Goanna Energy Consulting Pty Ltd

Tasmanian Small Business Council
Uniting Small Business

TasNetworks Transmission and Distribution Determination 2019-20 to 2023-24

Response to the AER's Draft Decision and TasNetworks' Revised Proposals

January 2019

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Acknowledgements & Disclaimer

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Submission Highlights & Key Messages

Themes	The AER's draft decision addresses a number of concerns raised by the TSBC, however in a number of areas TasNetworks' revised proposals would see those concerns reinstated, which the AER should address in its final decision. The TSBC reiterates the point made in its May submission that every opportunity must be taken to reduce electricity prices to small businesses and this determination is one such opportunity.
Value of TasNetworks' combined regulatory asset base (RAB)	The AER's draft decision would see the value of TasNetworks' combined transmission and distribution RABs in real terms remain relatively flat over the 2019-20 to 23-24 period. TasNetworks rerevised proposals would see an increase of more than 12% in the distribution RAB. Such an increase, at a time of reducing demand, would in itself lead to an increase in network charges and is not acceptable to Tasmania's small businesses.
Capital expenditure (capex) – transmission	The TSBC notes the AER's draft decision to substitute a reduced forecast amount for total transmission capex of $222.7 million, compared to TasNetworks' proposed $260.6 million. We contend that TasNetworks' revised forecast of $260.3 million should be rejected. In particular the TSBC contends that TasNetworks' revised proposal for replacement and ITC expenditure are excessive and not efficient.
Contingent projects – second Bass Strait interconnector (Marinus)	The TSBC is of the view that the objectives (Identified Need) of the project are not sufficiently clear and similarly, it is not clear how funding, benefits, and costs would be shared. In particular, there is not yet any indication of the impact on Tasmanian electricity prices as a direct result of a second Basslink. The TSBC notes that the expected benefits are principally to mainland National Electricity Market (NEM) customers and is concerned at: the suggested requirement that the link only proceed if the present pricing framework is modified; the possibility that the Marinus project might proceed without the completion (and approval) of a RIT-T; the potential for investment based on political, rather than economic, motivation; and the associated risks to Tasmanian electricity consumers and taxpayers.
Capital expenditure (capex) – distribution	The TSBC notes the AER's draft decision to substitute a reduced forecast amount for total distribution capex of $550.9 million, compared to TasNetworks' proposed $738.7 million. We contend that TasNetworks' revised forecast of $706.9 million should be rejected. The TSBC contends, in line with its position in relation to transmission capex, that TasNetwork's revised proposal for replacement and ITC expenditure are excessive and not efficient. We also note the errors in TasNetworks' forecasts for customer connections and customer capital contributions in their January proposal which have been corrected in their revised proposal.

Rate of return (WACC) – transmission and distribution	The TSBC notes the application of the AER's final decision in its review of the Rate of Return Guideline to TasNetworks proposals. We question the AER's draft decision to apply different rates of return to determine transmission and distribution revenues, given that TasNetworks proposed to apply the same rate to both distribution and transmission revenues, with the distribution rate being lower.
Operating expenditure – transmission and distribution	We register our concern that the AER has accepted, without any changes, the opex proposed by TasNetworks. We continue to believe that there is scope to further reduce, particularly the distribution opex, but also the transmission opex, proposed by TasNetworks. The AER's own modelling of TasNetworks' opex proposals is curiously producing results that indicate a higher level of opex than proposed by TasNetworks is efficient, an incongruity that the AER has begun to address. TasNetworks has a revised opex proposal for distribution that it materially higher than it originally proposed, whilst it has reduced its transmission opex. To this end, there have been some large changes in its opex components. Insufficient explanation has been provided for these swings and roundabouts, especially given the original proposal was said by TasNetworks to be prudent and efficient. AER benchmarking of electricity networks shows that while TasNetworks transmission arm is efficient, its distribution arm is demonstrably not. Seen in this context its newly proposed higher distribution opex is even more questionable.
Annual revenue requirement	We welcome the reductions made by the AER to TasNetworks' proposal which have reduced TasNetworks Annual Revenue and go some way towards addressing issues the TSBC raised in its original submission.
Indicative Network prices	Under the AER's Draft Decision electricity retail prices will be around 3.4 per cent higher in nominal terms after 5 years. The average small business will be paying $250 more a year for its electricity by then. Even with the Tasmanian Government's price cap in place, small businesses on regulated tariffs still face the prospect of a 5.5 per cent nominal increase in their distribution charges, with transmission charges about 2 per cent higher, over the final two years of the next regulatory period under the AER Draft Decision. These are disappointing pricing outcomes for small business in Tasmania.
Tariff Structure Statement and tariff reform	The AER has suggested that TasNetworks should speed up the pace of removing of cross-subsidies from its non-discounted tariffs, which includes the main small business tariff. (This tariff sees small business paying electricity prices that are higher than TasNetworks' associated costs.) The AER has also suggested that TasNetworks improve its information on removing cross-subsidies. The TSBC strongly supports both proposals and encourages TasNetworks to respond positively to both.

	The AER has also suggested that Aurora Energy could increase the pace of the retail price reform that needs to accompany network price reform for consumers to benefit fully. Aurora Energy has deemed the risks to it of retail price reform too great but has options such as the more innovative use of market offers it could make use of. For all the benefits that the Tasmanian Government's retail price cap has delivered to small consumers, it and retail price regulation also act as brakes on retail price reform and the removal of cross-subsidies.

Executive Summary

The Tasmanian Small Business Council (TSBC) welcomes the opportunity to participate in the Australian Energy Regulator's (AER) reset of TasNetworks' transmission revenue and distribution regulatory determination for the period 2019-20 to 2023-24. We also welcome the opportunity to provide this submission on TasNetworks' Tasmanian Transmission and Distribution Revised Regulatory Proposals (November 2018) as an important step in the Determination.

We note the AER's Draft Decision and TasNetworks response via its Revised Proposals.

This submission presents the results of our detailed analysis of both the AER's Draft Decision and TasNetworks subsequent Revised Proposals.

The TSBC wishes to point out that the task of undertaking a meaningful and value adding assessment of TasNetworks' Tasmanian Transmission Revenue and Distribution Regulatory Proposals (January 2018) and the revised proposals (November 2018) is made unnecessarily difficult by the lack of identification (numbering) of supporting information.

The numbering of the table of attachments in the Proposals, commencing at page 217; and the table of supporting documents commencing at page 118 of the Revised Proposals; is not reflected in the document lists on the AR's website, or in the documents themselves. That situation makes finding the relevant documents difficult and comparisons between the proposals, the AER's draft decision and the revised proposals doubly difficult.

