Issues Paper

TasNetworks
Electricity distribution
regulatory proposal

1 July 2017 to 30 June 2019

March 2016

AUSTRALIAN ENERGY REGULATOR

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Request for submissions

Energy consumers and other interested parties are invited to make submissions on the TasNetworks electricity distribution regulatory proposal and Tariff Structure Statement (TSS) by 28 April 2016. TasNetworks' proposal and TSS are available on the AER's website www.aer.gov.au

We will consider and respond to submissions in our draft determination in September 2016.

We prefer that all submissions are in Microsoft Word or another text readable document format. Submissions should be sent to: TASelectricity2017@aer.gov.au

Alternatively, submissions can be sent to:

Mr Chris Pattas
General Manager
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

- clearly identify the information that is the subject of the confidentiality claim
- provide a non-confidential version of the submission in a form suitable for publication.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (June 2014), which is available on our website ACCC and AER information policy.

If interested parties have any enquires about this Issues Paper, or about lodging submissions, please send an email to: TASelectricity2017@aer.gov.au.

Contents

Shortened forms

Shortened form	Extended form
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
capex	capital expenditure
CESS	capital expenditure sharing scheme
DMIS	demand management incentive scheme
DNSP	Distribution Network Service Provider
DUoS	distribution use of system
EBSS	efficiency benefit sharing scheme
kW	kilowatt
MW	megawatt
MWh	megawatt hour
NEL	National Electricity Law
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
NSP	network service provider
opex	operating expenditure
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
RPPs	Revenue and pricing principles
STPIS	service target performance incentive scheme
VCR	Value of Customer Reliability
WACC	weighted average cost of capital

1 Introduction

Tasmanian households and businesses consume electricity, which is supplied through a network of 'poles and wires'. The electricity network in Tasmania is commonly divided into two parts:

- a transmission network, which carries electricity from the large generators to the major load centres
- a distribution network, which carries electricity from the points of connection with the transmission network to virtually every building, house and apartment in Tasmania.

The transmission and distribution networks charge their customers for transmitting and distributing electricity across their networks. These 'network charges' do not appear directly on most customers' electricity bills, which are sent by the retail businesses. Nevertheless, the network charges are important as they account for a significant component of each customer's final bill.

On 29 January 2016, Tasmanian Networks Pty Ltd (TasNetworks) submitted its electricity distribution regulatory proposal for the regulatory control period from 1 July 2017 to 30 June 2019 (2017–19 regulatory control period). The proposal sets out the revenue TasNetworks proposes to collect from Tasmanian electricity consumers through distribution charges (or 'tariffs') from 2017 to 2019.

On 29 January TasNetworks also submitted its Tariff Structure Statement (TSS) for the period 1 July 2017 to 30 June 2019. The TSS explains how TasNetworks' tariffs have been developed and how TasNetworks proposed to move to more cost reflective pricing, consistent with new pricing rules.[1]

The forthcoming regulatory control period for TasNetworks will run for two years, from 1 July 2017 to 30 June 2019 instead of the usual 5 years. The two year regulatory control period will allow TasNetworks to align the regulatory control periods of its distribution and transmission businesses. The AEMC approved TasNetworks' proposed change in the length of the regulatory control period in its final rule determination issued on 9 April 2015.[2]

We, the Australian Energy Regulator (AER), regulate the revenues of the network businesses by setting the annual revenue requirement they may recover from customers. Other components of consumer bills include the cost of generation, transmission network charges, and retailer costs. We do not set retail prices.

1.1 Consultation on TasNetworks' regulatory proposal

We are just starting the process of reviewing TasNetworks' regulatory proposal for the 2017–19 regulatory control period. This involves examining TasNetworks' proposal.

1 NER, cl. 6.18.1A

2 AEMC, *Rule Determination: National Electricity Amendment (Aligning TasNetworks' regulatory control periods) Rule 2015*, 9 April 2015.

The purpose of this issues paper is to help consumers and other stakeholders understand TasNetworks' regulatory proposal. A separate issues paper discussing TasNetworks' TSS is being published concurrently with this issues paper.

Consumers can get involved in TasNetworks' pricing review in a number of ways. We will host public forums during which consumers can ask us and TasNetworks' questions. Consumers can make submissions on the TasNetworks' proposal and our draft determinations (see details below).

As part of our 'Better Regulation Program' and to ensure that consumers have a say in our decision making process, we established the Consumer Challenge Panel to challenge the way we work with consumers, and to help ensure we have a good understanding of the things that matter to consumers. Panel members will present their views and analysis at our public forums and consultative group meetings, which will help inform consumer views.

Our draft decision is to be released by September 2016 and the final decision is to be released on or before 30 April 2017. Table 1.1 lists the key dates of the review.

Table 1 Key dates for the TasNetworks distribution determination process

Step	Date
AER published Framework & Approach paper for TasNetworks	9 July 2015
TasNetworks submitted regulatory proposal to AER	29 January 2016
AER publishes issues paper	10 March 2016
AER to hold public forum on issues paper	17 March 2016
Submissions on regulatory proposal close	28 April 2016
AER to publish draft determination	September 2016*
AER to hold public forum on draft determination	October 2016*
TasNetworks to submit revised regulatory proposal to AER	tba
Submissions on revised regulatory proposal and draft determination	tba
AER to publish final determination	On or before 30 April 2017

* Indicative dates only and will be confirmed as the process progresses.

Merits review - Tribunal decision on the AER's ACT and NSW 2014–15 distribution determinations

In May 2015, ACT and NSW distributors and the Public Interest Advocacy Centre (PIAC) applied to the Australian Competition Tribunal for merits review of the AER's final 2014–19 distribution determinations released on 30 April 2015. The Tribunal hearings commenced in September 2015 and the Tribunal handed down its decision on 26 February 2016. We are

considering the Tribunal's decision and its implications for TasNetworks' proposal and other regulatory decisions.

1.2 Submissions

Submissions on TasNetworks' regulatory proposal and TSS are due by Thursday 28 April 2016.

Your submission will be of greater value to us if it is supported by evidence and analysis. Submissions that address specific issues, supported by evidence and analysis, can be very useful.

If you consider a certain aspect of the regulatory proposal is not justified, you should state why you consider it is not justified. You should also state what further information you consider TasNetworks should provide to justify that aspect of its proposal. Likewise, if you consider a certain aspect of the proposal is justified, you should state why.

When considering the questions on which we would like feedback, it is useful to keep in mind that our jurisdiction in reviewing the proposal is set out in the National Electricity Law (NEL) and National Electricity Rules (NER). The objective of the regulatory framework is to promote the efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity. Under the NER, we assess the business' proposal in light of this objective.

We are most interested in receiving submissions on TasNetworks' proposed approach to customer engagement, operating expenditure (opex), capital expenditure (capex), the expected rate of return and gamma. However, we welcome submissions on all aspects of the proposal.

Public forum

We will hold a public forum on TasNetworks' regulatory proposal and TSS in Hobart on 17 March 2016. To attend, please contact us at TASelectricity2017@aer.gov.au

2 Our initial observations

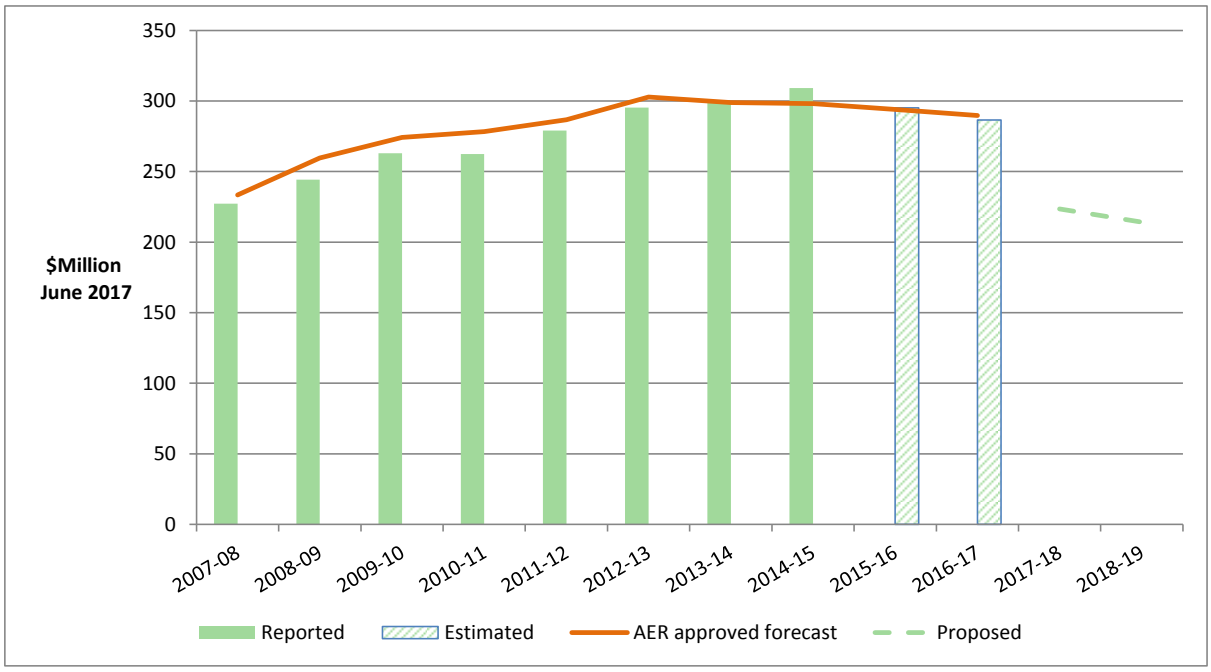
This section sets out our initial observations on TasNetworks' regulatory proposal.

