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Electranet's Proposed Amendments to Revised Electricity Transmission Code - Draft Decision
Essential Services Commission of SA
GPO Box 2605
Adelaide SA 5001

By email: escosa@escosa.sa.gov.au

6 May, 2013

Dear Commissioners,

Thank you for the opportunity to comment on Electranet's proposed amendments to the Revised Electricity Transmission Code - Draft Decision.

As the peak body for the community services sector in South Australia, SACOSS has a long–standing interest in the delivery of essential services and particular the cost of basic necessities like electricity because they impact greatly and disproportionately on vulnerable disadvantaged people.

Background

ElectraNet wrote to ESCOSA in late 2012 outlining a number of proposed changes to the Electricity Transmission Code (ETC) that[1] "ElectraNet considers … will help to achieve a better balance between reliable electricity supply and associated costs to consumers."

ESCOSA's Draft Decision was to reject the majority of the proposal. The Commission stated (emphasis added):

> *(page 2)* "Of note, the Commission observes that the amendments have been proposed outside of the detailed review and consultation processes undertaken every five years (prior to the start of a new regulatory period for ElectraNet), last occurring during 2010 to 2012 and, moreover, that certain of the changes proposed would fundamentally alter the operation of the code.
>
> *(page 5)* … While it accepts that there may be some merit in the general principles underlying this proposal, the Commission is concerned that, based on the information put before it by ElectraNet, <u>there is no formal and definitive means by which it could be given effect or for any savings to pass through to customers</u>. In the absence of such means, the Commission is not prepared to make the changes sought at this point in time, as those changes would appear to lead only to a windfall gain to ElectraNet at the expense of customers."

The Australian Energy Regulator (AER) released its final decision on ElectraNet's 2013-18 regulatory period on May 1st, 2013. The AER made a number of comments in relation to the

[1] http://www.escosa.sa.gov.au/library/121214-ProposedAmendmentstoTransmissionCodeLetter-ElectraNetAddendum.pdf

particular subject matter of this submission[2]. The AER do not appear to support the need to change the ETC. Further, the AER has expressed some concern over ElectraNet's approach to demand forecasting[3]:

> "ElectraNet did not provide a clear description of its revised forecasting methodology [footnote reference to NER, clause S6A.1.1(2), (3) and (4)." And " … It is not clear how ElectraNet has addressed the concerns expressed in our draft decision about embedded generation in its revised demand forecast."

The Australian Energy Market Commission is undertaking a review of the national framework for transmission reliability and is consulting on an Issues Paper[4] concurrently with ESCOSA's consultation on this draft decision. There is very relevant common ground covered in the AEMC review.

SACOSS has also engaged with both ElectraNet and ESCOSA in order clarify some aspects of the ElectraNet proposal and ESCOSA's response.

Introduction

ElectraNet contacted SACOSS on April 24th, 2013. In correspondence, ElectraNet have confirmed that the intention of their proposed changes is to provide[5] *"… cost reductions for consumers and minimal impacts on supply reliability.*"

ElectraNet also provided SACOSS with a copy of their response to the draft decision (by email May 2nd, 2013) and SACOSS appreciate such openness and the ability to consider this in making a submission to ESCOSA. We note that ElectraNet strongly reject the implication that "… the proposed changes to support lower demand forecasts may be motivated by a desire for windfall gains at the expense of customers."

The nuanced details of network regulation, particularly Transmission regulation, make for a difficult subject on which to engage SACOSS members. However, it is possible to outline some guiding principles upon which the proposals and ESCOSA's draft decision have been assessed.

SACOSS is of the view that there is some merit in having a flexible approach as long as the benefits of doing so are shared with consumers. SACOSS is acutely aware of the incentives apparent to network businesses and is experienced in the ability of these businesses to respond to them. It would be naive to assume otherwise. In this context, the inherent incentive is to extend the time lag between revenue raised (under the formal revenue regulation process with the AER) and expenditure incurred.

On face value, the proposals from ElectraNet could be interpreted as an example of trying to leave open the possibility of being able to delay investments while being able to capture the revenue provided for making them. This, of course, would not be an approach that SACOSS

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[2] Available from http://www.aer.gov.au/node/16617 see page 89-92
[3] AER Final Decision, page 22
[4] AEMC ref EPR0028 Review of the national framework for transmission reliability – Issues Paper
[5] By email from Mr Simon Appleby (Senior Manager, Regulatory Affairs ElectraNet) to Mr Andrew Nance (SACOSS energy advisor), April 25th, 2013.

would support and, if any proposals were to be supported, SACOSS would need assurances from ESCOSA that this would not in fact be the case.

