18 May 2018

Mr Chris Pattas
General Manager
Australian Energy Regulator
By email: tasnetworks2019@aer.gov.au

Dear Mr Pattas

Submission on TasNetworks' Distribution and Transmission Determination 2019-24

Aurora Energy welcomes the opportunity to provide feedback on TasNetworks' Transmission Revenue and Distribution Regulatory Proposal (regulatory proposal) for the five years commencing 1 July 2019. Aurora Energy is a Tasmanian Government owned energy retailer, providing energy services to over 99 per cent of Tasmania's electricity customers. As TasNetworks' largest customer, Aurora Energy supplies 279,636 Tasmanian residential and business customers. Aurora Energy's core focus is on its customers, by creating valued outcomes and providing sustainable returns to the Tasmanian community.

Aurora Energy provides in-principle support for the six key themes guiding TasNetworks' regulatory proposal, in particular the theme "*delivering services for the lowest sustainable cost*". Energy affordability continues to be a significant issue for Tasmanians, with energy costs comprising a much higher share of household income, on average, than any other National Energy Market jurisdiction. Aurora Energy is committed to delivering value and support to all of its Tasmanian customers, including supporting vulnerable Tasmanian customers through its Your Energy Support (YES) Program, which helps customers remain connected with energy saving tips and tools, budgeting advice and tailored and flexible payment plans for immediate and long term relief.

As noted in the Issues Paper released by the Australian Energy Regulator (AER), the cost of network charges is the most significant component of the electricity bills paid by Tasmanian customers, and is ultimately recovered through electricity retail charges. It is important for the AER to be cognisant of the following current context for retail pricing in Tasmania when considering TasNetworks' regulatory proposal.

- Despite full retail competition commencing in Tasmania in 2014, Aurora Energy remains the sole residential retailer in the State, and is required to offer regulated standard retail (standing offer) contracts. The Tasmanian Economic Regulator (TER) sets the maximum prices that Aurora Energy can charge its regulated customers.

- In 2017-18, the Tasmanian Government acted to cap average electricity price increases for Tasmanian households at two per cent for 2017-18, and is currently in the process of legislating to cap price increases at the Consumer Price Index (CPI) for the next three years. This prohibits Aurora Energy's ability to pass through cost-reflective movements in network prices to customers.

Aurora Energy is supportive of TasNetworks' actions to reduce its revenue requirement since preliminary estimates were presented in the Directions and Priorities Consultation Paper. However, Aurora Energy notes that the final estimated price movements for an average small customer are still above assumed inflation (average increases of 2.5 per cent for small customers, which is 0.05 per cent above the assumed inflation rate). Additionally, there is a high risk that the network prices will increase above this baseline due to the potential for increases in the cost of debt throughout the period, reduction in consumption below the current forecast or the triggering of a contingent transmission capex project. Aurora Energy is of the view that TasNetworks should seek to achieve price increases no higher than assumed inflation, consistent with the Tasmanian Government policy to cap electricity price increases at CPI.

Aurora Energy welcomes the reductions in capital and operating expenditure that TasNetworks has achieved since its formation in 2014. However, it is noted that the proposed capital investment projections for 2019 to 2024 increase significantly from current levels. Aurora Energy's view is that the willingness of Tasmania customers to pay for further investment in the network must be established before investment is undertaken. In particular, if increased capital expenditure is being driven to create business efficiencies (for example through investment in information technology and communication infrastructure), there must be a mechanism to ensure that these efficiencies are realised by TasNetworks and that any cost savings arising from these efficiencies are ultimately passed through to Tasmanian customers.

In the context of the Tasmanian Government capping retail prices at CPI, Aurora Energy does not support the transition to cost reflectivity for network prices. Given Aurora Energy's inability to pass-through network price signals to customers, the move to cost reflective network prices results simply shifts price risk to Aurora Energy, rather than sending a retail price signal to consumers. Aurora Energy suggests that the AER ensures that TasNetworks' approved tariff structure remains flexible in order to reflect and respond to the Tasmanian policy environment.

Aurora Energy's views on questions raised by the AER in its Issues Paper are provided at Attachment 1. Aurora Energy looks forward to continuing to proactively engage with the AER and TasNetworks throughout this Transmission and Distribution 2019-24 Determination process, supporting the shared objective of delivering value for Tasmanian energy customers.