2.1 Total revenue

TasNetworks' proposed a total revenue allowance of $493.3 million (smoothed, $June 2017) over the 2017–19 regulatory control period.[3] TasNetworks submitted that its proposed smoothed revenue for 2017–18 is 12.89 per cent lower in real terms than its regulated revenue allowance for 2016–17. Following this reduction, the building block calculation indicates a further modest decrease of 2 per cent in real terms in 2018–19.[4]

TasNetworks' actual, expected and forecast revenue is outlined in Figure 1 below.

Figure 1 TasNetworks – proposed total revenue ($million, June 2017)



Source: TasNetworks, Regulatory proposal RIN response , January 2016; AER, Final decision PTRM for Aurora 2012-17; TasNetworks (D), Economic Benchmarking RIN response 2014-15; TasNetworks (D), Economic Benchmarking RIN response 2013-14; Aurora, Economic Benchmarking RIN response 2006–13; AER analysis.

Revenue impact by building block revenue component

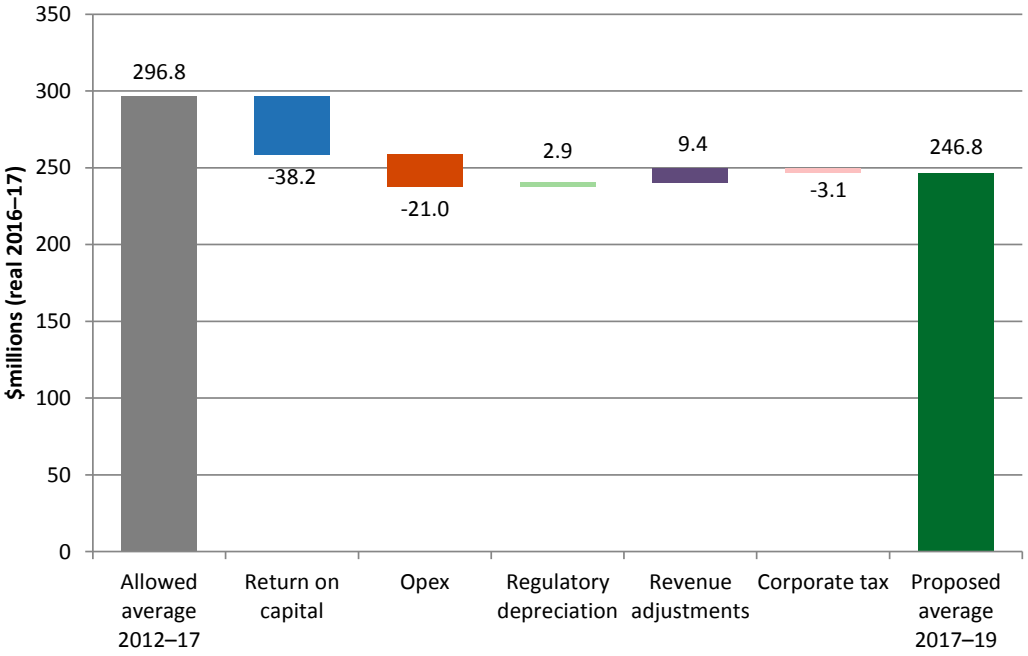
To assist consumers to understand the drivers of the decrease in TasNetworks' proposed revenue requirement we have separated TasNetworks' proposed changes in revenue into the various building block elements.

3 TasNetworks, *Regulatory proposal 2017–19*, January 2016, p. 130.
4 TasNetworks, *Regulatory proposal 2017–19*, January 2016, pp. 130–131.

In the Figure 2 we show the impact of these changes as if they were to all occur in the first year. By doing so, we can see more clearly the key drivers of TasNetworks' proposed revenue decrease.

As reflected in this figure, the return on capital and opex building blocks are the key drivers of the proposed decrease in revenues in the 2017–19 regulatory control period.

Figure 2 TasNetworks – change in 2012–17 average revenue to proposed average revenue for 2017–19 – by revenue component



Source: TasNetworks, *Regulatory proposal 2017–19*, January 2016; AER analysis.

Impact on distribution prices

TasNetworks submitted that transmission and distribution network costs presently make up around 50 per cent of the average Tasmanian residential and small business customer's electricity bill.[5]

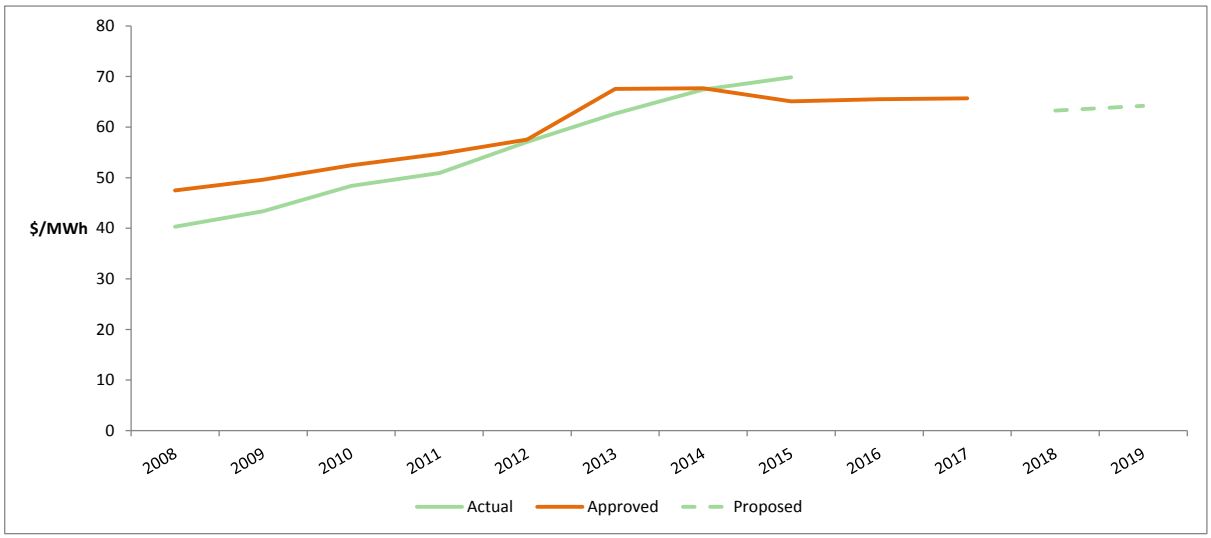
TasNetworks' proposed revenue, if accepted, would translate to annual distribution price decrease for Tasmanian consumers.

Figure 3 shows the actual, approved and expected price path derived from TasNetworks' regulatory proposal. As reflected in this figure, in the current regulatory control period prices have increased from 2012 to 2015 and are expected to decline slightly from 2016 to 2017.

TasNetworks proposes a decrease in indicative distribution prices of 3.72 per cent in 2017–18 relative to indicative prices based on current approved revenues forecasts.[6]

5 TasNetworks, *Regulatory proposal 2017–19*, January 2016, pp. 132–133.
6 TasNetworks, *Regulatory proposal 2017–19*, January 2016; AER analysis.

Figure 3 TasNetworks – indicative distribution price path from 2007–08 to 2017–19 ($/MWh, nominal)



Source: TasNetworks, Regulatory proposal RIN response , January 2016; TasNetworks (D), Economic Benchmarking RIN response 2014–15; TasNetworks (D), Economic Benchmarking RIN response 2013–14; Aurora, Economic Benchmarking RIN response 2006–13; AER, Final decision PTRM for Aurora 2012–17; TasNetworks (D), Economic Benchmarking RIN response 2014–15; Aurora, OTTER Energy and load forecasts 2005–12; Aurora, OTTER Regulatory model 1998–12; AER analysis.

2.2 Capital expenditure

TasNetworks' next regulatory control period is only two-years in duration (1 July 2017 to 30 June 2019). As a result, TasNetworks considers that a five year forecast (two years covering the forthcoming regulatory period plus an additional three years) of its proposed capex provides a transparent comparison with the current regulatory control period.[7] TasNetworks has proposed forecast capex of $556.2 million ($June 2017) over the next five year period from 2017–18 to 2021–22.[8]

TasNetworks expects to spend approximately $31 million, or five per cent, less capex during the current five year period, compared to the allowance set by the AER.[9]

TasNetworks submitted it is planning a further reduction of approximately $39 million or 6.6 per cent compared to its actual capex, over the five year period commencing 1 July 2017.[10]

See section 4 of this paper for further details.

2.3 Operating expenditure

TasNetworks proposed total opex of $123.1 million ($June 2017) for the 2017–19 regulatory control period.[11] TasNetworks submitted that its opex in the 2017–19 regulatory control

7 TasNetworks, *Regulatory proposal overview*, January 2016,p p. 10, 66.

8 TasNetworks, *Regulatory proposal overview*, January 2016, p. 11.

9 TasNetworks, *Regulatory proposal overview*, January 2016, p. 12; TasNetworks, *Regulatory proposal*, January 2016, p. 11.

10 TasNetworks, *Regulatory proposal overview*, January 2016, p. 12; TasNetworks, *Regulatory proposal*, January 2016, p. 11.

period is forecast to be 13.1 per cent lower in real terms than its average expenditure for the current regulatory control period. [12]

TasNetworks submitted that it has adopted the AER's 'base-step-trend' approach when developing its opex forecasts.[13]

TasNetworks submitted that its opex forecast is built on the significant efficiencies that it has already achieved by improving the business processes and reducing labour and contracted services costs across a range of functions. TasNetworks' proposed cost base in 2014–15 is approximately 16 per cent below the allowance set by the AER.[14]

See section 5 of this paper for further details.

