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Your reference:

In reply quote: R00001177277

10 March 2015

Mr Warwick Anderson  
General Manager  
Network Investment and Pricing  
Australian Energy Regulator  
GPO Box 3131  
Canberra ACT 2601

Dear Mr Anderson

### **Submissions in response to TasNetworks' transmission Revised Revenue Proposal**

As you are aware, the AER received submissions from the following stakeholders in response to our transmission Revised Revenue Proposal:

- Bell Bay Aluminium;
- Electrical Trade Unions;
- Tasmanian Minerals and Energy Council;
- Tasmanian Small Business Council;
- Major Energy Users; and
- a number of network businesses.

In addition to these stakeholders, a submission was also made by the AER's Consumer Challenge Panel – sub panel.

We would like to take this opportunity to respond to a number of common themes raised by stakeholders. The attachment to this letter therefore discusses these themes, provides a short description of matters typically raised in submissions, and sets out our response.

While we recognise that there is no formal regulatory process for lodging this submission, we believe that it will promote further constructive engagement with stakeholders.

If you have any queries on this submission please contact John Sayers on 03 6271 6469 or via email at john.sayers@tasnetworks.com.au.

Yours sincerely



Bess Clark  
General Manager Strategy & Stakeholder Relations



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# Submissions in response TasNetworks' transmission Revised Revenue Proposal

## 1. Introduction

As you are aware, TasNetworks has accepted the Australian Energy Regulator's (AER) draft decision. We provide this submission to respond to issues raised by stakeholders as part of the AER's stakeholder consultation process for our Revised Revenue Proposal.

## 2. Key themes raised in submissions

The following themes have emerged from our review of the submissions lodged with the AER in relation to our Revised Revenue Proposal that we comment on:

- efficient costs and savings from the merger;
- cost of capital;
- benchmarking; and
- regulatory framework.

## 3. Efficient costs and savings from the merger

Most customer submissions highlighted the positive steps TasNetworks has taken to reduce our forward operating and capital expenditure, with some residual concerns in relation to our expenditure allowances. It is noteworthy that while the Tasmanian Small Business Council (TSBC) is concerned that our expenditure allowances may be too high, the TSBC and Major Energy Users (MEU) also recognised that TasNetworks had put forward an operating expenditure proposal *lower* than an allowance resulting from the AER's benchmarking assessment.

Some stakeholders raised concerns about the realisation of savings as a result of the merger that formed TasNetworks. For example, Bell Bay Aluminium noted:

*...TasNetworks has indicated in many communications that further efficiency gains will be achieved. Although pathways to achieving these are not clear at this time, the AER should expect TasNetworks to have a reduction in their application to better represent what is expected in the future...<sup>1</sup>*

TasNetworks commenced operations on 1 July 2014 and our proposal forecast a 12 per cent reduction in prescribed (regulated) transmission operating expenditure this year. Our proposal reflects that there are further efficiencies to be gained over this regulatory control period as we invest to rationalise our systems and find better ways of delivering services to our customers. These savings will offset a range of upward pressures on our operating costs, including from increased regulatory obligations.

Further, any efficiency gains we are able to achieve, above and beyond those already proposed, will be shared with our transmission and distribution customers through the operation and application of the AER's Efficiency Benefit Sharing Scheme.

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<sup>1</sup> Bell Bay Aluminium – Submission of TasNetworks' revised proposal – 6 February 2015, page 1

## 4. Cost of capital

All submissions provided views on the cost of capital and rate of return that TasNetworks receives for investments made to provide safe and reliable network services to our customers. Some stakeholders raised concerns that the rate of return is too high for TasNetworks; some consider that the rate is too low in an environment where electricity network businesses face unprecedented risks.

Given the commercial pressures presently faced by our transmission customers, TasNetworks adopted an approach to measuring the cost of capital that is consistent with the AER's published guideline. This was despite expert advice that supported a higher cost of capital.

Given present financial market conditions, including a very low risk-free rate, the application of the AER's approach is expected to see the lowest cost of capital for many years. While this outcome will support lower transmission charges over the present regulatory period, it will also mean that our shareholders will receive a very low return on their long-term investment in transmission assets. TasNetworks will continue to review the framework for setting the cost of capital as we prepare for our distribution regulatory proposal.