(By way of example – in the revised proposals, document TN007 was listed in the table of key strategies and policies, but the reference TN007 does not appear on the AER's list of supporting information; the document was not uploaded to the AER's website on the 29th November 2018 along with the revised proposals and other supporting documentation, but was uploaded on the 18th December 2018; the document itself does not indicate the reference TN007 anywhere and neither does it include the title "Marinus Link Contingent Project Explanatory Paper", which is the label in the key strategies and policies table in the revised proposals and in the AER's list of supporting documentation.)

This is a situation the TSBC believes should not be repeated in any of its future determinations.

BACKGROUND

As stated in its May 2018 submission to the AER[1], the TSBC believes that every opportunity to reduce electricity prices to small business must be pursued with vigour, and this review of TasNetworks' revised Regulatory and Revenue Proposals 2019-24 is one such opportunity.

TasNetwork's *Tasmanian Transmission Revenue and Distribution Regulatory Proposals Regulatory Control Period 1 July 2019 to 30 June 2024*, submitted to the AER on 31 January 2018, proposed total capital expenditure (transmission and distribution) over the five year regulatory period of $997.7 million ($June 2019), operating expenditure of $603.2 million, revenue of $2192.3 million, an allowance for contingent projects of $938 million and a rate of return (WACC) of 5.89% on both transmission and distribution assets.

[1] TSBC, TasNetworks Transmission Revenue & Distribution Regulatory Proposal 2019-20 to 2023-24, May 2019

The AER's Draft Determination, handed down in September 2018, proposed total capital expenditure (transmission and distribution) over the five year regulatory period of $777.2 million ($June 2019), operating expenditure of $604.2 million, revenue of $2095.8 million, no allowance for contingent projects and a rate of return and corporate tax allowance based on its Draft Decision, Rate of Return Guidelines Review in July 2018.

The TSBC broadly endorses the AER's reduction of TasNetwork's capital and operating expenditure proposals, and notes the application of its draft decision on its Rate of Return Guideline Review to TasNetworks Regulatory Asset Base and to the corporate tax allowance.

TasNetworks' *Tasmanian Transmission and Distribution Revised Proposals 2019 - 2024 Regulatory Control Period 1 July 2019 to 30 June 2024*, submitted to the AER on the 29th November 2018, forecast total capital expenditure (transmission and distribution) over the five year regulatory period of $967.2 million ($June 2019), operating expenditure of $589.0 million, revenue of $2,132.5 million and an allowance for contingent projects of $788 million.

There are areas where the TSBC considers that TasNetworks' revised claims are still excessive and should not be allowed, as follows:

- Capital expenditure – transmission
- Capital expenditure – distribution
- Contingent projects
- Operating expenditure - transmission
- Operating expenditure – distribution

We are concerned that electricity network prices for small business are projected to increase in nominal terms by around $250 by 2024, and remain concerned at the slow pace of tariff reform. Those reforms are required to address existing cross subsidies which result in electricity prices to small business customers remaining higher than they would be under a cost reflective pricing regime

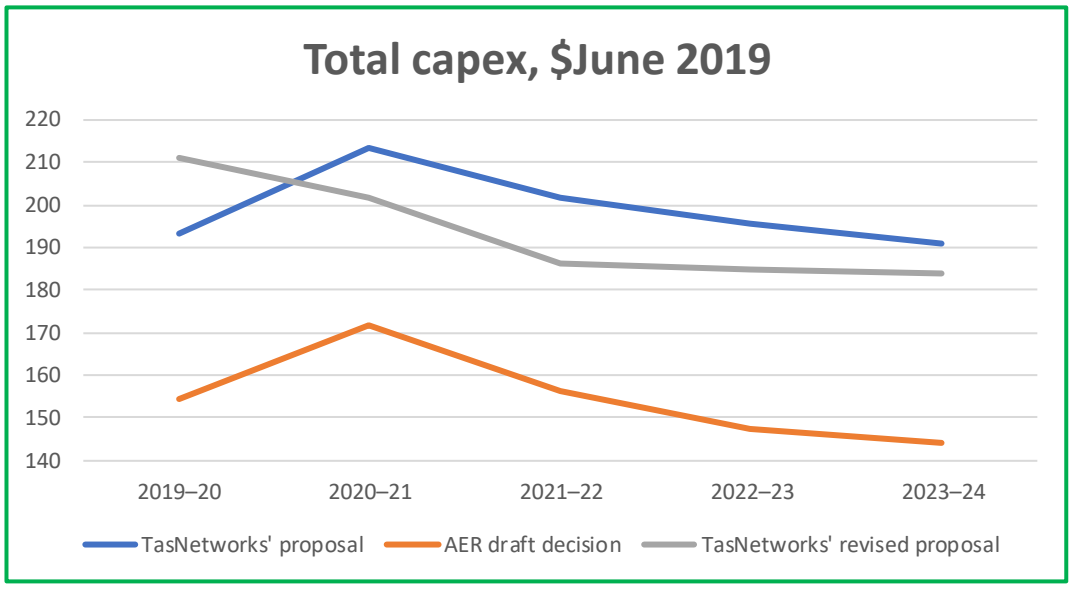
This submission provides the TSBC's detailed views on the matters noted above.

CAPITAL EXPENDITURE – TOTAL

The TSBC notes that TasNetworks' revised proposals involves total capex of $260.4 million, compared to its original proposals of $260.6 million (ie, almost identical) and the AER's draft determination of $222.7 million, and further notes that in all categories of capex, with the exception of replacement expenditure, TasNetworks' revised proposals have increased from its initial proposals.

The differences between the expenditure amounts in TasNetworks January 2018 proposals, the AER's draft determination and TasNetworks' revised proposals are shown in the figure ES 1 below.

Figure ES 1: Total capital expenditure



Source – Goanna Energy analysis

The TSBC expects the AER to scrutinize in particular the increase in capex proposed in 2019-20 – the revised proposal being $57 million more than the AER's draft decision and $18 million more than the January proposal.

Total capital expenditure forecast in TasNetworks' revised proposals is $193.6 million greater than the AER's draft decision forecast. The TSBC expects the AER to reject that increase.

CAPITAL EXPENDITURE – TRANSMISSION

The AER's draft decision reduced TasNetworks proposed transmission capital expenditure of $260.6 million by $37.9 million, which TasNetwork's has reinstated almost in its entirety in its revised proposal totaling $260.3 million. Of particular note is that TasNetworks' revised proposal brings forward expenditure and includes in the first year of the regulatory period, 2019-20, an increase of $21.3 million over the AER's draft decision.

CAPITAL EXPENDITURE – DISTRIBUTION

The AER's draft decision reduced TasNetworks proposed distribution capital expenditure (net of customer contributions) of $738.7 million by $156 million to $550.9 million, on the basis that TasNetworks had not justified that its total net capex forecast reasonably reflects the capex criteria as prescribed in the National Electricity Rules.