2.4 Rate of return

TasNetworks submitted that its rate of return proposal is consistent with the AER's rate of return guideline and therefore the AER should accept the resulting WACC estimate, subject to the outcomes of the NSW, ACT and South Australian distributors' appeals.[15]

TasNetworks has proposed a rate of return of 6.04 per cent.

This comprises:

- 7.30 per cent return on equity
- 5.20 per cent return on debt
- 60 per cent gearing.

However, TasNetworks has departed from the AER's rate of return guideline with respect to gamma. It has adopted a value of gamma of 0.25, compared to guideline's estimate of 0.5.

TasNetworks submitted that if the Australian Competition Tribunal concludes that the AER is correct, then TasNetworks will adopt the Tribunal's findings on gamma in its revised proposal.[16]

See section 6 of this paper for further details.

11 TasNetworks, *Regulatory proposal*, January 2016, pp. 12–13.
12 TasNetworks, *Regulatory proposal*, January 2016, pp. 12–13.
13 TasNetworks, *Regulatory proposal*, January 2016, p. 90.
14 TasNetworks, *Regulatory proposal*, January 2016, pp. 12–13.
15 TasNetworks, *Regulatory proposal*, January 2016, pp. 116–119.
16 TasNetworks, *Regulatory proposal*, January 2016, pp. 120–121.

3 Background to our assessment

This section provides information about the AER and TasNetworks. If you are familiar with the AER's pricing review process, then refer straight to section 4.

The NEL and NER set out the regulatory framework for the National Electricity Market (NEM). Chapter 6 of the NER contains timelines and processes for the regulation of distribution businesses. It provides that regulated distribution businesses must periodically apply to us to assess their revenue requirements. Typically, this happens every five years. The regulatory proposal as submitted by each business starts a process often referred to as a pricing review or 'revenue reset'.

3.1 The Australian Energy Regulator

The AER is Australia's national energy market regulator and an independent statutory authority. Our functions are set out in national energy market legislation and rules, and mostly relate to energy markets in eastern and southern Australia. These functions include:

- setting the charges for using energy networks (electricity poles and wires and gas pipelines) to transport energy to customers
- monitoring wholesale electricity and gas markets so suppliers comply with the legislation and rules, and taking enforcement action where necessary
- publishing information on energy markets, including the annual State of the Energy Market report and more detailed market and compliance reporting, to assist participants and the wider community
- assisting the Australian Competition and Consumer Commission with energy-related issues arising under the Competition and Consumer Act, including enforcement, mergers and authorisations.

The NEL and NER set out the regulatory framework under which we operate.

We exercise our functions in a manner that will or is likely to contribute to the achievement of the National Electricity Objective (NEO). The NEO in turn is supported through the revenue and pricing principles and the various objectives, criteria and elements within the rules. The NEO is:

> …to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to—
>
> (a) price, quality, safety, reliability and security of supply of electricity; and
>
> (b) the reliability, safety and security of the national electricity system.

Energy Ministers have provided us with a substantial body of explanatory material that guides our understanding of the NEO. [17] The long term interests of consumers are not

[17] Hansard, *SA House of Assembly*, 9 February 2005 pp. 1451–1460.
Hansard, *SA House of Assembly*, 27 September 2007 pp. 963–972.
Hansard, *SA House of Assembly*, 26 September 2013 pp. 7171–7176.

delivered by any one of the NEO's factors in isolation, but rather by balancing them in reaching a regulatory decision. [18]

In general, we consider that we will achieve this balance and, therefore, contribute to the achievement of the NEO, where consumers are provided a reasonable level of safe and reliable service that they value at least cost in the long run.[19] In most industries, competition creates this outcome. Competition drives suppliers to develop their offerings to attract customers. Where a supplier's offering is not attractive it risks being displaced by other suppliers.

However, in the energy networks industry the usual competitive disciplines do not apply. Electricity transmission and distribution businesses such as TasNetworks are largely natural monopolies.[20] In addition, many of the products they offer are essential services for most consumers. Consequently, in an uncompetitive environment, consumers would have little choice but to accept the quality, reliability and prices the network service provider offers.

The NEL and NER aim to remedy the absence of competition by providing that we, as the regulator, make decisions that are in the long term interests of consumers. For example, we might require a distribution business to offer its services at a different cost than they would choose themselves. By its nature, this process will involve exercising regulatory judgement to balance the NEO's various factors.

It is important to recognise that there are a number of plausible outcomes that may contribute to the achievement of the NEO. The nature of decisions under the NER is such that there may be a range of economically efficient decisions, with different implications for the long term interests of consumers.[21] At the same time, however, there are a range of outcomes that are unlikely to advance the NEO to a satisfactory extent. For example, we do not consider that the NEO would be advanced if allowed revenues encouraged overinvestment and resulted in prices so high that consumers are unwilling or unable to efficiently use the network.[22] This could have significant longer term cost implications for those consumers who continue to use network services.

Equally, we do not consider the NEO would be advanced if the revenue recoverable from customers results in prices so low that investors are unwilling to invest as required to adequately maintain the appropriate quality and level of service, and where customers make more use of the network than is sustainable. This could create longer term problems and have adverse consequences for safety, security and reliability of the network.[23]

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18 Hansard, *SA House of Assembly*, 26 September 2013 p. 7173.

19 Hansard, *SA House of Assembly*, 9 February 2005 p. 1452.

20 A natural monopoly is a distinct type of monopoly that may arise when there are extremely high fixed costs of distribution, such as exist when large-scale infrastructure is required to ensure supply. Examples of infrastructure include cables and grids for electricity supply, pipelines for gas and water supply.

21 Re Michael: Ex parte Epic Energy [2002] WASCA 231 at [143].
Energy Ministers also accept this view – see Hansard, *SA House of Assembly*, 26 September 2013 p. 7172.
AEMC, *Rule Determination National Electricity Amendment (Economic Regulation of Transmission Services) Rule 2006* No. 18, p. 50

22 NEL, s. 7A(7).

23 NEL, s. 7A(6).

3.2 Who is TasNetworks and what does it do?

TasNetworks is a Tasmanian state-owned energy corporation which commenced operations on 1 July 2014. TasNetworks was established as an integrated network business to drive efficiencies in the networks and to deliver better outcomes for Tasmanian customers. It was formed as a result of the integration of:[24]

- Transend Networks Pty Ltd (Transend), the previous owner and operator of the Tasmanian electricity transmission network, and
- Aurora Energy Pty Ltd (Aurora), the previous owner and operator of the Tasmanian electricity distribution network.

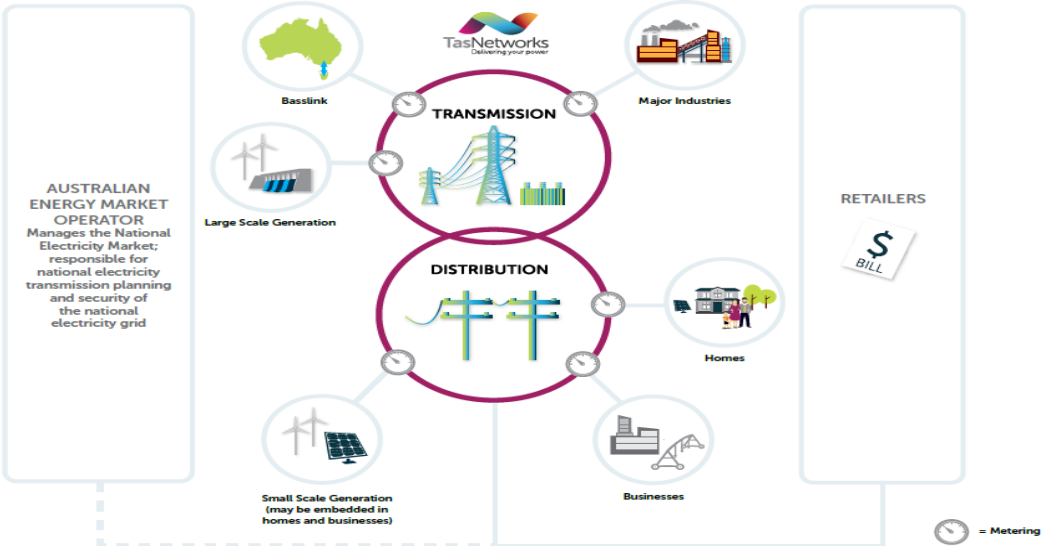
TasNetworks owns, operates and maintains the network that delivers electricity to more than 280,000 households, businesses and organisations on mainland Tasmania.

TasNetworks' integrated network comprises:

- transmission assets, which include 3,516 circuit kilometres of transmission lines; 7,852 transmission line support structures; 49 substations; seven switching stations; two transition stations; 11,176 hectares of easements; and 37 communications repeater sites
- distribution assets, which include approximately 15,100 kilometres of overhead high voltage lines; 5,000 kilometres of overhead low voltage lines; 2,500 kilometres of high and low voltage underground cables; 30,000 ground and pole-mounted substations; and almost 221,000 poles.

Figure 4 below shows TasNetworks' role in Tasmania's electricity supply industry and customer service relationship.

Figure 4 Tasmania's electricity supply industry and TasNetworks' service relationship with customers



Source: TasNetworks, *Regulatory proposal 2017–19*, January 2016, p. 24.

24 TasNetworks, *Regulatory proposal 2017–19*, January 2016, p. 24.

3.3 Regulatory framework

3.3.1 National Electricity Rules

The NER guides our assessment of TasNetworks' regulatory proposal.[25] During our 2013 Better Regulation program we developed, through an extensive consultation process, a number of guidelines. These guidelines accommodated changes to the NEL and NER and set out approaches we consider are most likely to advance the NEO.