If you have any questions regarding this submission please contact Hayden Moore, Regulatory & Policy Manager at hayden.moore@auroraenergy.com.au.

Yours sincerely

Kane Ingham
General Manager Commercial Services

Enclosure:
Attachment 1

TASNETWORKS DISTRIBUTION AND TRANSMISSION DETERMINATION 2019-24 AURORA ENERGY SUBMISSION

Aurora Energy has prepared this submission in response to TasNetworks' Transmission Revenue and Distribution Regulatory Proposal (regulatory proposal) for 2019-24. This submission presents Aurora Energy's views on questions raised by the Australian Energy Regulator (AER) in its Issues Paper.

We are interested in stakeholders' views on the reasonableness of TasNetworks' capex proposal and how well it reflects the key themes emerging from its customer engagement.

A key question for us is whether such a significant increase in repex is justified.

Aurora Energy welcomes the reductions in capital and operating expenditure that TasNetworks has achieved since its formation in 2014. TasNetworks' actions in this regard have contributed to easing pressure on energy price affordability. Notwithstanding this, Aurora Energy notes that TasNetworks is proposing to increase its capex for both distribution and transmission by 30 per cent and 23 per cent respectively across the five-year period 2019-24, compared to the last regulatory period. Despite other reductions, the distribution capex is 11 per cent higher than that proposed in its Directions and Priorities Paper. The increasing capital expenditure is one of the key reasons why annual average network charge increases remain above the rate of inflation.

These increases in capex appear to be largely driven by substantial increases in replacement expenditure (repex), with TasNetworks proposing to increase distribution repex by 53 per cent from the previous five-year period and transmission repex by 32 per cent. While TasNetworks' regulatory proposal states that the focus on renewal expenditure is to "*ensure our assets are safe, fit for purpose, and reliable*", Aurora Energy is of the view that the onus is on TasNetworks to more clearly demonstrate how the increase in repex will specifically benefit customers or improve customer outcomes. In particular, the distribution repex is much higher than the regulatory depreciation, resulting in a significant increase in the distribution regulatory asset base (RAB) over the five-year period. There is insufficient justification or quantification of the need for such a substantial increase above the previous five-year period and, more importantly, the commensurate return to customers from such a large uplift in repex is unclear.

Similarly, Aurora Energy observes that TasNetworks is proposing a significant increase in distribution information technology (IT) and communications expenditure compared to the previous period. Aurora Energy is of the view that any capital expenditure of this nature must be commensurate with an improvement in customer service outcomes or future efficiency savings. It is unclear what commensurate benefit would be provided to customers by undertaking the IT and communications investments identified in TasNetworks' regulatory proposal. Where the capital investment is justified by future efficiency savings, Tasmanian customers ultimately wear the risk of paying for this investment without receiving the proposed benefit. Given this, the proposed efficiency savings must be made transparent and a mechanism for these being returned to customers must be made clear.

We will consider stakeholder views on the five contingent projects for TasNetworks' transmission system.

Aurora Energy notes that TasNetworks has proposed five contingent projects, with a total combined capex of $938M. Aurora Energy observes that the proposed combined capex for contingent projects is $170 million greater than that proposed TasNetworks' Directions and Priorities Consultation

Paper.[1] Should all these contingent projects proceed, they would more than triple TasNetworks' transmission capex and increase TasNetworks' RAB by more than 60 per cent. Aurora Energy notes that this presents a significant risk to consumers of increased prices in the future as they will necessarily be passed on by Aurora Energy through its regulated prices.

Specifically, Aurora Energy does not support the inclusion of contingent projects related to the second Bass Strait interconnector, in particular Contingent Project 1 (Second Bass Strait Interconnector) and Contingent Project 2 (Sheffield to Palmerston 220 kV augmentation). This view is based on the high uncertainty of the second interconnector project proceeding within the forthcoming regulatory period (if at all) and the need to more comprehensively consider whether the costs associated with these projects should be recovered from Tasmanian customers (if at all). This is particularly important given that the driver, viability and funding model are yet to be established and will be predicated on providing renewable energy to benefit mainland customers as opposed to Tasmanian consumers.

Should TasNetworks' network tariffs place a stronger incentive on Aurora and other Tasmanian retailers to reform their retail offerings?