TasNetwork's revised forecast proposes expenditure totaling $706.9 million, which is $156 million more than the AER's draft decision, on the basis that the matters raised by the AER in their decision to substitute their own estimate have been addressed by TasNetworks in the revised proposal.

CONTINGENT PROJECTS

In its January 2018 Regulatory Proposal, TasNetworks proposed five contingent projects, with the first, a second Basslink interconnector, being of major concern to the TSBC.

The TSBC's May 2018 submission responding to TasNetworks' proposal noted, at page 39:

"The benefits would be largely invisible to consumers, but the impact on electricity prices would not be. The TSBC therefore requests that information concerning the impact on prices should be made public and become part of the public discussion around the merits or otherwise of a second interconnector.

In its draft decision, the AER rejected TasNetworks' contingent project proposals on the basis that the project triggers were not sufficiently specific and the projects would probably not be required during the forthcoming regulatory period.

TasNetworks' revised proposal now includes only three contingent projects, including a second Basslink interconnector, now labelled Project Marinus.

TasNetworks is progressing the case for the second Basslink interconnector and is applying the Regulatory Investment Test – Transmission (RIT-T) to the proposed project (Marinus).

The TSBC has undertaken a consumer focused assessment, including the impact on Tasmanian small business, of the Project Marinus Project Specification Consultation Report (PSCR) published by TasNetworks, available at *http://goannaenergy.com.au/wp-content/uploads/Goanna-Report-TSBC-TasNetworks-Project-Marinus-Consultation-Oct-2018-Print-Version.pdf.*

That assessment suggests, at page 5 –

"*Consumers, especially those in Tasmania and Victoria, could bear significant risks from the construction of a second Bass Strait interconnector, especially if it operates as a regulated link. Risks include stranding or underutilisation of the asset, uncompetitive markets so that benefits are not passed through and risks from government intervention and regulation."*

The TSBC's submission on TasNetworks' Direction and Priorities Consultation Paper (August 2017) commented:

> *The TSBC notes the number and scale of transmission contingent capital projects (p19) totalling $768M, and the trigger events which would need to occur before any of those projects moved from being contingent to part of the capital expenditure program.*
>
> *The TSBC suggests the trigger of passing the AER's Regulated Investment Test should include an analysis of costs and quantifiable financial benefits which will accrue to each section of the Tasmanian electricity customer base, and that the project approval process should ensure that audited benefits exceed costs for any approved project.*

The TSBC considers the lack of such an analysis to be a major deficiency in the current RIT-T, which is not addressed in the recently completed review of Regulatory Investment Tests by the AER and should be the subject of a rule change proposal to the AEMC, which the TSBC is prepared to sponsor.

In particular the TSBC notes the lack of a requirement to identify specific benefits which accrue to different types of consumers (for example small business or households), and further, the lack of any requirement to identify the impact on consumer prices flowing directly from the proposed investment.

The TSBC also notes one outcome from the December review, being the introduction of guidance on how to account for external capital contributions. The RIT guidelines clarify that a RIT is not required where the external financial contribution results in the project falling below the cost threshold. The RIT guidelines also now set out how external contributions should be treated in the RIT market-wide cost benefit analysis.

The TSBC considers that whilst there may be some logic in this approach, there is also a potential two-edged sword for consumers if, for example, the government contribution is poorly founded or politically based. The external contribution could help the project pass the RIT-T even though it would not have done so without such a contribution. Electricity consumers/ taxpayers (virtually the same people) would be left with a sub-optimal investment to pay for by one means or another.

The potential for such outcomes is heightened in the absence of a comprehensive energy strategy at the federal government level, and in Tasmania the government's energy strategy (www.stategrowth.tas.gov.au/energy_and_resources/energy/strategy) which currently has different objectives to its election policy (www.tas.liberal.org.au/sites/default/files/Tasmanian%20First%20Energy.pdf).

TasNetworks provided an Explanatory Statement to the AER on the 18th December 2018 concerning the Marinus project. The TSBC notes the acknowledgement in that statement that the major beneficiaries of the Marinus project would be mainland NEM customers, which reinforces the need to model the costs and benefits to Tasmanian electricity consumers, and the impact on Tasmanian electricity prices.

The TSBC has major concerns in relation to the proposed trigger points for the project which are in summary:

- The requirement that the link only proceed if the present pricing framework is modified;
- Changes which have occurred over time to the project triggers;
- The possibility that the Marinus project might proceed without the completion (and approval) of a RIT-T; and
- The potential for investment based on political, rather than economic motivation, and the associated risks to Tasmanian electricity consumers and taxpayers.

The TSBC sees the combination of those concerns as being very significant and expects that the AER will also regard them as being very significant.

The TSBC notes that the two other contingent projects in TasNetworks revised proposal are the Sheffield to Palmerston 220 kV augmentation at an estimated cost of $120 million and augmentation of the 220 kV transmission system between Sheffield and Burnie, at an estimated cost of $80 million.

Both projects may be required to support the development of wind generation resources in the north west of the state, and to the operation of a second interconnector should that project proceed.

The benefits of those projects to wind generation proponents are readily apparent, however the benefits to Tasmanian electricity consumers, and the impact on electricity prices, are not at all clear.

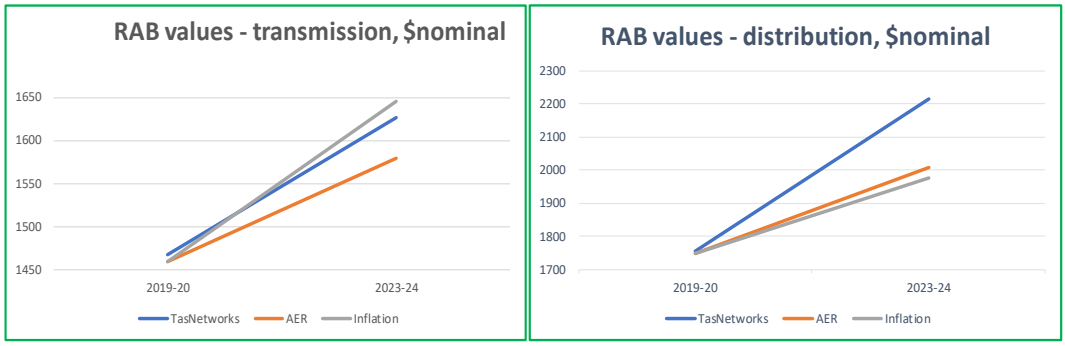
Until that information is made available the TSBC does not support the inclusion of those projects as contingent projects.

REGULATORY ASSET BASE (RAB)

Figure ES 2 below compares the increases in the value of TasNetworks transmission and distribution RABs in its revised proposals, The AER's draft decision and the value of the opening RAB plus inflation, over the Regulatory Control Period 2019-20 to 2023-24.

