Tasmanian Networks Pty Ltd
ABN 24 167 357 299
PO Box 606, Moonah, TAS, 7009
1300 137 008

10 March 2022

Sebastian Roberts
General Manager, Network Expenditure
Australian Energy Regulator
GPO Box 3131
CANBERRA ACT 2601

Dear Sebastian

RE Review of Incentive Schemes for Regulated Networks

TasNetworks is the Transmission Network Service Provider, Distribution Network Service Provider and Jurisdictional Planner in Tasmania. TasNetworks is also the proponent assessing the business case for Marinus Link, a new interconnector between Tasmania and Victoria. The focus in all of these roles is to deliver safe, affordable and reliable electricity network services to Tasmanian and National Electricity Market (**NEM**) customers.

TasNetworks has contributed to the development of the Energy Networks Australia (**ENA**) submission and supports the points made therein. In addition, TasNetworks would like to emphasise the following matters.

The current incentive scheme framework is improving outcomes for customers of electricity services. Any changes should be carefully considered to ensure that customer benefits are not diluted and continue to be realised.

TasNetworks supports the Australian Energy Regulator (**AER**) further engaging with stakeholders on how best to increase the transparency of incentive scheme outcomes. As a starting point, we agree that Network Service Providers should outline incentive scheme benefits being claimed as part of the regulatory reset process.

Regulatory certainty, stability of approach and predictability is important for all stakeholders. Bespoke arrangements to expenditure incentive schemes would add complexity and uncertainty when customer outcomes incentivised by these schemes are already well-defined.

However, TasNetworks does support more flexible service and reliability incentive schemes that can better accommodate customer preferences and expectations. A good example of this is the Customer Service Incentive Scheme.

As noted in the AER's Discussion Paper, Capital Expenditure Sharing Scheme (**CESS**) outcomes are related to capital expenditure (**capex**) forecasts in regulatory proposals. TasNetworks understands that a lot of the CESS concerns being raised by stakeholders relate to capex forecasts as opposed to the CESS itself.

Since the CESS has been introduced, there has been substantial improvements in the capex forecasting process, including:

- development of a number of expenditure assessment guidance notes;
- increase use of the replacement expenditure (**repex**) model; and
- increased and more effective stakeholder engagement and the release of the Better Resets Handbook.

CESS deferrals are often identified and CESS adjustments made by Network Service Providers using the existing arrangements. The guidance material and more effective engagement will provide additional transparency and help stakeholders understand the drivers of any capex overspends / underspends in previous regulatory periods. TasNetworks believes this should mitigate many of the concerns expressed with the CESS, including the identification of and adjustments for capex deferrals.

The capex profile within a regulatory period does not indicate a CESS design issue. There are a number of different factors that impact the capex profile. For example, supply chain and deliverability issues caused by the COVID-19 pandemic has impacted TasNetworks' ability to deliver our capex program at the beginning of our 2019-24 regulatory period. Plans are in place to deliver the program in the remaining years of the regulatory period.

A review of TasNetworks' underspends in the current regulatory period also show that the categories most impacted are network repex and non-network capex. Under the repex model and expenditure assessment guidance notes, future allowances for these categories are at least partially based on actual spend. Any underspends in these categories will therefore impact future allowances and future CESS outcomes. TasNetworks does not consider capex profiles should inform CESS amendments, but agrees that transparency of underlying factors impacting capex profiles during the regulatory reset process could help stakeholders understand CESS benefits / penalties being claimed.

TasNetworks considers it prudent to consider the effectiveness of the CESS over a longer period before making any changes. Particularly, improvements to capex forecasting should be allowed to be implemented and assessed to determine if they resolve concerns being raised with the current scheme.

As noted in the Discussion Paper the EBSS is broadly fit-for-purpose. In conjunction with other aspects of the regulatory regime (e.g. benchmarking and setting of base year operating expenditure) the EBSS is delivering lower costs through improved operating practices.

The appropriateness of the existing incentive framework in the changing NEM should be a focus area of the review. The NEM is changing at a rapid pace and network operating environments are different now to what they were even three years ago at the beginning of TasNetworks' current regulatory period.

The expenditure incentive schemes are being impacted by the rapidly changing operating environment. For example, TasNetworks has seen large increases in insurance costs and customer connections capex since the beginning of the current regulatory control period. Both of these factors are largely outside TasNetworks control. Penalising or rewarding NSPs for under/over spends outside its control does not promote efficient behaviour.

The Australian Energy Market Operator's Integrated System Plan (**ISP**) is forecasting substantial investment in the Tasmanian transmission network. A small percentage under/over spend on an ISP project (which may or may not be due to efficiency purposes) will significantly impact TasNetworks' incentive scheme outcomes. This is not consistent with the objective of the scheme to incentivise efficiencies across all capex categories. TasNetworks considers that ISP projects should have the option of being excluded from incentive scheme targets if they will materially impact the outcome and the incentives that apply to the broader program of work. This will remove the risk that CESS rewards / penalties on one significant project weaken incentives to find efficiencies in the underlying program of work.

In Tasmania, the Tasmanian Government has legislated the Tasmanian Renewable Energy Target to double Tasmania's renewable energy production by 2040. To help achieve this target, the ISP is forecasting 2.5 gigawatts of new wind generation in Tasmania by 2050, supported by $3.5 billion of investment in Marinus Link and the Tasmanian transmission network. The ISP forecasts similar developments in other NEM regions.

Considering the forecast changes in the NEM, TasNetworks considers it necessary to urgently review the market impact and service components of transmission STPIS to ensure that these components are delivering positive customer outcomes.

Market impact component (**MIC**) targets are set based on network performance at managing constraints over five of the past seven years. As forecast in the ISP, renewables will continue to become a more prominent source of generation in the NEM. This will create many new constraints in the network that will have to be managed. To expect past performance on a network to reflect future performance on a vastly different network is unrealistic.

The result of the mismatch between the ability to manage constraints in the historic and future networks reduces incentives provided through the MIC. TasNetworks considers customer outcomes will be improved if MIC targets are more representative of the network that will be managed over the period the incentives apply. As a result, we, along with other ENA members, support an urgent review of the MIC to investigate how this can be achieved.

Considering the timing of this review and any subsequent changes to the incentive schemes, TasNetworks would welcome the opportunity to discuss how any scheme amendments will apply to our 2024-29 regulatory control period.

Thank you for the opportunity to provide comments on the review of incentive schemes. If there are any questions on this submission, please contact [redacted], Leader Regulation, by email, [redacted]

Yours sincerely

Wayne Tucker

General Manager Regulation, Policy and Strategic Asset Management