3.3.2 AER Guidelines

We developed the following guidelines under our Better Regulation program. These guidelines are available on our website and include:[26]

- **Expenditure forecast assessment guideline**

This guideline sets out how we propose to assess the operating and capital expenditure proposals from businesses.

- **Rate of return guideline**

This guideline sets out how we propose to assess the allowed rate of return businesses earn on their investments.

- **Expenditure incentives guideline**

We have schemes which are designed to create the right incentives to encourage efficient spending by businesses. These schemes are explained in this guideline.

- **Consumer engagement guideline for network service providers**

This guideline looks at our expectations of what the businesses should consider in implementing consumer engagement strategies that are effective for all stakeholders.

- **Shared asset guideline**

This guideline explains how revenue the networks earn from shared assets is shared with consumers.

- **Confidentiality guideline**

This guideline sets out how we manage confidential information claims within the regulatory determination process.

We consulted extensively in developing these guidelines. This consultation process was very important for testing our views and hearing from a range of interested parties. In particular, we made a special effort to engage consumers in the process through our Consumer Reference Group. The guidelines provide a solid foundation for our decision making and

25 The National Electricity Rules can be viewed on the Australian Energy Market Commission's website: http://www.aemc.gov.au

26 http://www.aer.gov.au/Better-regulation-reform-program

provide predictability in how we propose to exercise our discretion. Predictability provides confidence to both investors and consumers.

3.4 Our framework and approach paper

We released our Framework and Approach (F&A) paper for TasNetworks on 9 July 2015. The framework and approach (F&A) paper is the first step in the regulatory process and determines the broad nature of any regulatory arrangements that will apply in this process. It also facilitates early public consultation and assists network service providers to prepare regulatory proposals.

3.5 Total revenue requirement

In accordance with the NER, we must approve the total revenue requirement for a DNSP for a regulatory control period, and the annual revenue requirement for each regulatory year of the regulatory control period, as set out in the DNSP's current building block proposal. [27] That revenue requirement is determined by estimating the efficient costs that the DNSP is likely to incur in providing prescribed distribution services. The underlying cost elements include:

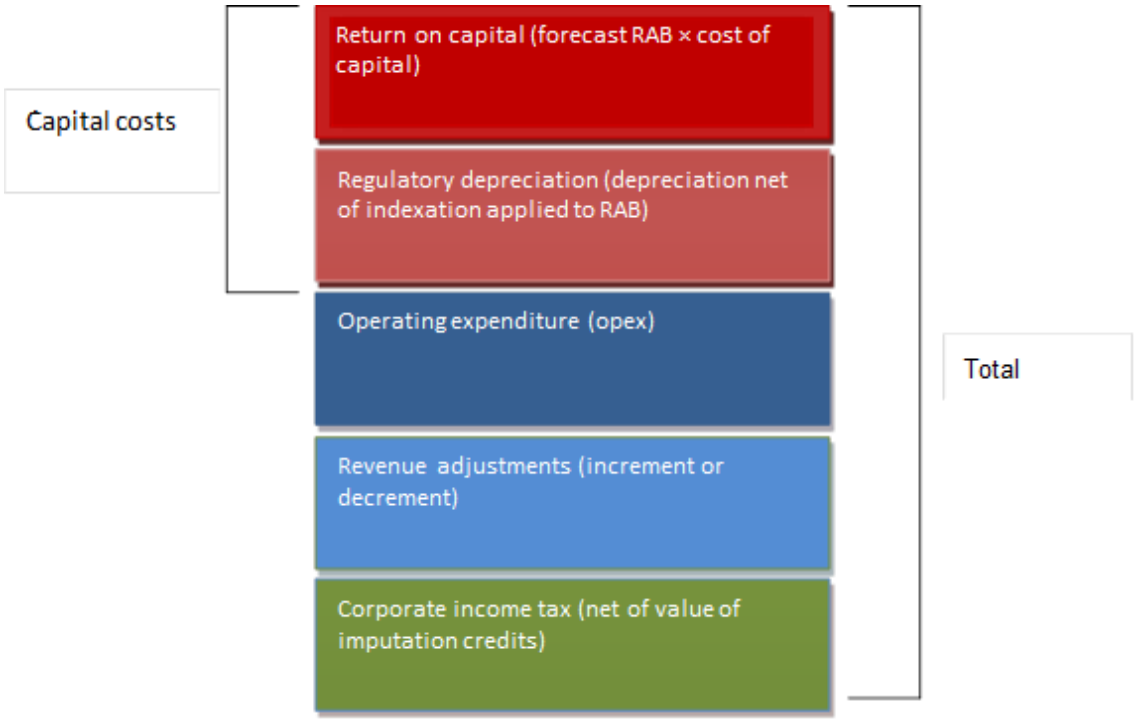
- a return on the regulatory asset base (RAB) (return on capital)
- depreciation of the regulatory asset base (return of capital)
- forecast operating opex
- increments or decrements resulting from the application of incentive schemes
- the estimated cost of corporate income tax.

Our assessment of capex directly affects the size of the RAB and therefore the return on capital and return of capital building blocks.

In our assessment of TasNetworks' regulatory proposal we will consider each of the building blocks shown in Figure 5. However, we must decide TasNetworks' revenue as a whole and describe how the component parts of the decision relate to each other.

27 NER, cl. 6.12.3(d).

Figure 5 The building block approach for determining total revenue allowed revenue



The key drivers of these cost elements in the regulatory proposal are discussed in sections 4 to 7 of this paper.

4 Capital expenditure

Capital expenditure (capex) refers to the capital expenditure incurred in the provision of network services. The most significant elements of total capex are generally network augmentation expenditure (augex), asset replacement expenditure (repex) and connections.

Capex is added to the regulatory asset base (RAB) and so forms part of the capital costs of the building blocks used to determine total required revenue. Under the rules, we must accept the proposed forecast of total capex if we are satisfied it reasonably reflects the capital expenditure criteria (capex criteria) set out in the Rules.[28] The capex criteria relate to the efficient costs incurred by a prudent operator in light of realistic demand forecasts and cost inputs to achieve certain capex objectives set out in the NER. We must have regard to the capex factors in the NER when making that decision.[29]

4.1 How do we assess capex expenditure

Our approach is to compare the service provider's total capex forecast with an alternative estimate that we develop and that reasonably reflects the capex criteria.

If we are satisfied that the service provider's proposal reasonably reflects the capex criteria, we accept it. If we are not satisfied, the rules require us to put in place a substitute estimate which we are satisfied reasonably reflects the capex criteria taking into account the capex factors.[30] Where we have done this, our substitute estimate is based on our alternative estimate.

The assessment techniques that we may adopt to assess TasNetworks' forecasts of total capex are outlined in our expenditure forecast assessment guideline.

4.2 TasNetworks' capex proposal

TasNetworks submitted that its total capex in the current five year period is expected to be $595.3 million ($June 2017) compared to the AER's allowance of $626.7 million ($June 2017), which is a reduction of five per cent.

TasNetworks considers that a five year forecast of its proposed capex provides a transparent comparison with the current regulatory control period.[31] Consistent with that approach, over the next five year period (from 2017–18 to 2021–22), forecast capex is expected to further reduce by 6.6 per cent, to $556.2 million ($June 2017).[32]

When this five year forecast is disaggregated, TasNetworks' total forecast capex for the two year 2017–19 regulatory control period is $235.6 million ($June 2017).

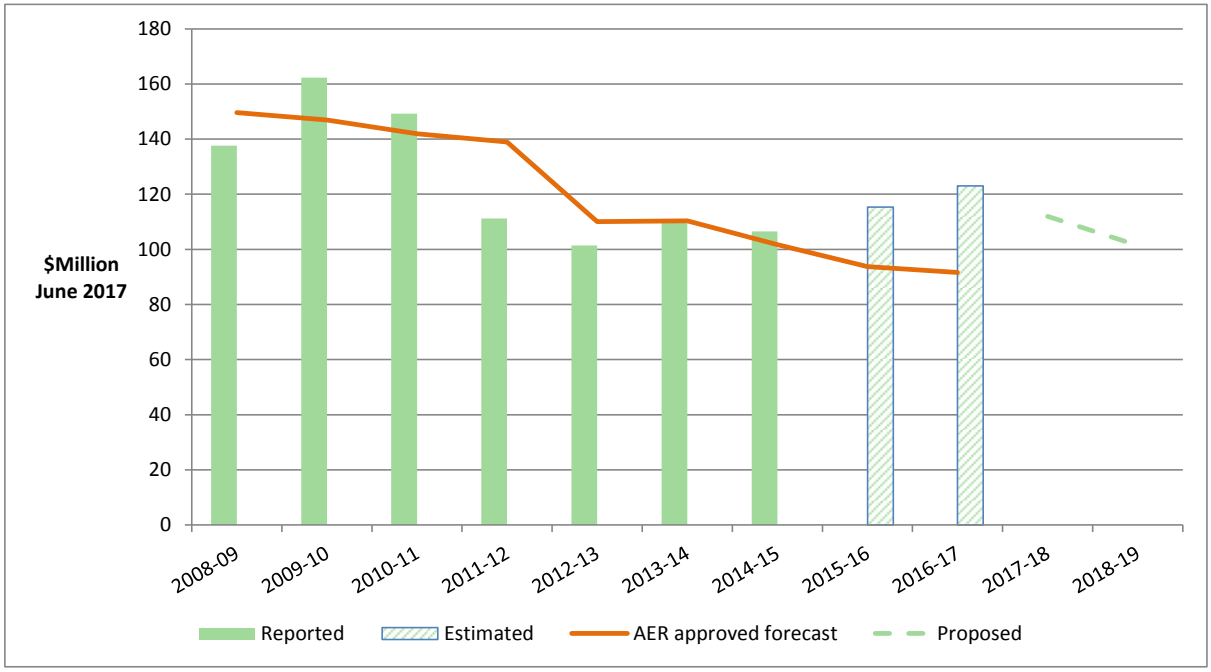
28 NER, cl.6.5.7(c).
29 NER, cl.6.5.7(e).
30 NER, cl.6.5.7(d).
31 TasNetworks, *Regulatory proposal overview*, January 2016, pp. 66, 71.
32 TasNetworks, *Regulatory proposal overview*, January 2016, p. 11.