The combined RAB values (expressed in nominal dollars) in the TasNetworks proposals would result in an increase above inflation from June 2019 levels of around $193 million, during a period when total demand is expected to fall, which would, by itself, lead to an increase in network charges over that period.

Figure ES 2 : Growth in RAB values



Source – Goanna Energy analysis

The TSBC believes that, given AEMO's projections of demand (Figure ES 3 below), TasNetwork's proposed increases in the value of its transmission and distribution RABs are not justified.

Figure ES 3: Forecast demand

Forecast regional maximum operational demand (10% POE), Neutral scenario (MW)

	NSW		QLD		SA		TAS		VIC	
	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter
2016–17	14,096	13,104	9,354	8,334	3,099	2,716	1,416	1,765	9,477	7,801
2021–22	13,902	12,954	9,546	8,574	2,947	2,674	1,398	1,741	9,340	7,712
2026–27	14,171	13,153	9,929	8,868	2,925	2,702	1,409	1,754	9,330	7,515

Forecast regional maximum operational demand (50% POE), Neutral scenario (MW)

	NSW		QLD		SA		TAS		VIC	
	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter
2016–17	13,157	12,630	8,700	7,964	2,925	2,623	1,377	1,718	8,869	7,520
2021–22	12,891	12,522	8,910	8,161	2,783	2,591	1,361	1,699	8,662	7,463
2026–27	12,914	12,699	9,442	8,517	2,752	2,604	1,375	1,711	8,618	7,258

Source – AEMO

RATE OF RETURN (WEIGHTED AVERAGE COST OF CAPITAL)

In its draft decision the AER allowed a WACC of 5.77% on TasNetworks' transmission RAB and 5.51% on the distribution RAB.

Had the AER accepted the position proposed by TasNetworks in their January Proposals, that is a WACC of 5.51% to apply to both RABs, electricity charges over the five years 2019-20 to 2023-24 paid by Tasmanian electricity consumers would be lower by around $20 million than in its draft decision.

The TSBC wishes to understand why the AER did not adopt the position put forward by TasNetworks, and why that position should not apply in the AER's final determination.

OPERATING EXPENDITURE – TRANSMISSION & DISTRIBUTION

We note that the AER's Draft Decisions have accepted without change the transmission and distribution opex forecasts originally proposed by TasNetworks. In this regard, we note again our concern that the AER has consistently produced forecasts for TasNetworks opex using its opex forecasting model that are higher than the forecasts proposed by TasNetworks. This was the case for its previous transmission and distribution determinations and is again the case for this joint draft determination. This is a surprising outcome of the model and may be indicative of shortcomings within it.

Notwithstanding a useful reduction in transmission opex in TasNetworks' Revised proposals it remains of concern to the TSBC that TasNetworks' annual transmission opex over the next regulatory period (expressed in constant dollars) is forecast to remain virtually unchanged from its level of $29.5 million in 2017-18 (the most recent year for which audited actual opex is available). The expectation of the TSBC is that TasNetworks will continue to find ways to reduce the aggregate level of its opex over time through efficiencies and other cost savings rather than settle on a steady state.

The overall opex forecast for distribution for the 2019-24 regulatory period represents an increase of $18.9 million, or 4.5 per cent over the previous five years; and $31.7 million, or 7.7 per cent, over TasNetworks' original proposal. We believe that TasNetworks needs to provide clear and acceptable justifications for this increase and urge the AER to ensure that this happens.

We find it somewhat incongruous that TasNetworks original proposal put forward a lower level of distribution opex as being prudent and efficient but it now suggests that a materially higher level is needed, notwithstanding that there are substitution possibilities between transmission and distribution opex, and that the combined level of forecast opex is lower than originally proposed.

Examining TasNetworks Revised Proposal compared to its original Proposal reveals that forecast distribution opex in the category Emergency Field Operations has increased from $43 million under TasNetworks' original Proposal to $92.8 million under its Revised Proposal, an increase of $49.8 million, or 116 per cent. This is a very significantly increase and is the main driver behind the significantly higher distribution opex in the Revised Proposal. Increases are also evident in other expenditure categories across both distribution and transmission.

TasNetworks has provided insufficient explanation for these significant inter-business and category changes and variations in its Revised Proposal. We suggest that the AER undertake a thorough assessment of the reasons for the increases and changes in TasNetworks' distribution and

transmission opex in its Revised Proposal compared to its original Proposal. It should also seek further advice from the business as necessary.

The choice of a base year for the opex forecasts is an important part of the process of forecasting TasNetworks' opex for the 2019-24 regulatory period. The choice made is meant to reflect an efficient level of opex for TasNetworks.

TasNetworks proposed that 2017-18 should be chosen as the base year for both its transmission and distribution opex and the AER accepted this. TasNetworks' Revised Proposal also nominated 2017-18 as its base year, which the TSBC did not support in its earlier submission.

We note that the actual outcomes for transmission opex in 2017-18 produced a significantly lower level of opex than TasNetworks' original estimate and also lower than for 2016-17. On this basis and as 2017-18 is the latest year for which actual opex is now available, we now support its use as a suitable base year for the transmission opex forecasts.

Significant increases have been proposed by TasNetworks for distribution opex, justified as due to higher bushfire risks based on Victorian assessments. We believe these claims and the associated opex should be thoroughly assessed by the AER. We continue to maintain that 2014-15, rather than 2016-17, is more reflective of TasNetworks' underlying efficient distribution opex and should be used as the base year for forecasts.

The TSBC believes that it is important for the regulatory process to ensure that network service providers continue to pursue greater efficiencies through productivity growth and that the associated benefits flow through to customers, thus helping to keep network prices affordable. We therefore support the inclusion of a productivity factor in TasNetworks' distribution opex forecasts, but hold the view that the one per cent per annum favoured by the AER is too low.

Benchmarking Opex

Benchmarking is an important tool to help the AER and consumers assess TasNetworks' opex forecasts. The AER's economic benchmarking reports for 2018 show TasNetworks' transmission business to be consistently among the best performers in the NEM. This is a welcome outcome, although we note that several others have outperformed TasNetworks from 2016 to 2017 and that TasNetworks has sought to dampen expectations that its good performance will continue. For TasNetworks' distribution business the benchmarking results are disappointing with TasNetworks lagging most other NEM distribution businesses and its opex a major contributor to poor outcomes. This gives us further cause for concern about TasNetworks' opex forecasts.

ANNUAL REVENUE REQUIREMENTS

We welcome the reductions made by the AER to TasNetworks' proposals which lower its Annual Revenue Requirements (AAR) and go some way towards addressing issues the TSBC raised in its original submission. These changes assist in the task of keeping prices for small business lower than would otherwise be the case.

We welcome:

- The return on capital allowance adjustment made by the AER of -$14.9 million, or -3.3 per cent, which accounts for 88 per cent of the reduced total AAR.
- The AER's reduction in the cost of corporate income tax allowance of $9.2, million, or 45.7 per cent, on TasNetworks' proposals. This comprises 54 per cent of the reduced total AAR.