The MEU stated concerns about the effects on customer electricity prices of the Tasmanian Government's transfer of a significant amount of debt to TasNetworks.<sup>2</sup> TasNetworks observes that the transfers were part of its shareholders balancing capital between businesses. TasNetworks' revenues set by the AER are considered independently to the actual debt/equity gearing ratio of the business and therefore actual levels of debt have no impact on customer prices.

A number of stakeholders including the Consumer Challenge Panel made submissions on TasNetworks' approach to the rate of return and incorrectly quoted TransGrid's (the NSW transmission business) draft decision rate of return and cost of debt. In contrast to TransGrid's approach, TasNetworks proposal and the AER's draft decision adopted a lower rate of return under the methodologies set out in the AER' Rate of Return Guideline.

## 5. Benchmarking

The Consumer Challenge Panel's submission suggested that it would be churlish of TasNetworks to criticise the data used in benchmarking as we prepared the data. This reflects a misunderstanding of TasNetworks' concerns. TasNetworks is concerned about the AER's *use of data* gathered through the regulatory information notices (**RIN**) as we believe the data set is adversely affected in three ways:

- **Different interpretations of the RIN requirements**

Each network company's RIN responses have been independently audited and assessed as being compliant with the basis of preparation documents used by each business. However as many expert reviews have highlighted, much of the data, whether it be at a category level or a disaggregated level, is not comparable between businesses.

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<sup>2</sup> Major Energy Users Inc, Australian Energy regulator Tasmanian Electricity Transmission Revenue Reset, AER Draft Decision and TasNetworks Revised Proposal, Response, February 2015, page 19

- **Use of estimates where actual data is not available**

The use of estimates in the absence of actual data, particularly in the earlier years for which the AER has collected information, is potentially a source of inaccuracy.

- **Differences in policies, standards and operating conditions**

Network companies have different capitalisation policies, maintenance standards, network voltages, vegetation management responsibilities, cost allocation methodologies, reliability standards and demarcation points between transmission and distribution.

Further, as our recent submissions to the AER in respect of the NSW and ACT determinations highlight, we are concerned that the AER's benchmarking models are still immature, do not properly account for the differences between networks, and cannot be relied upon to determine efficient expenditure allowances.

## 6. Regulatory framework

A number of submissions raised concerns about aspects of the regulatory framework, and the AER's role in applying this framework. For example, the Tasmanian Minerals and Energy Council's submission questions the relevance of the AER and the value it provides to Tasmanian customers:

*...TMEC has formed the view that the AER has no relevance to the determination process, and arguably, has created an administrative burden on TasNetworks which invariably has to be funded by consumers. The AER appears to be little more than a cost penalty which serves no benefit to Tasmanian consumers (or potentially TasNetworks)...<sup>3</sup>*

The AER's role is to ensure a revenue allowance that provides for efficient costs. Where a business proposes an efficient allowance, it is entirely appropriate for the regulator to make no cuts below this efficient level.

If the only way that a regulator could add value to the determination process was by further cutting proposed allowances, regulated businesses would need to 'game' the framework by proposing higher than efficient allowances, in anticipation of cuts by the regulator.

The TasNetworks Revenue Proposal was developed by undertaking extensive and meaningful consultation with our customers and stakeholders. The proposal provides for a safe and reliable transmission service at an efficient cost. The TasNetworks approach has been validated by the AER largely accepting our proposal in its draft decision. In contrast, the AER has made large cuts to expenditure proposals in other recent draft decisions.

TasNetworks agrees that it should be in all parties' interests to reduce the administrative burden and cost of regulatory processes. The revenue setting process imposes a significant cost on regulated businesses, and ultimately our customers. The process requires a huge range of confidentiality-screened documentation to be provided up front to the regulator, supported by independent analysis in many cases. As noted above, a range of audited RINS containing a huge amount of data is also submitted. Much of the information provided by TasNetworks was not published or used by the AER in its review.

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<sup>3</sup> Tasmanian Minerals and Energy Council – Submission on TasNetworks revised proposal 6 February 2015, page 3

TasNetworks strongly supports reducing the regulatory burden and simplifying the regulatory framework. We will work constructively with stakeholders and the AER to embed learnings from the transmission determination process as we prepare for our distribution proposal due in January 2016.