Figure 6 outlines TasNetworks' proposed capex forecasts, compared to historic levels and capex allowances.

The figure shows that over the current regulatory control period, capex spending gradually increased, and is expected to peak in the 2016–17 regulatory year. Over this 2012–17 period, TasNetworks expects total capex to be five per cent less than the AER allowance. This is despite the unexpected additional capital costs associated with bushfire recovery and investment in the IT systems needed to facilitate full retail competition in Tasmania.[33]

The figure below shows the first two years of the five year capex forecast provided by TasNetworks in its regulatory proposal. TasNetworks' full five year capex forecast is shown in Figure 7.

Figure 6 TasNetworks - Historical and forecast capex ($million, June 2017)



Source: TasNetworks, Regulatory proposal RIN response, January 2016; AER, Final decision PTRM for Aurora 2012-17; TasNetworks (D), Category analysis RIN response 2014-15; TasNetworks (D), Category analysis RIN response 2013-14; Aurora, Category analysis RIN response 2008–13; AER analysis.

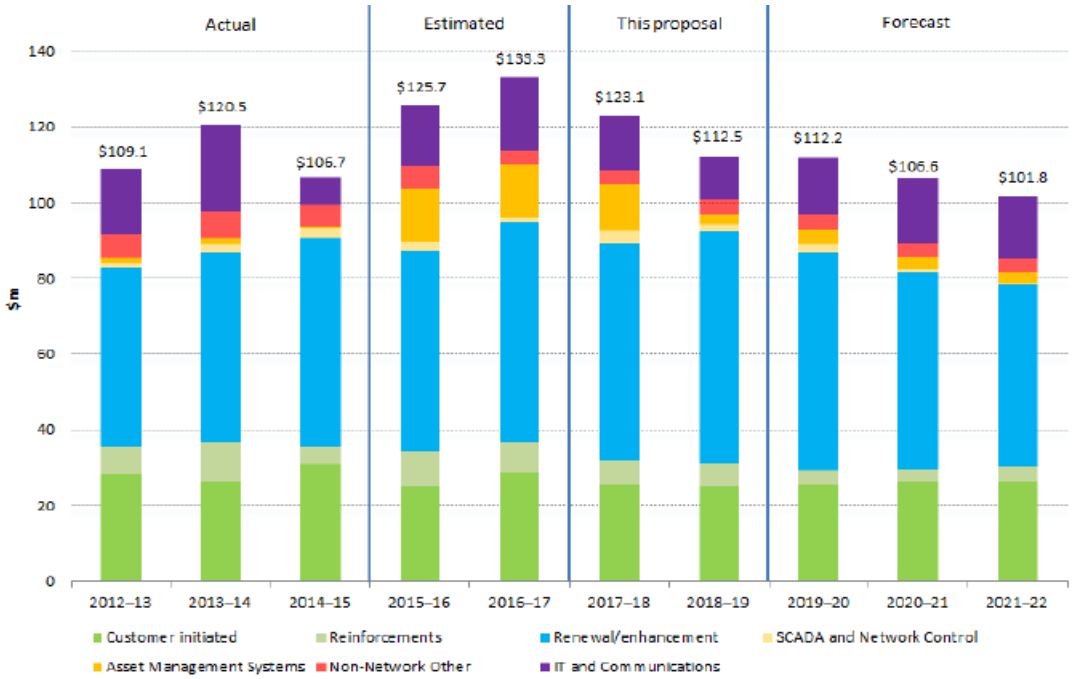
4.3 Key drivers of the capital expenditure proposal

Figure 7 below provides a breakdown by capex category and a comparison with the current regulatory control period gross of capital contributions.[34].

33 TasNetworks, *Regulatory proposal*, January 2016, p. 11.

34 TasNetworks, *Regulatory proposal*, January 2016, pp. 71–72.

Figure 7 TasNetworks - Overview of forecast and actual capex ($million, June 2017)



Source: TasNetworks, *Regulatory proposal*, January 2016, pp. 11, 72.

The key capex drivers as outlined in TasNetworks' regulatory proposal are summarised below:

- **Development capex:** TasNetworks' development capex forecast for the five year period commencing 1 July 2017 is $152.9 million ($June 2017) compared to the actual capex of $179.6 million ($June 2017) for the current regulatory control period. The forecast shows a reduction of $26.7 million ($June 2017) or 14.9 per cent.[35] Two components of development capex are:
    - **Customer initiated capex:** Over the current regulatory control period, actual capex inclusive of customer capital contribution totalled $139.9 million ($June 2017). TasNetworks' forecast for the forthcoming five year period is $128.7 million ($June 2017), which is $11.2 million (8 per cent) lower.[36]
    - **Reinforcement capex:** TasNetworks' total reinforcement capex for the current regulatory control period is expected to be $39.8 million ($June 2017). The forecast capex for the forthcoming five year period is $24.1 million ($June 2017), which is $15.7 million (39.4 per cent) less than the amount spent in the current regulatory control period.[37]
- **Renewal/enhancement capex:** TasNetworks' total renewal and enhancement capex in the current regulatory control period is $263.3 million ($June 2017). For the forthcoming five year period, TasNetworks is forecasting an increase of $12.9 million (4.9 per cent) in

35 TasNetworks, *Regulatory proposal*, January 2016, pp. 74–75.
36 TasNetworks, *Regulatory proposal*, January 2016, p. 75.
37 TasNetworks, *Regulatory proposal*, January 2016, p. 77.

expenditure to $276.2 million ($June 2017). TasNetworks considers that the need for increased expenditure is driven mainly by the need to address increased safety and reliability risks associated with age-related asset deterioration.[38]

- **Operational Support Systems:** TasNetworks' total operational support systems capex for the current regulatory control period is expected to be $41.4 million ($June 2017). The forecast capex for the forthcoming five year period is $33.7 million ($June 2017), which is $7.7 million ($June 2017) or 18.6 per cent less than the amount spent in the current regulatory control period. Two components of operational support systems capex are:
    - **SCADA and Network Control Systems:** SCADA[39] and Network Control capex is forecast to decrease slightly from $9.6 million ($June 2017) in the current regulatory control period to $8.9 million ($June 2017) in the forthcoming five year period.[40]
    - **Asset Management System (AMS):** TasNetworks is planning to decrease AMS capex from a total of $31.7 million ($June 2017) in the current regulatory control period to $24.9 million ($June 2017) over the forthcoming five year period.[41]
- **Non-Network Other:** TasNetworks' total non-network other capex is forecast to reduce from $28.7 million ($June 2017) in the current regulatory control period to $18.5 million ($June 2017) over the forthcoming five year period.[42]
- **IT and Communications:** TasNetworks total IT and communication capex is forecast to reduce from $82.0 million ($June 2017) in the current regulatory control period to $74.7 million ($June 2017) in the forthcoming five year period.[43] This shows a reduction of 8.9 per cent compared to the amount spent in the current regulatory control period.

4.4 Regulatory asset base

A distributors' regulated asset base (RAB) is the outcome of its cumulative capex spending. TasNetworks submitted that its regulatory asset base as at 1 July 2017 is derived by:

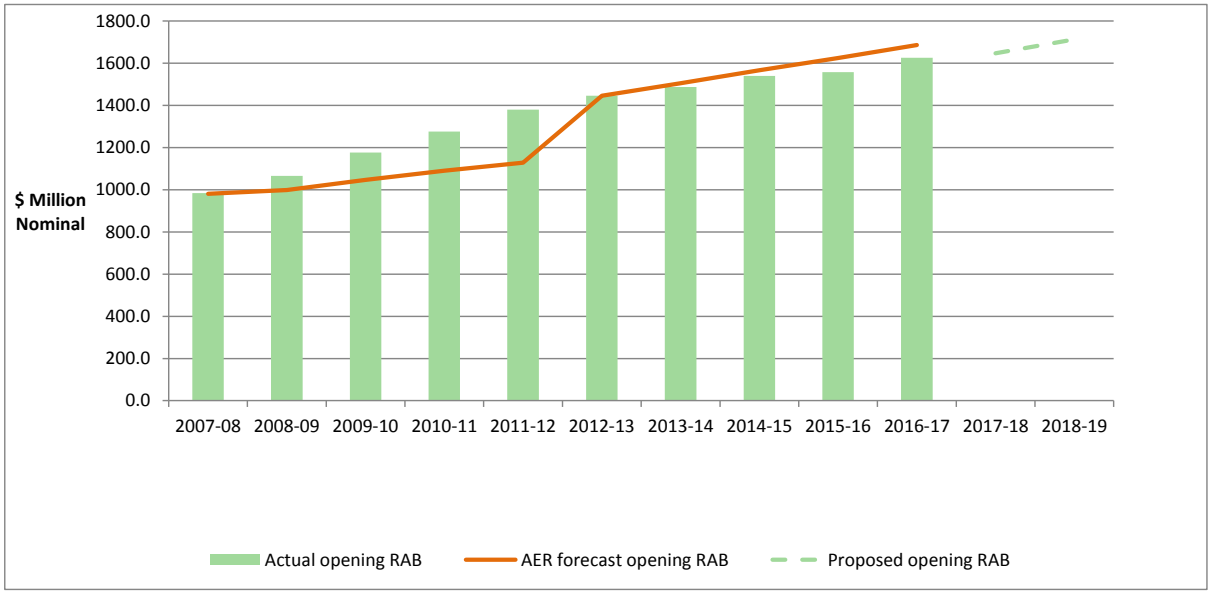
- adjusting for any difference between forecast and actual capex that is embedded in the 1 July 2012 opening value of $1445.2 million ($ nominal)
- rolling forward the 1 July 2012 value for actual additions, disposals, inflation escalation and deductions of actual depreciation using the AER's roll forward model.