The impacts of these on the total AAR are partly offset by an increase in the revenue adjustments of $8.6 million. We recognise that this is to compensate TasNetworks for greater efficiencies in its capex and opex, which is intended to ultimately benefit customers.

However, we are disappointed that the AER has accepted, without any changes, the opex proposed by TasNetworks, which we questioned in our earlier submission. We continue to believe that there is scope to further reduce the distribution opex proposed by TasNetworks in particular, but also its transmission opex and have raised in Section 5.4 of this submission our concerns about the AER's current modelling of TasNetworks' opex proposals.

INDICATIVE NETWORK PRICES

The AER estimates that average real transmission charges are expected to decrease from around $16.2 per MWh in 2018–19 to $13.9 per MWh in 2023–24, or by 16.5 per cent, under its Draft Decision.
In nominal terms, however, transmission prices would decline by total of only 3.8 per cent under the AER's Draft Decision. This translates to a 0.97 per cent reduction in network charges and 0.42 per cent reduction in retail prices.

These changes represent a welcome, albeit modest, decline in the network prices of Tasmanian small businesses over the five years from 1 July 2019.

The AER estimate that its draft decision will result in a real increase to average distribution charges of about 0.1 per cent per annum over the 2019–24 regulatory control period with further average annual declines of 1.1 per cent to follow. The nominal increase in average distribution prices would be 11.8 per cent over the regulatory period compared to 24.5 per cent under TasNetworks original proposals and 18 per cent under TasNetworks Revised Proposals.

Whilst the increases may be tempered by the Tasmanian Government's decision to cap regulated retail tariffs, including for small business, to the CPI until the end of 2021-22, small business will be exposed to increases for the final two years of the regulatory control period. Moreover, small and medium size businesses on market offers will be exposed for the entire regulatory control period.

We note that the impact of the increase in distribution prices forecast under the Draft Decision would more than outweigh the reduction in transmission prices, leaving retail prices around 3.4 per cent higher in nominal terms. Under the Revised Proposal the increase would be closer to 4 per cent.

Overall, these are disappointing pricing outcomes for small business in Tasmania.

Impact on small business electricity bills

The AER Draft Decision estimates that an electricity bill for an average small business customer in Tasmania would decrease by about $35 ($nominal) from the 2018–19 level in 2019-20 (0.5 per cent), followed by average annual increases of $72 ($nominal) over the remaining regulatory years of the 2019–24 regulatory control period (2020–21 to 2023–24), or 1.1 per cent. The average small business will be paying $250 more a year for its electricity by then due to these increases. Under TasNetworks' original and revised proposals there would be increases in each year and an even bigger impact on electricity bills.

These overall increases in electricity bills likely to be faced by small business over the term of the 2019-24 regulatory control period as a result of increases in network charges are a further indication of the overall disappointment that the Tasmanian small business sector is likely to feel about the outcome of the AER's draft determinations for TasNetworks.

Small and medium size businesses on market rates will feel the full force of the network charge increases in their bills, except for a small reduction in 2019-20.

TARIFF STRUCTURE STATEMENT AND TARIFF REFORM

The AER has also made a draft decision on TasNetworks' proposed Tariff Structure Statement (TSS) suggesting several changes to it and TasNetworks has provided a revised TSS. The TSS covers network pricing reforms being gradually introduced into Tasmania that unwind cross-subsidies and introduce networks prices that more closely reflect the costs of providing network services.

Most importantly for the small business sector, he AER proposed that TasNetworks should consider accelerating the unwinding of cross subsidies and include non-discounted tariffs, such as the main small business tariff, and improve transparency by providing forecasts of the change in revenue recovered from tariffs due to this unwinding. The TSBC strongly supports these points and generally welcomes the response of TasNetworks, although the TSBC continues to support a faster pace of tariff reform and suggests that TasNetworks should regularly provide information that clearly demonstrates to consumers and their advocates, such as the TSBC, the progress being made in removing cross-subsidies in both discounted and non-discounted tariffs.

We strongly support the unwinding (and its acceleration) of cross subsidies in non-discounted tariffs, and believe that small business continues to pay a significant cross-subsidy through TAS22, notwithstanding some unwinding in recent years.

The TSBC has been a long, strong and consistent supporter of the need to remove cross-subsidies from Tasmanian distribution (and retail) tariffs. We support the application of cost reflective network pricing in Tasmania as soon as possible and note that small business tariffs such as TAS22 (and its T22 retail equivalent) are not yet cost reflective and that tariffs such as the popular uncontrolled load heating tariff (TAS41), are not only inefficient but also inequitable (given they are also available to wealthy households). We continue to oppose the overly lengthy transition period of 15 years to remove cross-subsidies from legacy tariffs, including TAS22. The qualified response of TasNetworks to the AER suggestion that TasNetworks consider accelerating the time to unwind non-discounted tariffs is a concern to us.

Unfortunately, the pace of retail tariff reform which needs to accompany network pricing reform to ensure benefits are passed on to customers has been extremely slow in Tasmania to date and has lagged behind the reforms in network charges. The Government price cap currently in place, which limits regulated retail price increases to the CPI, has undoubtedly benefitted small consumers in Tasmania, including small business but one impact of this has been to limit the extent to which retail price reform is linked to network price reform.

Under these circumstances, Aurora Energy has been more reluctant to proactively pursue retail price reform, perceiving (with some justification) that the risks it would be exposed to in doing so are unacceptable. The AER has pointed out that Aurora has the ability to provide market offers that include cost reflective pricing. The TSBC would also welcome a more positive response from Aurora to retail price reform whereby small business could benefit from more cost reflective retail prices.

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Contents

Table of Figures

Table of Tables

1

INTRODUCTION

1 Introduction

This document is the Tasmanian Small Business Council's (TSBC) submission on the Australian Energy Regulator's (AER) Draft Decisions on TasNetworks' Transmission and Distribution Determinations for the Regulatory Period 2019-20 to 2023-24. It also provides our response to TasNetworks' Revised Proposals. The TSBC welcomes the opportunity to participate in the Australian Energy Regulator's (AER's) regulatory reset of TasNetworks' transmission and distribution network for the period 2019-20 to 2023-24.

We have previously provided a submission responding to TasNetworks' Regulatory Proposals in May 2018. That submission provided information about the TSBC and its interest in the AER's regulatory determinations for TasNetworks.

