which accommodate a streamlined setting of placeholder revenues for year 1 of a 5 year regulatory control period, with a subsequent NPV-neutral true-up arrangement applying to years 2-5. This mechanism features in all but the 'AEMC Consultation Paper' model (which instead involves a limited scope building block determination for the transitional year, an associated 7 month consultation period, and a subsequent full determination for years 2 to 6).

SA Power Networks considers that given the development of guidelines under the Rules during 2013, the Framework and Approach Paper and Regulatory Proposal in 2014 both the 'Mechanistic Approach' and the 'Hybrid Model' are superior to the 'TransGrid/AER Proposal'.

A significant benefit of these two options relative to the 'TransGrid/AER Proposal' is in the simplicity and efficiency of determination of the placeholder revenue for year 1, being that the year 1 proposal would simply be the first year of the full 5 year proposal that SA Power Networks would submit in November 2014. This negates any need for a separate 'placeholder revenue statement' as described in the 'TransGrid/AER Proposal'.

Stakeholder engagement would also be more efficient and less confusing for stakeholder groups. Consultation would focus on the full 5 year proposal rather theses groups having to run parallel processes for input into a one year transitional and a 5 year proposal concurrently. Since both options incorporate an appropriate cap on year 1 revenue, customers would not be at risk of inappropriate price rises in year 1, and the true-up mechanism would in any case ensure no pricing detriment at all over the 5 year period. As both these models derive year 1 from the full 5 year regulatory proposal it is in the interest of all parties to have a smoothed price path over the across years 1 to 5.

SA Power Networks notes that the key difference between the 'Mechanistic Approach' and the 'Hybrid Model' is that the latter provides for year 1 pricing that *might* exceed the proposed placeholder revenue cap. In this case, the AER would need to conduct a more detailed assessment of the proposal, including consultation processes. The current view is that this circumstance has limited likelihood of arising, and on this basis, we have no preference between the options.

For the purposes of the discussion below, we ignore the prospect of the year 1 placeholder exceeding the appropriate cap, and outline key features of a workable model (which could be either the 'Mechanistic Approach' or the 'Hybrid Model').

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2 Names of the 4 alternative models are as used in the AEMC slides titled 'Transitional Arrangements – Alternative Models' dated 23 October 2012 as discussed at the market participant workshop held on 23 October 2012.

A Workable Transition Model for South Australia

The following table outlines SA Power Networks clarification and amendments to the AER paper to establish a workable model for setting of year 1 revenue and related matters for SA Power Networks next revenue determination.

Regulatory Control Period	5 years: 1 July 2015 to 30 June 2020 noting "year 1"is the period 1 July 2015 to 30 June 2016.
Year 1 Placeholder Revenue Cap Amount	Year 1 placeholder revenue cap be set at the 2014/15 revenue requirement escalated by the forecast CPI.
Placeholder Revenue	The placeholder revenue would be derived from the first year of the full 5 year regulatory proposal that SA Power Networks would submit in November 2014, for Standard Control Services and Alternate Control Services (which only relate to SA Power Networks' metering services). SA Power Networks would submit proposed revenue for year 1 taking into account the approach to having a smoothed price path across the 5 years. The placeholder revenue would be accepted by the AER as the basis for SA Power Networks Pricing submission for 2015-16 where the revenue is below the placeholder revenue cap. For the avoidance of doubt, a separate 'placeholder revenue statement' would not be required.
Regulatory Determination	The single determination would be made by the AER in April 2016, for the full 5 year regulatory control period, in accordance with new rules and guidelines.
True-up of year 1 Revenue	As part of the final determination an NPV-neutral revenue true-up of year 1 revenue would be determined would be applied to years 2-5 on a smoothed basis.
Stakeholder Consultation	The consultation process would focus on the full proposal for the entire 5 year regulatory control period in accordance with the extended stakeholder engagement model proposed under the draft rules.

SA Power Networks considers of the following issues also need to be accommodated in transition arrangement for the next regulatory control period.

Framework and Approach	The Framework and Approach to be published in May 2014 needs to address certain issues related to the delayed decision on full determination and the risks faced by networks businesses during year 1. These issues include the need to accommodate DNSP debt risk management strategies, WACC determination approaches, and incentive scheme frameworks and their application, among other things. These matters are discussed separately below.