The closing RAB value as at 1 July 2017 is $1646.7 million ($ nominal). TasNetworks stated that in accordance with the Rules, only actual and estimated capex properly allocated to the provision of standard control distribution services has been included in the RAB. The

38 TasNetworks, *Regulatory proposal*, January 2016, pp. 78–79.
39 Supervisory, Control and Data Acquisition) systems (SCADA).
40 TasNetworks, *Regulatory proposal*, January 2016, pp. 80–81.
41 TasNetworks, *Regulatory proposal*, January 2016, p. 82.
42 TasNetworks, *Regulatory proposal*, January 2016, p. 84.
43 TasNetworks, *Regulatory proposal*, January 2016, p. 85.

forecast closing RAB at the end of 2017–19 regulatory control period is $1763.2 million ($ nominal).[44]

Figure 8 TasNetworks - Regulatory Asset Base ($million, nominal)



Source: TasNetworks, Regulatory proposal PTRM, January 2016; AER, TasNetworks, Regulatory proposal RFM, January 2016; AER, Final decision PTRM for Aurora 2012-17, AER, Final decision RFM for Aurora 2012-17; AER analysis.

Questions

1. Do you consider that TasNetworks has sufficiently justified its capex proposal?

2. Do you consider that TasNetworks has adequately considered customer views in developing its capex proposal?

44 TasNetworks, *Regulatory proposal*, January 2016, pp. 107–109.

5 Operating expenditure

Operating expenditure (opex) refers to the operating, maintenance and other non-capital expenditure incurred in the provision of network services. It includes labour costs and other non-capital costs that a prudent service provider is likely to require for the efficient operation of its network.

Opex is one of the building blocks used to determine TasNetworks' total revenue requirement. Under the rules, we must accept a service providers' forecast of total opex if we are satisfied it reasonably reflects the opex criteria.[45] The opex criteria relate to the efficient costs incurred by a prudent operator in light of realistic expectations of the demand forecast. We must have regard to the opex factors when assessing the distributor's forecast opex.[46]

Under the Rules, if we are not satisfied a service providers' opex proposal reasonably reflects the opex criteria, we must not accept it.[47] We must estimate the total required opex that, in our view, reasonably reflects the opex criteria taking into account the opex factors.

5.1 How we assess operating expenditure

We have outlined our approach to assessing the service providers' forecasts of total opex in our expenditure forecast assessment guideline.[48]

Our approach is to compare the service provider's total forecast opex with an alternative estimate that we develop and that reasonably reflects the opex criteria.[49] By doing this we form a view on whether we are satisfied that the service provider's proposed total forecast opex reasonably reflects the opex criteria. If we conclude the proposal does not reasonably reflect the opex criteria, we use our estimate as a substitute forecast.

Our estimate is unlikely to exactly match the service provider's forecast because it may not adopt the same forecasting method. However, if the service provider's inputs and assumptions are reasonable, its method should produce a forecast consistent with our estimate.

If a service provider's total forecast opex is materially different to our estimate and we find there is no satisfactory explanation for this difference, we may form the view that the service provider's forecast does not reasonably reflect the opex criteria. Conversely, if our estimate demonstrates that the service provider's forecast reasonably reflects the expenditure criteria, we will accept the forecast.[50]

45 NER, cl.6.5.6(c).
46 NER, cl.6.5.6(e).
47 NER, cl.6.5.6(d).
48 AER, *Expenditure forecast assessment guideline*, November 2013.
49 AER, *Expenditure forecast assessment guideline*, November 2013, p. 7.
50 NER, cl.6.5.6(c).

5.2 TasNetworks' operating expenditure proposal

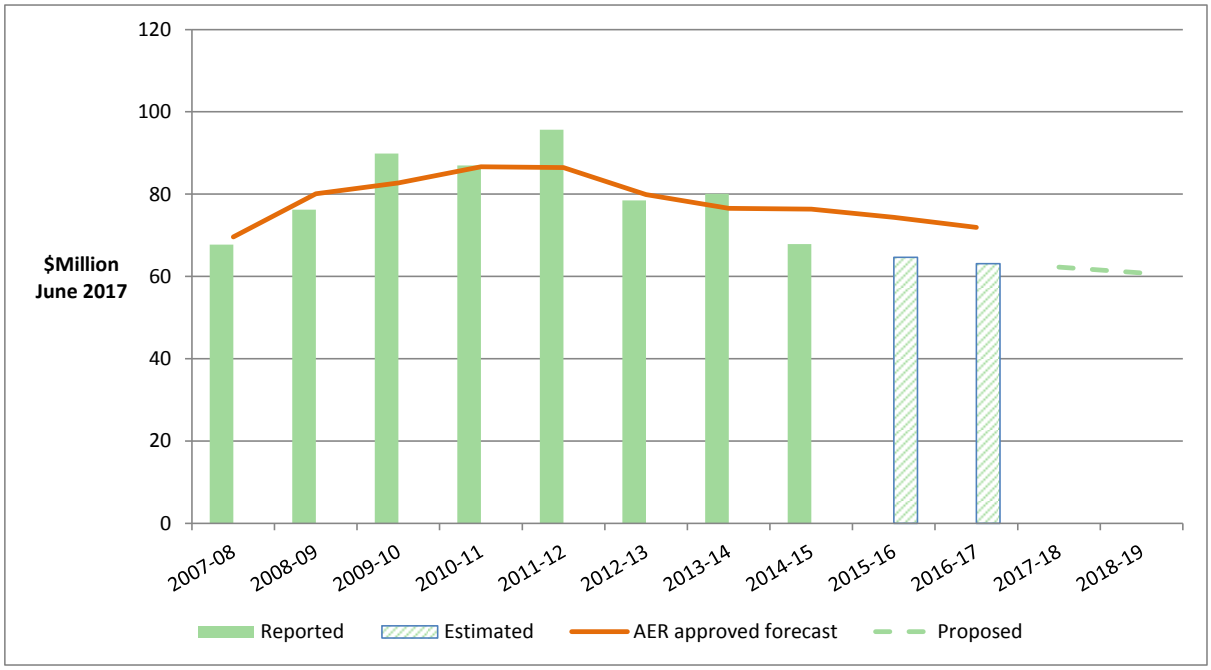
TasNetworks proposed total opex of $123.1 million ($June 2017) for the 2017–19 regulatory control period.[51] This is approximately 13.1 per cent lower in real terms than its average expenditure for the current regulatory control period. [52]

TasNetworks submitted that it has adopted the AER's 'base-step-trend' approach when developing its opex forecasts. This methodology projects future expenditure by building from an efficient base year. It is a simple method that is effective in identifying the opex drivers for the forecast period.[53]

TasNetworks submitted that in contrast to its capex forecasts, the opex forecasts are limited to the two year regulatory control period. By extending its opex forecast beyond the two-year regulatory control period would not provide any additional context or insights regarding the reasonableness of the forecast.[54]

Figure 9 below shows TasNetworks' actual opex for the current regulatory period alongside its forecast for the 2017–19 regulatory control period. It also shows that TasNetworks costs are reducing in real terms, reflecting the expected efficiency savings in the forthcoming regulatory period.

Figure 9 TasNetworks - Operating expenditure ($million, June 2017)



Source: TasNetworks, Regulatory proposal RIN response, January 2016; AER, Final decision PTRM for Aurora 2012–17; TasNetworks (D), Economic Benchmarking RIN response 2014–15; TasNetworks (D), Economic Benchmarking RIN response 2013–14; Aurora, Economic Benchmarking RIN response 2006–13; AER analysis.

51 TasNetworks, *Regulatory proposal*, January 2016, pp. 12–13.
52 TasNetworks, *Regulatory proposal*, January 2016, pp. 12–13.
53 TasNetworks, *Regulatory proposal*, January 2016, p. 90.
54 TasNetworks, *Regulatory proposal*, January 2016, p. 90.

TasNetworks submitted that it has chosen the 2014–15 regulatory year as the base year for determining the recurrent component of the opex forecast because:[55]

- it is the most recent full regulatory year of actual reported opex at the time of preparing its regulatory proposal
- it is representative of underlying operating conditions for the current and forthcoming regulatory periods
- it incorporates the efficiency gains that TasNetworks has achieved to date
- its selection is consistent with the design of the incentive mechanisms, which provides a constant incentive to deliver efficiency savings.