2

CAPEX

Goanna Energy Consulting Pty Ltd

Tasmanian Small Business Council
Uniting Small Business

2 Capital Expenditure (Capex)

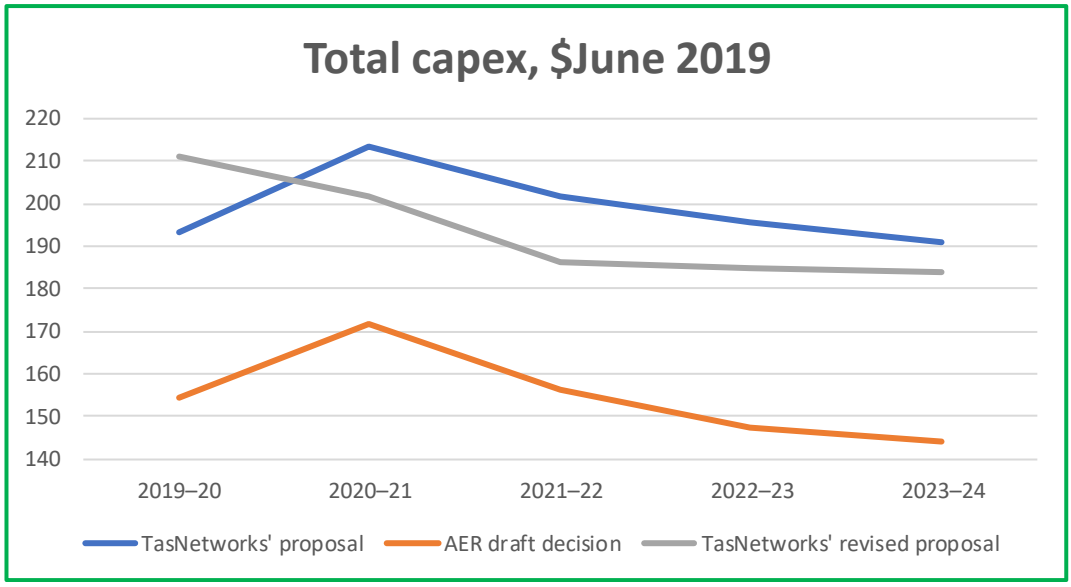
In this section we comment on TasNetworks' capex proposals for both transmission and distribution.

The TSBC notes that total capital expenditure (capex) forecast in TasNetworks' January 2018 proposals[2] was $995.1 million.

The AER's substitute estimate in its September draft decision[3] was $773.6 million, and TasNetwork's revised estimate in its November revised proposals[4] was $967.2 million.

Figure 1 below shows the comparison between those estimates on an annual basis for the Regulatory Control Period 1 July 2019 to 30 June 2024 31 January 2018.

Figure 1: Total capex



Source – Goanna Energy analysis

The differences between the expenditure amounts in TasNetworks January 2018 proposals, the AER's draft determination and TasNetworks' revised proposals are analyzed in the following sections.

[2] TasNetworks- Tasmanian Transmission Revenue and Distribution Regulatory Proposals, Regulatory Control Period 1 July 2019 to 30 June 2024, 31 January 2018

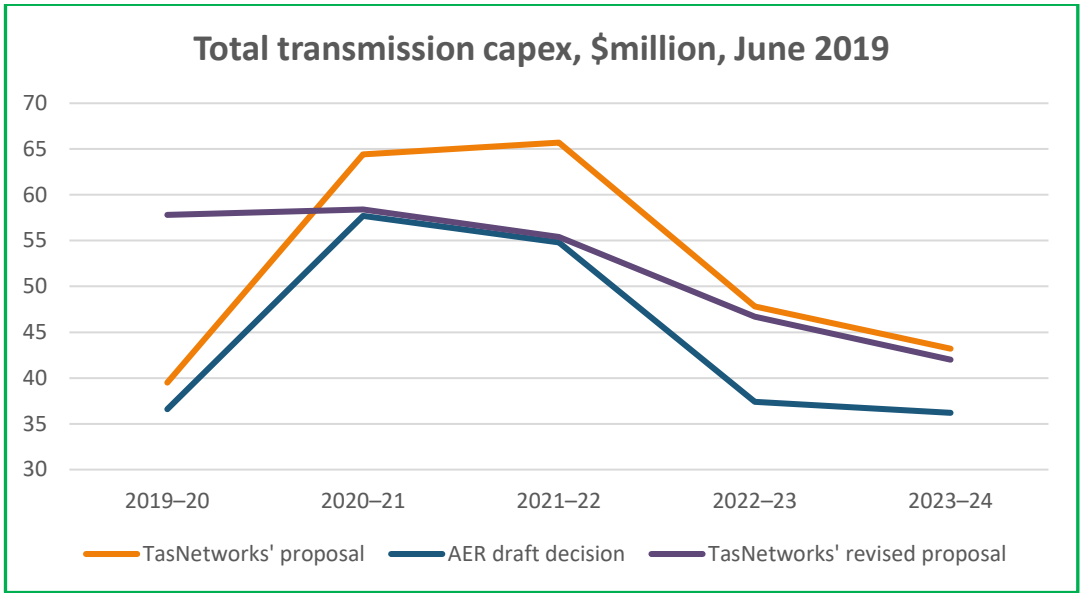
[3] AER – Draft Decision, TasNetworks Transmission and Distribution Determination 2019 to 2024, September 2018

[4] TasNetworks - Tasmanian Transmission and Distribution Revised Proposals 2019 – 2024, Regulatory Control Period 1 July 2019 to 30 June 2024, 29 November 2018

2.1 TOTAL TRANSMISSION CAPEX

We comment below on TasNetworks' response to the AER's draft decision on total transmission capex and then examine the main elements of the TasNetworks' transmission capex proposal – augmentation, replacement, other (including information technology (IT)) and contingent projects.

Figure 2: Total transmission capex



Source – Goanna Energy analysis

The AER's draft decision reduced TasNetworks proposed transmission capital expenditure of $260.6 million by $37.9 million, which TasNetworks has reinstated almost in its entirety in its revised proposal totaling $260.3 million. Of particular note is that TasNetworks' revised proposal brings forward expenditure and includes in the first year of the regulatory period, 2019-20, an increase of $21.3 million over the AER's draft decision.

Years four and five of the Regulatory Control Period (2022-23 and 2023-24) also see increases above the AER's draft decision of $9.2 million and $6.2 million respectively.