SACOSS therefore asks ESCOSA to consider ElectraNet's proposals on the basis of acknowledging that this underlying incentive exists and that the consumer interest is served when any benefits of investment deferral are shared with them.

The AER's very recent final decision[6] on ElectraNet's 2013-18 regulatory control period approves a list of 11 contingent projects for a contingent capex of $1490m over the period. This is more than twice the final decision's approved capex allowance of $690m. While SACOSS accepts that there is some merit in using the contingent project mechanism, the outturn in this recent case is that consumers are left with a potentially significant uplift on what otherwise appears to be a modest revenue determination. Applying the WACC of 7.5% to the full contingent project list would add over $110m pa to allowable revenue over-and-above the otherwise approved Maximum allowed revenue of an average $315m pa – around 35%.

In summary, SACOSS understands the need for flexibility but is concerned as to how the consumer interest can be preserved.

Ultimately, the long term interests of consumers lie in an efficient balance between investment and the end product: reliable electricity supplies for consumers. It is on this basis that the proposals should be judged.

The key question for SACOSS then is as to whether or not it is appropriate to change the ETC at this stage in the regulatory cycle?

Based on the fact that the AER's final decision reflects ElectraNet's revised proposal for reduced capital expenditure in light of lower demand forecasts, SACOSS can accept that much of the changes proposed by ElectraNet have already delivered some benefit to consumers.

There is also some obvious potential that the end result of the SCER initiated AEMC Review of the national transmission reliability frameworks may initiate amendment of the ETC. It is however unlikely, given the historic pace of reform, that this would occur prior to the next review cycle in the lead up to the 2018-2023 regulatory control period.

SACOSS notes its reservations around the timing of changes to the code, in line with ESCOSA's comments about the amendments having been proposed outside of the review and consultation processes undertaken every five years (prior to the start of a new regulatory period for ElectraNet).

Discussion

In the context of the ElectraNet proposals and ESCOSA's draft decision, the interests of residential consumers should be interpreted as:

- Households should only pay for the reliability they want, and;

[6] http://www.aer.gov.au/node/16617

- Households should get the reliability they pay for.

The ElectraNet proposals have a strong relationship to the NEM's treatment of the Value of Customer Reliability (VCR). VCR represents the dollar value that customers place on the reliable supply of electricity – an indicator of customers' *willingness to pay* for not having supply interrupted.

VCR is not a parameter that can be measured directly and it is not a parameter that has a single value applicable to all customers across Australia's National Electricity Market. It is a parameter that must be approximated or estimated and the methods by which this is done will impact on the uncertainty with which it can be determined. In turn, the uncertainty with which it can be determined should influence the way in which it is used.

For example, ElectraNet have proposed an increase to the reliability standard for the Kanmantoo Mine Exit Point on the basis of modelling around a VCR of $46,000 / MWh. As outlined in the referenced SACOSS submission to the AER, this figure is around three times current estimates of the VCR of residential customers.

In submissions[8] to ESCOSA during the 2011 Review of the ETC, concerns were raised about the use of a state-wide average VCR (as a measure of consumer's willingness to pay) of $46k/MWh by AEMO and ElectraNet as compared to the $15-20k assessed for residential consumers:

> "… the implication of this is that significant transmission investment will exceed the willingness to pay of the most numerous customer class. This represents a significant challenge to the economic efficiency of these investments."

SACOSS notes the Commission's comment[9]:

> "Of note, the Commission is not aware of any studies, customer surveys or similar sources of evidence which would support ElectraNet's claims in respect of South Australian customers' willingness to accept lower reliability."

However, SACOSS would contend that both the historic Victorian surveys and the recent surveys for the AEMC in NSW show that residential customers place a lower value on reliability than the value used to assess Transmission investments.

On a further point, SACOSS note that ESCOSA have stated[10]:

> "The standard requires ElectraNet to negotiate in good faith with its customers (generally SA Power Networks …) to establish on an agreed basis the future demand levels. This element of the code explicitly recognises the need for commercial, market-based outcomes, an underpinning principle of the National Electricity Market (NEM)."

SACOSS would like to comment that this arrangement for "*commercial, market-based outcomes*" might be appropriate for negotiations between ElectraNet and the small number

[8] http://www.escosa.sa.gov.au/library/120215-ElectricityTransmissionCodeDraftDecisionSubmission-StKitts.pdf
[9] ESCOSA Draft Decision, page 20
[10] ESCOSA Draft Decision, page 2

of very large, directly connected commercial enterprises but that it is a very difficult concept to accept (let alone communicate to SACOSS constituents) when these negotiations are held between two regulated monopolies. This is especially so when the monopoly representing households in this case (SAPN) treats transmission costs as a simple pass through that is around 35-40% funded by residential tariffs[11]. We note the comments in AEMO's submission in this regard and that SACOSS can see the *prima facie* benefits of independent demand forecasting in this regard.