TasNetworks submitted that it has derived a base year efficient opex of $66.0 million ($June 2017) based on its audited opex of $68.0 million ($June 2017) for 2014–15 regulatory year.[56]

TasNetworks submitted that the AER's benchmarking analysis provides strong evidence that its base year opex is efficient. [57]

5.3 Key drivers of the operating expenditure proposal

The key opex drivers as outlined in TasNetworks' regulatory proposal are summarised below:[58]

- **Step changes:** TasNetworks stated that the base year opex reflects the scope of the distribution business activities in 2014–15. However, the scope of its business activities and obligations may change in the 2017–19 regulatory control period, resulting in increases or decreases in its forecast of recurrent opex. These changes in costs are termed 'step changes'. TasNetworks forecast additional expenditure above the base year opex of $4.1 million ($June 2017) for the 2017–19 regulatory control period.[59] TasNetworks has proposed negative step changes (meaning costs are removed from base year opex) for costs associated with damage to assets caused by third parties and the removal of self-insurance expenses. The proposed positive step changes causing the increase in base year opex include:
    - increase in access track and corridor maintenance
    - increase in inspection of overhead lines and structures
    - increase in low conductor span rectification[60]
- **Output growth:** TasNetworks stated that its opex requirements increase as the size of the distribution business grows, both in terms of assets and customer numbers. However, there is not a simple one-for-one relationship between business growth and its

55 TasNetworks, *Regulatory proposal*, January 2016, p. 96.
56 TasNetworks, *Regulatory proposal*, January 2016, pp. 96–97.
57 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 97.
58 TasNetworks, *Regulatory proposal 2017–19,* January 2016, pp. 96–106.
59 TasNetworks, *Regulatory proposal 2017–19,* January 2016, pp. 99–100.
60 TasNetworks, *Regulatory proposal 2017–19,* January 2016, pp. 99–100

operating costs, as a result of economies of scale. TasNetworks forecast output growth above the base year opex of $3.0 million ($June 2017) for the 2017–19 regulatory control period.[61]

- **Zero based expenditure items:** TasNetworks stated that any zero based expenditure items are subject to a separate forecast on the grounds that the base year expenditure does not reflect the recurrent costs. For the purpose of 2017–19 regulatory control period there are no such items.[62]
- **Real price escalation:** TasNetworks stated that this component of the rate of change calculation captures the impact of the increases in the prices of its inputs, which feed through to higher opex.

  TasNetworks stated that it engaged Jacobs to estimate non-labour cost escalation rates. Across all of its distribution asset categories, Jacobs forecasts the average non-labour cost escalation rate to be 3.3 per cent in nominal terms for the period to 2022, compared to a forecast CPI of 2.5 per cent over the same period. [63]
- **Productivity growth:** TasNetworks submitted that it is targeting and offering further efficiency gains. It has incorporated these expected efficiencies into opex forecast. This reflects its response to the feedback of customers and other stakeholders, who reasonably expect the merger of the transmission and distribution networks to deliver further cost savings. TasNetworks considers it appropriate to forecast a productivity gain over the 2017–19 regulatory control period that delivers a cumulative total cost saving of $32.8 million ($June 2017) in real terms over the four years from 2015–16 to 2018–19, relative to the 2014–15 efficient base year costs.[64]
- **Other expenditure items:** TasNetworks submitted that two 'other' expenditure items must be included to derive a forecast of efficient opex for the 2017–19 regulatory control period. These items are:[65]
  - a self-insurance allowance of $0.9 million ($June 2017) per annum
  - a benchmark debt raising cost allowance of $1.1 million ($June 2017) per year.

Questions

3. Do you consider that TasNetworks has sufficiently justified its opex proposal?

4. Do you consider that TasNetworks has adequately considered customer views in developing its opex proposal?

61 TasNetworks, *Regulatory proposal 2017–19,* January 2016, pp. 100–102.
62 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 102.
63 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 102.
64 TasNetworks, *Regulatory proposal 2017–19,* January 2016, pp. 103–104.
65 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 104.

6 Rate of return

The allowed rate of return is the forecast cost of funds a distribution business requires to invest in the network. To estimate this cost, we consider the cost of the two sources of funds for investments-equity and debt. The return on equity is the return shareholders of the business require to attract new investment. The return on debt is the interest rate the business pays when it borrows money to invest in capex. We consider that efficient distribution network businesses would fund their investments by borrowing 60 per cent of the required funds, while raising the remaining 40 per cent from equity.

We published our Rate of Return guideline in December 2013.[66] It sets out the method we propose to use to estimate the allowed rate of return for electricity and gas network businesses. The Rate of Return guideline is not binding, but if a business seeks to depart from it, the business must include reasons in its proposal for doing so. If we seek to depart from its guideline when making our draft or final decision, we must also include reasons for doing so.

6.1 TasNetworks' proposed overall rate of return

TasNetworks submitted that its rate of return proposal is consistent with the AER's rate of return guideline and therefore the AER should accept the resulting WACC estimate, subject to the outcomes of the NSW, ACT and South Australian distributors' appeals.[67]

TasNetworks has proposed a rate of return of 6.04 per cent.

This comprises:

- 7.30 per cent return on equity
- 5.20 per cent return on debt
- 60 per cent gearing.

TasNetworks indicated it would revisit this in its revised proposal in light of the Tribunal's findings and the AER's draft decision. [68]

6.2 Return on equity (RoE)

Recognising there is not one perfect model to estimate the return on equity, our rate of return guideline approach draws on a variety of models and information which we have assessed as relevant. Our starting point is the standard capital asset pricing model (CAPM)—our 'foundation model.' We then use a range of models, methods, and information to inform our return on equity estimate. We use this information to either set the range of inputs into the CAPM foundation model or assist in determining a point estimate within the range of estimates of overall return on equity resulting from the CAPM foundation model.

66 AER, *Rate of return guideline*, December 2013.
67 TasNetworks, *Regulatory proposal*, January 2016, pp. 116–119.
68 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 114.

We propose to use the Sharpe–Lintner capital asset pricing model (SLCAPM) as the foundation model, which runs as follows:

- The SLCAPM is estimated by adding to the risk free rate the product of the equity beta and market risk premium (MRP).
- Our approach is to estimate the risk free rate based on market conditions that prevail as close as possible to the commencement of the regulatory control period.
- Our point estimates for equity beta is 0.7.
- As at December 2013, our point estimate for MRP is 6.5.

The range and point estimate for the expected return on equity is calculated based on the range and point estimates from the corresponding input parameters. For example, the lower bound of the expected return on equity range is calculated by applying the point estimate for the risk free rate and the lower bound estimates of the equity beta and MRP. A probability will not be assigned to values within the range, but it will not be assumed that all values within the range are equally probable.

TasNetworks' RoE proposal

TasNetworks submitted that in estimating the WACC (including ROE) for this regulatory proposal, it has applied the AER's rate of return guideline.[69]

6.3 Return on debt (RoD)

The AER rate of return guideline sets out a new methodology for the estimation of the return on debt. This methodology departed from previous practice in two key respects:

- First, the AER proposed to estimate the RoD by gradually transitioning from the current "on-the-day" approach to a "trailing average" approach. The on-the-day approach resets the return on debt allowed based on prevailing interest rates around the start of the regulatory period. Under the trailing average approach the return on debt is estimated as the simple average of the historic rate of return on ten-year debt during a period in time in each of the last ten years.
- Second, the AER proposed to allow the RoD to vary from year to year during the regulatory period.

TasNetworks' RoD proposal

TasNetworks submitted that in estimating the WACC (including ROD) for this regulatory proposal, it has applied the AER's rate of return guideline.[70]

69 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 116–119.

70 TasNetworks, *Regulatory proposal 2017–19,* January 2016, p. 116–119.

6.4 Value of imputation credits

In the building block model an allowance is made for the estimated tax paid by the benchmark firm. In Australia companies typically pay tax at the rate of 30 per cent on their profit. However, under the Australian taxation system, investors can receive an 'imputation credit' for income tax paid at the company level. For investors that meet certain eligibility criteria, this credit can be used to offset their tax liabilities. If the amount of imputation credits received exceeds an investor's tax liability, that investor can receive a cash refund for the balance. Imputation credits are a benefit to investors in addition to any cash dividend or capital gains from owning shares.

The rate of return guideline proposes that the value of imputation credits would be estimated as a market-wide parameter, rather than estimating this on an industry or business specific basis. Under the guideline, it would be determined as the product of:

- a distribution rate (referred to in our guideline as the 'payout ratio'), which represents the proportion of imputation credits generated by the benchmark entity that is distributed to investors
- a utilisation rate, which is the extent to which investors can use the imputation credits they receive to reduce their tax or to get a refund.

In the guideline, our assessment of this evidence produced an estimate of 0.7 for the utilisation rate and 0.7 for the distribution rate. The guideline therefore proposed an estimate of 0.5. However, in the recent NSW determinations we re-examined the evidence and clarified our understanding of the utilisation rate as the utilisation value to investors in the market per dollar of imputation credits distributed. This re-examination, in addition to new evidence and advice considered since the guideline, led us to depart from the 0.5 value of imputation credits we proposed in the guideline. Instead, we chose a value for imputation credits of 0.4 from within a range of 0.3 to 0.5.

TasNetworks' proposal

TasNetworks has departed from the AER's rate of return guideline with respect to gamma. TasNetworks submitted that for the purpose of this regulatory proposal, it has applied the estimation method and input values adopted by the Australian Competition Tribunal in its 2011 findings in appeals relating to gamma.[71] TasNetworks has therefore, adopted a value of gamma of 0.25, compared to guideline's estimate of 0.5.[72]

Questions

5. Do you have any comments on TasNetworks' proposed approach to calculating the rate of return?

6. Do you agree with TasNetworks' proposal to use a gamma value of 0.25 in valuing imputation credits?

71 TasNetworks, *Regulatory proposal*, January 2016, pp. 120–121.

72 TasNetworks, *Regulatory proposal*, January 2016, pp. 120–121.

7 Service Target Performance Incentive Scheme

The Service target performance incentive scheme (STPIS) provides a financial incentive to distributors to maintain and improve service performance. The STPIS aims to safeguard service quality for customers against incentives for the distributors to seek out cost efficiencies.