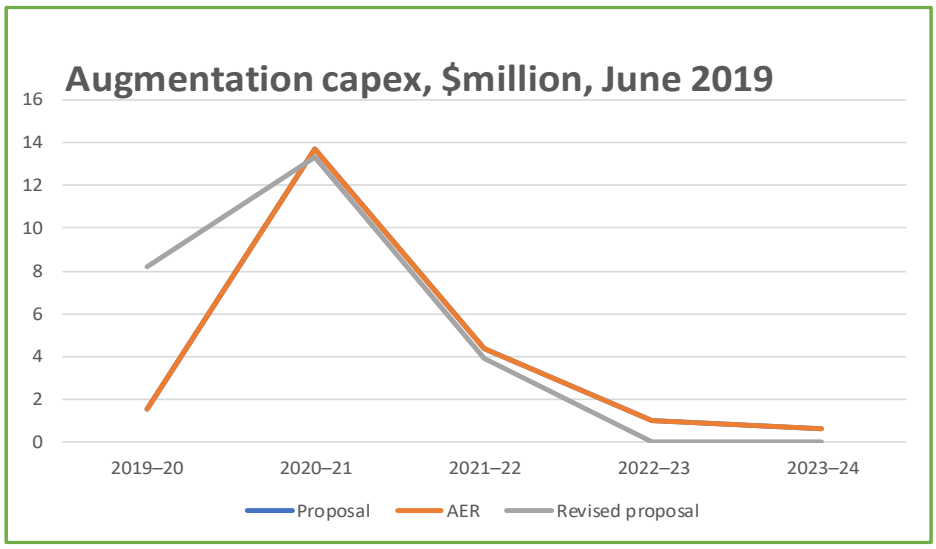
These increases are further analyzed in the following sections.

2.2 Comments on Elements of Proposed Transmission Capex

In this section, we comment on some specific elements of the proposed, draft decision and revised transmission capex forecasts.

2.2.1 Augmentation

Figure 3: Augmentation capex, transmission



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

The AER's draft decision allowed the expenditure as proposed by TasNetworks, however an additional $6.7 million is included in year 1 of TasNetworks' revised proposal, which indicates (page 32):

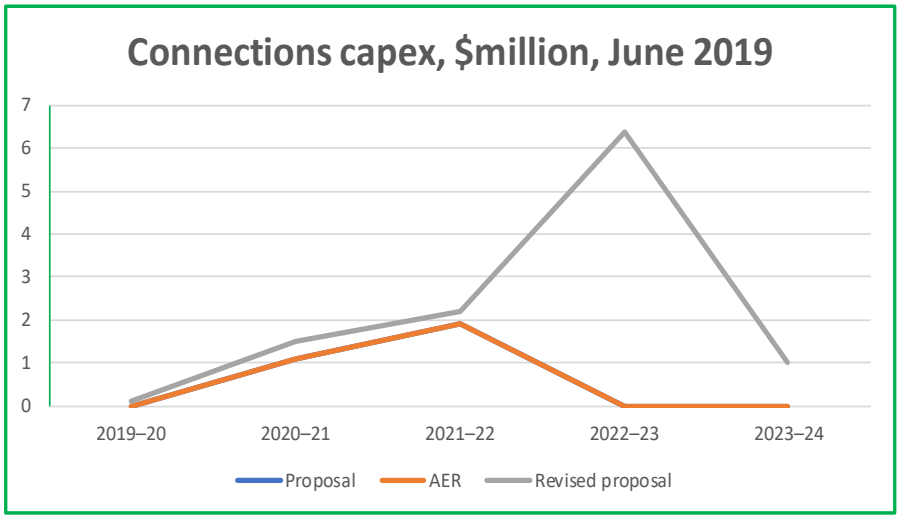
- *"The AER's draft decision rejected two projects from our NCIPAP proposal on the grounds that these projects deliver reliability benefits rather than increasing capacity. In this revised Regulatory Proposal, we have therefore transferred these projects to development capital expenditure – the projects are:*

- *Waratah Tee remote control of a disconnector; and Second Farrell bus coupler, the costs of which have been updated to reflect the latest available information."*

The value of those projects in TasNetworks' January proposal is $610,000 and $1,250,000 respectively, therefore the basis of the increase of $6.7 million is not clear, and the increase should be rejected by the AER.

2.2.2 Connections

Figure 4: Connections capex, transmission



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

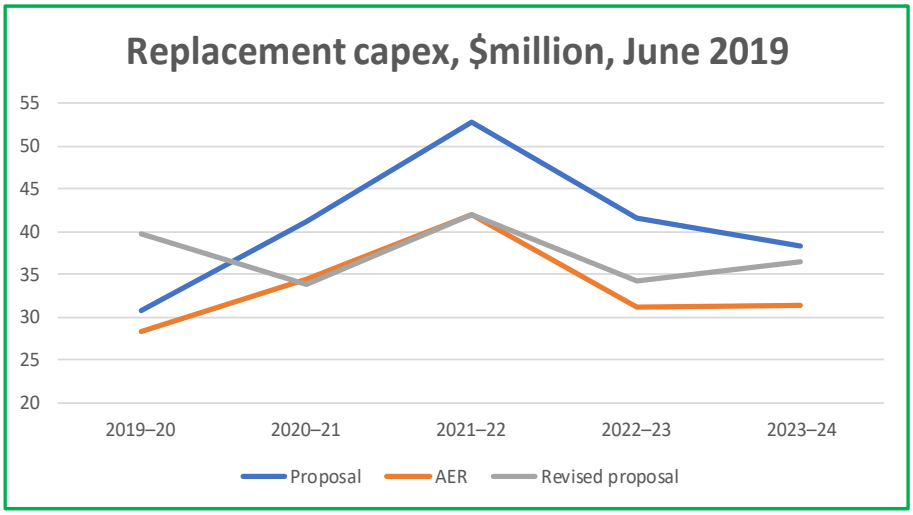
In its draft decision the AER assessed TasNetworks' proposed connections expenditure of $3 million, relating to a single project to establish an additional 22kV connection point at the Sheffield substation, as prudent and efficient. TasNetworks' proposed expenditure, totaling $3 million, is superimposed over the AER's draft decision in Figure 4 above.

TasNetworks have not provided any information in their revised proposal as to why total connections capex has increased from $3 million to $11.2 million.

The TSBC does not accept that an increase of $11.2 million is justified and it should be rejected.

2.2.3 Replacement capex

Figure 5: Replacement capex, transmission



Source – Goanna Energy analysis

The AER's draft decision indicates that a prudent and efficient level of replacement capex is $167 million, compared to TasNetworks' proposed level of expenditure of $204.5 million.

In explaining its position the AER noted at page 5.34 of its draft decision, Appendix 5[5]:

"Our analysis indicates that TasNetworks has applied several very conservative assumptions in its underlying cost-benefit analysis. ……..

These assumptions compound together to produce overly conservative estimates for unserved energy.

This subsequently brings the optimal investment timing into the 2019–24 regulatory control period. However, using less conservative input assumptions in the underlying cost-benefit analysis pushes the optimal investment timing into the 2024–29 regulatory control period (or later) for several transmission repex programs and projects".

And at page 5.35[6]:

"Our modelling and analysis results in partial or full deferral of the 13 programs and projects, as the optimal asset replacement timing moves from the 2019–24 regulatory control period to the 2024–29 period or later. We therefore assess that it would be prudent to partially or fully defer these programs and projects".

The AER's advisors, Arup, concurred with the AER's position[7].