Debt Risk Management	For SA Power Networks' efficient debt risk management, it is important that the determination process accommodates sufficient and timely certainty in terms of key approaches and processes. Accordingly, the Framework and Approach would need to lock in the 'averaging period' for any market parameters used in the calculation of the overall rate of return in the final determination. This averaging period would be agreed with the AER as is current practice and would be a period prior to the commencement of the next regulatory control period i.e. 1 July 2015. The value of any market parameters used by the AER in determining the overall rate of return as part of the final decision would be sourced form the agreed averaging period. The Framework and Approach will also need to specify the approach to estimating the return on debt (e.g. historical weighted average or spot rate) that is to be used in making the final determination..
Form of Control	The form of control would be determined in the Framework and Approach . It would apply consistently for the full regulatory control period, i.e. years 1 to 5.
Service Target Performance Incentive Scheme (STPIS)	The STPIS can operate in a straightforward manner from the commencement of the 5 year regulatory control period. . The STPIS target for the regulatory control period can be readily calculated using the existing STPIS methodology and would be based on the period commencing 2009/10, being the period immediately following the previous target setting period for the current STPIS arrangements. The revenue at risk for year 1 would be the same as for the current period (=/- 3%) unless an alternative level is agreed between the AER and the DNSP as part of the Framework and Approach. Revenue at risk for years 2-5 would be as per the final determination.
Efficiency benefit Sharing Scheme (EBSS)	As an approved operating expenditure allowance for year 1 will not be determined until well into year 1 the automatic rolling forward of the EBSS is problematic. The transitional rules should provide appropriate flexibility for the EBSS so that either the initial year of the regulatory control period is ignored for EBSS purposes or the EBSS is rolled forward on the basis that the allowance and actual expenditure are the same for year 1.

Demand Management and Embedded Generation Connection Initiative Scheme (DMEGCIS)	DMEGCIS arrangements for year 1 would also be finalised as part of the Framework and Approach. The transitional rules should deem the following roll-over of arrangements to occur, unless the AER makes a different determination as part of the Framework and Approach paper. For part A of the scheme, the transitional rules should deem a DMIA allowance in year 1 based on the average yearly DMIA amount provided (i.e. 1/5th of the total provided) in the prior regulatory control period for the current DMIS. Claw back amounts relating to the unused DMIA only occur in year 2 of the next period – so no transitional arrangement would be required. Part B of the scheme (foregone revenue related to projects approved under part A) would not be applied during year 1 of the transitional determination.
New Incentive Schemes	Any new incentive schemes (including those for capital expenditure) apply only from year 2 of the regulatory control period
Connection Policies	Connection policies should be rolled-forward under the jurisdictional arrangements from year 5 of the current regulatory control period. In the case of South Australia, the State Government will need to extend the currently proposed NECF transitional arrangements to 1 July 2016.
Pass Through Events	The transitional rules would need to ensure that during the first year DNSPs would have access to the same pass through events on the same basis as apply in the current regulatory control period. Any changes to the nominated pass throughs decided as a result of using the new rules in the full determination would apply from year 2 of the regulatory control period.
Other Policy & Framework Papers	Certain policy and framework papers applying in the current regulatory control period, such as the *negotiating framework, Negotiated Service Criteria,* and *pricing methodology,* would continue to apply in year 1 until a full regulatory determination is made.

Key Regulatory Control Period Milestones

The table below identifies the key milestones for the next regulatory control period under these transitional arrangements:

Key Milestone	Milestone Date/s	Responsible
2015-2020 Framework and Approach Paper	End May 2014	AER
2015-2020 Regulatory Proposal Submitted	End November 2014	SA Power Networks
Annual Pricing Proposal for 2015-16 based on placeholder revenue	May 2015	SA Power Networks
2015-2020 Regulatory Control Period - Final Determination	End April 2016	AER
Annual Pricing Proposal for 2016-17 based on final determination	May 2016	SA Power Networks

Consultation on Transitional Rules

The AEMC, AER and network businesses have actively engaged in discussions on alternative approaches to facilitating a timely and efficient transition to the new rules for the next round of revenue resets. These discussions have focussed on the principles and the key elements of the preferred arrangements taking account of the specific circumstances and timing of determinations to be made.

It is appropriate that network businesses are afforded the opportunity to review and comment on the drafting of the specific transitional rules to give effect to the outcomes of these discussions before they are finalised and made by the AEMC.

If sufficient time is not available prior to before 15 November 2012 being the date for the release of the final rule determination then the transitional rules should be remain open for consultation for a further short period thereafter.

Should you have any questions or require further information on this submission please do not hesitate to contact me on 08 8404 5649 or Wayne Lissner on 08 8404 5391 or at wayne.lissner@sapowernetworks.com.au.

Yours sincerely,

Sean Kelly

Sean Kelly
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