As outlined in TasNetworks' final F&A, our proposed approach is to continue to apply the national STPIS to TasNetworks in the 2017–19 regulatory control period. In the F&A we proposed to maintain revenue at risk for TasNetworks within the range ±5 per cent.[73]

7.1 TasNetworks' STPIS proposal

TasNetworks submitted that it support the AER's proposed STPIS approach, with the exception of the revenue at risk. TasNetworks stated that its customer consultation has found that customers do not want to pay for improvements in reliability. Customers want TasNetworks to maintain existing performance. and also support measures to reduce annual price volatility.

TasNetworks submitted that the AER's proposed rate of revenue at risk in relation to distribution service performance is five times greater than its service incentive for transmission services. TasNetworks doubts whether a difference of this scale is warranted. As TasNetworks is an integrated transmission and distribution business, the interaction between the two schemes needs to be reconsidered.

In light of the issues raised above, TasNetworks proposed an incentive payment of ± 2.5 per cent. TasNetworks stated that the AER has recently accepted Ergon Energy and Energex's proposals to cap revenue at risk under the scheme at ± 2.0 per cent.[74]

Questions

7. Do you agree with TasNetworks' proposal for an incentive payment of ± 2.5 per cent?

73 AER, *Final Framework and approach*, July 2015, pp. 58–63.

74 TasNetworks, *Regulatory proposal*, January 2016, pp. 125–126.

8 Consumer engagement

This section summarises the consumer engagement strategies and activities described by TasNetworks in its regulatory proposal. We consider this is a valuable resource for readers to get a sense of TasNetworks' consumer engagement approaches. However, we also encourage consumers to review the consumer engagement material contained in TasNetworks' regulatory proposal and make submissions.

When assessing the regulatory proposal we will have regard to how a business engaged with its consumers and accounted for their long term interests.

8.1 Consumer engagement in the NER

Under the NER, consumer engagement is a factor we can consider when making our distribution determinations.[75] We will examine whether and how well a distribution business considered and responded to consumer views, equipped consumers to participate in consultation, made issues tangible and obtained a cross-section of views. We will make our assessment on a case-by-case basis, considering whether it would have been reasonable to engage on a particular issue. We will monitor consumer engagement activities through our consumer challenge panel and by our ongoing engagement with stakeholders. We may publicly comment on any shortcomings in a businesses' consumer engagement that we identify from a regulatory proposal.

Our obligation to have regard to the extent to which a distribution businesses' forecast includes expenditure to address the concerns of consumers forms part of our overall task of determining whether the distribution businesses' proposed forecasts reasonably reflect the efficient and prudent costs of achieving the capex (or opex) objectives.[76] Therefore, if proposed expenditure is not required to achieve one or more of the capex (or opex) objectives, even with evidence of consumer support we will not be satisfied that the proposed expenditure reasonably reflects the capex and opex criteria.

Furthermore, the extent to which the proposed forecasts include expenditure to address the concerns of consumers during the course of its engagement with consumers is only one of nine or more factors that we must have regard to in determining whether we are satisfied that the proposed capex (or opex) reasonably reflects the capex (or opex) criteria.[77] In this sense, the factor relating to consumer engagement alone is not determinative.[78]

If a distribution business submits that particular expenditure programs will address the concerns of consumers identified through its consumer engagement, we will consider whether such claims are supported by solid evidence of the preferences of affected consumers. This may include consideration of whether the engagement was sufficient to identify key areas of consumer concern, whether consumers have been adequately informed

75 NER, cl. 6.5.6(e)(5A), cl. 6.5.7(e)(5A).
76 NER, cl. 6.5.6(e)(5A).
77 NER, cl. 6.5.6(e)(5A).
78 NER, cl. 6.5.6(e)(5A).

of relevant price implications, and how the expenditure proposed would address those customer concerns.

Recent changes to the NER provide further support for consumer involvement in the regulatory process, and enable us to engage more productively with energy consumers and businesses.[79] Chapter 6 of the NER was amended to, among other things, require:

- distributors to submit an overview with their regulatory proposal which describes how they have engaged with consumers and sought to address any relevant concerns identified by that engagement.[80]
- the AER to publish an issues paper after receiving the distributor's regulatory proposal. The purpose of the issues paper is to assist consumer representative groups to focus on the key preliminary issues on which they should engage and comment.[81]

8.2 Our consumer engagement guideline

Our consumer engagement guideline sets out a framework for electricity and gas network service providers to better engage with consumers. It aims to help the businesses develop strategies to engage systematically, consistently and strategically with consumers on issues that are significant to both parties. The guideline sets out our expectations when considering service provider consumer engagement activities:

Priorities—we expect service providers to identify consumer cohorts, and the current views of those cohorts and their service provider; outline their engagement objectives; and discuss the processes to best achieve those objectives.

Delivery—we expect service providers to address the identified priorities via robust and thorough consumer engagement.

Results—we expect service providers to articulate the outcomes of their consumer engagement processes and how they measure the success of those processes reporting back to us, their business and consumers

Evaluation and review—we expect service providers to periodically evaluate and review the effectiveness of their consumer engagement processes.

Below, we summarise TasNetworks' approach to consumer engagement. For details, we encourage readers to review TasNetworks' regulatory proposal and supporting documentation.

8.3 TasNetworks' consumer engagement strategy

In its regulatory proposal, TasNetworks has outlined its consumer engagement strategy as summarised below:[82]

79 AEMC, Rule determination, National Electricity Amendment (Economic Regulation of Network Service Providers) Rule 2012.

80 NER, cl. 6.8.2(c1)(2).

81 NER, cl. 6.9.3(b).

82 TasNetworks, *Regulatory proposal,* January 2016, pp. 36–41.

- TasNetworks is committed to engaging with, informing and educating its customers about its activities and plans for the future.
- TasNetworks' customer strategic goal is to ‘understand its customers and make them central to all it do’, with the ultimate aim of improving price, service and reliability outcomes for customers.
- TasNetworks must understand and respond to each of its customer segments in order to deliver service propositions that meet their varied needs.
- TasNetworks has developed a ‘Voice of the Customer Program’ to sharpen its focus on delivering quality service outcomes for its customers.
- Through its Voice of the Customer program, focus on customers will
    - help TasNetworks to provide quality service outcomes for our customers
    - enable the successful achievement of its vision, which is: to be trusted by its customers to deliver today and create a better tomorrow.[83]

8.3.1 TasNetworks' revenue reset engagement plan

TasNetworks submitted that to inform its revenue reset activities, it gathered information and feedback from its customers and other stakeholders in a variety of different ways. The key milestones of its customer engagement activities under the plan are outlined below.[84]

- First round of customer engagement workshops held in October 2014
- Workshop with a number of stakeholder groups held in October 2014
- Established a Tariff Reform Working Group
- Participated in Agfest rural symposium in May 2015
- Quantitative research - telephone and online surveys were conducted by an external facilitator in May 2015
- Second round of customer engagement workshops held in June 2015
- System planning engagement held with representatives of developers, customers and external planning bodies from April to December 2015
- Direction and priorities consultation paper - insights collected through TasNetworks' engagement activities, along with its knowledge of the network, future trends and regulatory obligations.

8.3.2 Summary of customer feedback

TasNetworks submitted that it has undertaken a range of activities to gather feedback, and to understand the issues and concerns that are important to its customers. The key

83 TasNetworks, *Regulatory proposal,* January 2016, pp. 36–41.
84 TasNetworks, *Regulatory proposal,* January 2016, pp. 37–40.

messages emerging from the customer engagement as outlined in TasNetworks' regulatory proposal are summarised below:[85]

- TasNetworks is meeting most customers' needs from an overall performance perspective.
- Its most valued services include reliability and restoration of supply, followed by the management of the network to safely and reliably deliver electricity.
- Overall satisfaction with current reliability levels is quite high. The majority of customers support TasNetworks' proposed strategy to maintain reliability rather than investing more to improve it.
- While improvements in reliability and outage response could strengthen satisfaction, customers are not willing to pay higher prices for these improvements.
- Cost is the greatest concern and lower prices – without reducing service quality – would lead to the greatest uplift in satisfaction.
- Customers recognise that technology is changing the electricity industry, particularly in relation to solar PVs, battery storage and electric vehicles.

In relation to areas for improvement, customers highlighted the following issues:

- providing services at lower cost without compromising service quality
- providing customers with better information about restoration times
- addressing meter reading concerns
- addressing quality of supply issues such as voltage complaints
- ensuring that customers or stakeholders have sufficient information to make informed decisions on TasNetworks' future plans and network pricing reform
- improving the way TasNetworks' communicate with its stakeholders on how it is innovating and considering new technologies
- using more responsive and modern communication tools (for example SMS automatic messaging for outage updates) and improved online communication, especially for outages.

TasNetworks has recognised that there are many opportunities for it to improve the way it engage and communicate with its customers.[86]

Question

8. Please provide your comments on the quality of the consumer engagement conducted by TasNetworks in preparing its regulatory proposal.

85 TasNetworks, *Regulatory proposal,* January 2016, pp. 40–41.

86 TasNetworks, *Regulatory proposal*, January 2016, p.41.

9 Summary of questions

Questions

1. Do you consider that TasNetworks has sufficiently justified its capex proposal?

2. Do you consider that TasNetworks has adequately considered customer views in developing its capex proposal?

3. Do you consider that TasNetworks has sufficiently justified its opex proposal?

4. Do you consider that TasNetworks has adequately considered customer views in developing its opex proposal?

5. Do you have any comments on TasNetworks' proposed approach to calculating the rate of return?

6. Do you agree with TasNetworks' proposal to use a gamma value of 0.25 in valuing imputation credits?

7. Do you agree with TasNetworks' proposal for an incentive payment of ± 2.5 per cent?

8. Please provide your comments on the quality of the consumer engagement conducted by TasNetworks in preparing its regulatory proposal.