Recommendations

ElectraNet outlined seven areas where they sought revisions to the ETC. Based on our understanding of both ESCOSA's draft decision and ElectraNet's response, SACOSS makes the following specific recommendations:

1. Transition to new arrangements

   ESCOSA has proposed some minor clarifications for the Code and ElectraNet have accepted the ESCOSA proposal. SACOSS is comfortable with this approach.

2. Unanticipated demand increases

   Disagreement remains over the wording of Clause 2.11.2 of the code. SACOSS is not convinced that the proposed changes can be justified on the grounds of new information or developments since the process established to revise the code prior to the revenue determination. SACOSS recognises the value of the exchange of views on this matter (and for these to be on the public record) but cannot see a reason to support a change of the ETC at this point in time.

3. Basis of demand forecasts

   As discussed, SACOSS continues to hold concerns over the process and results of demand forecasting in South Australia. SACOSS is of the view that the revision of demand forecasts (to a 10% PoE basis) in the AER's revenue determination for ElectraNet 2013-18 is in the consumer interest. SACOSS notes that ElectraNet seems comfortable that the exchange of views and clarifications provided during the process that is the subject of this submission (ie ElectraNet's proposals and ESCOSA's responses) are satisfactory for their purposes. SACOSS supports the view that no changes to the code are necessary at this point in time.

4. Economic Augmentation

   The ElectraNet response to ESCOSA's draft decision seems to accept that the need to amend the ETC has been subsumed by the scope of the AEMC review of transmission reliability frameworks. SACOSS agrees and is participating in the AEMC review.

5. Quality of supply and reliability

   The ElectraNet response to ESCOSA's draft decision seems to accept that the need to amend the ETC has been reduced by the clarifications included in the draft decision. SACOSS agrees that clarifications have been helpful and supports the view that no changes to the code are necessary at this point in time.

[11] Based on SAPN published tariffs and the SAPN Post Tax Revenue Model (PTRM) published by the Australian Energy Regulator (AER)

6. Fault restoration obligations

   ESCOSA has acknowledged an omission in the ETC and intends to make a minor change. ElectraNet accepts the draft decision and SACOSS agrees.

7. Reclassification of Kanmantoo exit point

   ElectraNet has provided further analysis of the case for increasing the reliability standard for the Kanmantoo Exit Point. ElectraNet have proposed a reclassification from Category 1 to Category 2 prior to the currently planned substation refurbishment - the cost implication being the difference between installing one new transformer or two. SACOSS does not support this reclassification on two grounds. Firstly, on the basis that the exit point classification process is fundamental to the ETC revision process in the five-year regulatory cycle and the desire to revisit these on an ad-hoc basis makes consumer engagement even more challenging. Secondly, on the basis that the cost-benefit analysis has been conducted using a state-wide VCR and sensitivity tested only down to a VCR level that still exceeds contemporary estimates of the VCR for residential consumers. Based on the summary results ElectraNet's analysis, testing the project at a VCR in the region of $15,000 per MWh it appears unlikely that the project would be NPV positive. Finally, SACOSS agrees with the ESCOSA analysis that alternative supply and demand options may be more cost effective than the transformer duplication proposed by ElectraNet. While not familiar with the detailed economics of mobile substation transformers, it is unclear why the current emergency transformer could not be re-instated should a replacement fail as an alternative to installing a duplicate, but idle, transformer during the substation refurbishment.

Summary

SACOSS is unable to support any changes to the regulatory arrangements that will not confidently ensure consumers share in the benefits of the proposed changes. Consumers will need to be convinced that that any changes to investments patterns do not continue to " *…appear to lead only to a windfall gain to ElectraNet at the expense of consumers.*"[12]

SACOSS notes its reservations around the timing of changes to the code, in line with ESCOSA's comments about the amendments having been proposed outside of the review and consultation processes undertaken every five years (prior to the start of a new regulatory period for ElectraNet).

Having engaged with both ElectraNet and ESCOSA there does appear to be some differing understandings of each other's perspectives. SACOSS would be pleased to engage further in progressing these matters.

[12] ESCOSA Draft Decision, page 5

We thank you in advance for your consideration of our comments. If you have any questions relating to the above responses, please contact SACOSS Senior Policy Officer, Jo De Silva on 8305 4211 or via jo@sacoss.org.au.

Yours sincerely,

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Executive Director