We seek stakeholder views on:

- ***Whether retailers are likely to take up cost reflective network tariffs under the proposed 'opt-in' regime and whether it will, in stakeholders' opinion, provide an adequate pace of reform***
- ***Whether an 'opt-out' arrangement, whereby retailers are charged a cost reflective network tariff, is more appropriate.***

Aurora Energy notes that TasNetworks proposes to continue to move towards more cost-reflective pricing, and has included an additional guiding theme of *"bringing the community on the journey of pricing reform"* since the release of the Directions and Priorities Consultation Paper.

The Tasmanian Government's policy of capping retail prices in Tasmania prohibits Aurora Energy's ability to pass through price signals to customers. As the sole residential retailer in the State, Aurora Energy is required to offer regulated standard retail (standing offer) tariffs, with the Tasmanian Economic Regulator (TER) setting the maximum prices that Aurora Energy can charge its regulated customers. Under this framework, Aurora Energy is limited in its ability to change its tariffs unless explicitly approved by the TER. Furthermore, the Tasmanian Government's commitment to capping Tasmanian residential electricity price increases at CPI until at least 2021 means that network price signals cannot be passed on to customers.

Based on the above, Aurora Energy does not support the transition to cost reflectivity for network prices in Tasmania. Given Aurora Energy's inability to pass-through network price signals to customers, the move to cost reflective network prices simply shifts price risk to Aurora Energy, rather than sending a retail price signal to consumers.

Aurora Energy also does not support the introduction of an 'opt-out' approach to retailers taking up demand-based network tariffs in Tasmania. The current constraints around regulated retail pricing in Tasmania mean that Aurora Energy is effectively unable to pass through price signals reflected in new demand-based network tariffs to consumers, and this is unlikely to change in the forthcoming regulatory period. For this reason, Aurora Energy is of the view that an 'opt-in' regime should continue.

Aurora Energy notes that new demand-based tariffs introduced by TasNetworks would have to be reflected in retail prices for customers to receive the intended price signals. Aurora Energy considers

[1] This additional cost is attributable to an additional contingent project with an estimated cost of $80M, and a $92 million increase in the estimated cost of a second Bass Strait interconnector.

that sufficient customer willingness and clear customer benefits for demand based tariffs would have to be demonstrated before it would support implementation in Tasmania (including demonstrating that Tasmanian customers can understand and benefit from demand based tariffs). Aurora Energy has not observed any material customer desire to introduce demand-based tariffs and is of the belief that their introduction at this time may increase the risk of higher costs to Tasmanian consumers for no commensurate benefit.

With respect to the network expenditure drivers for the introduction of demand-based tariffs, TasNetworks has outlined that growth in maximum demand is no longer a key driver for network augmentation.[2] Aurora Energy suggests that, instead of introducing network demand-based pricing signals that cannot be passed-through to customers in retail prices TasNetworks considers engaging with Aurora Energy to explore, other non-pricing related methods for managing the demand constraints in the network.

Given the policy context in Tasmania, Aurora Energy is of the opinion that TasNetworks must work in collaboration with regulated retailers when seeking to embed cost reflective network pricing, particularly with regard to the relative distribution of costs between network and retail businesses. This can be facilitated by maintaining flexibility in TasNetworks' tariff structure over the next five years, given the likelihood of changing customer expectations and market disruption expected to occur during that timeframe.

We would be interested in stakeholder views on whether TasNetworks should recover the full capital costs of its meters in 2019-24 period.

TasNetworks has proposed to "*apply accelerated depreciation to recover the existing metering capital costs by June 2024".* Based on TasNetworks' modelling, this will increase metering charges "*by approximately $9.29 per annum per metering register".*

It is Aurora Energy's view that TasNetworks will have unnecessarily recovered the full capital cost of meter assets during this period, as TasNetworks' regulatory proposal estimates that 55-65 per cent of those meters will still be in use at June 2024.[3] Aurora Energy does not support the acceleration of depreciation for metering capital costs and considers that this will result in an unnecessary cost increase for customers with no commensurate benefit. Aurora Energy does not consider there to be any economic justification for TasNetworks' proposed approach.

Aurora Energy proposes that TasNetworks recovers the existing metering capital cost consistent with the forecast decline in the physical metering assets. Aurora Energy will continue to proactively engage with TasNetworks and the AER to outline its own expectations for the roll-out of advanced meters.

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[2] TasNetworks Annual Planning Report 2017.

[3] Estimate derived from Figure 2-14 of TasNetworks Regulatory Proposal.