We refer to the TSBC's May submission to the AER, referencing the Grattan Institute report, which found that TasNetworks' RAB was overvalued by $750 million due mainly to poor demand forecasts leading to excessive capex in the past[8].

The TSBC recognizes that overinvestment in any group of assets does not obviate the need to replace those assets within that group which are reaching the end of their life cycle and that there is not necessarily a direct offset between overinvestment and the need to replace assets.

Given that over-investment has occurred in the past however, with resulting low utilization rates[9], we expect TasNetworks to take every opportunity to reduce replacement expenditure and increase asset utilization. As part of that we expect TasNetworks to adopt less conservative as opposed to more conservative assumptions when calculating, for example, the net present values which influence the timing of replacements.

The TSBC is particularly concerned that different assumptions for the value of customer reliability (VCR) and different net present value (NPV) calculations lead to differing time frames for investment, with TasNetworks opting for those values which require earlier investment. Given that the prices which consumers pay are adversely affected this should not be the case and the TSBC expects TasNetworks, given past overinvestment arising primarily as a result of excessive demand

[5] Draft Decision, TasNetworks Transmission Determination 2019 to 2024, Attachment ,5 Capital expenditure, September 2018
[6] Ibid
[7] Arup, TasNetworks transmission repex addendum, August 2018, p. 13.
[8] TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposals 2019-20 to 2023-24, p12

[9] Ibid, p2

forecasts, to assign values for assumption parameters which are at the less conservative end of possible options and which result in the lowest possible consumer prices.

Accordingly the TSBC does not accept the arguments proposed by TasNetworks to increase its repex allowance for 2019-24 beyond the AER's draft decision of $167 million.

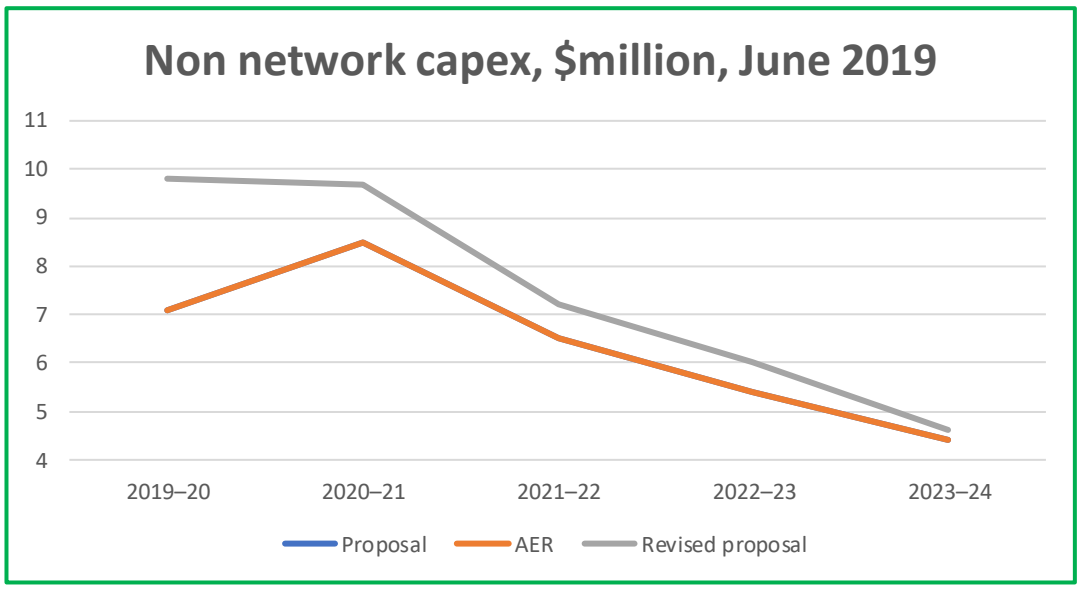
The issue of overinvestment in assets which form part of TasNetworks' RAB and therefore generate a return for TasNetworks, with a corresponding cost to Tasmanian electricity consumers despite the fact that the investment was not necessary and delivers little if any benefit to those consumers, is a matter which the TSBC believes the AER should not simply ignore in its determination, noting the obligations imposed by the National Electricity Law and Rules when exercising its (AER's) judgement.

In order to address that situation one possible option is for a Rule Change whereby in order for capital expenditure to be included in the RAB, the utilization rate for particular asset classes must be above a specified level, with all other requirements for investment (risk based) remaining and necessary investment undertaken, but only included in the RAB if the utilization rate achieves the required threshold.

This would provide a similar outcome over time to the write down of RABs suggested by the Grattan Institute[10] and the ACCC[11] and would provide some redress to consumers for the cost to them of the overinvestment.

2.2.4 Non network

Figure 6: Non network capex, transmission



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

[10] Down to the wire A sustainable electricity network for Australia, March 2018, p3

[11] Restoring electricity affordability and Australia's competitive advantage Retail Electricity Pricing Inquiry—Final Report, June 2018, page x

Non-network capex relates to expenditure on information and communications technology (ICT) assets, fleet, land and buildings. The AER also assessed TasNetworks forecast capex for network operational support systems as part of this category.

The AER's draft position[12] is that *"TasNetworks has justified that its forecast non-network capex of $31.9 million is prudent and efficient, and would form part of a total capex forecast that reasonably reflects the capex criteria. We have therefore included this amount in our estimate of total forecast capex for the 2019–24 regulatory control period".*

Figure 6 above shows the annual non-network capex included in TasNetwork's revised proposal which totals $37.3 million, an increase of $5.4 million over its January proposal. The breakup of that expenditure is shown in table 1 below.

Table 1: Non network capex, transmission

2019-24, $m, June 2019	**Proposed**	**Revised**	**Diff.**
Operational support systems	10.2	14.1	3.9
IT and communications	14.4	15.5	1.1
Other	7.3	7.7	0.4
Total	**31.9**	**37.3**	**5.4**

Source – Goanna Energy analysis – TasNetworks January proposal and November revised proposal

2.2.4.1 Operational support systems

TasNetworks' revised proposal indicates at page 37:

"Our most recent assessment is that our total expenditure in relation to our Asset Management Information System (AMIS) should increase by $15.2 million across our transmission and distribution activities for the 2019-24 regulatory period".

And: *"The transmission component of the proposed AMIS capital expenditure will increase by $4.1 million over the 5 year period".*

As noted in our May submission[13] the scale of total expenditure for IT (including operational support) and communications in TasNetworks' January proposal, at $24.9 million for transmission, was considered excessive by the TSBC and could not be justified.

(The combined transmission and distribution expenditure on operational support systems over the previous period, 2014-19, was $49 million[14] and proposed for 2019-24 was $32.3 million).

The AER's draft decision on operational support systems (including asset management information systems) concluded, after extensive scrutiny, that:

[12] DRAFT DECISION, TasNetworks Transmission Determination 2019 to 2024, Attachment ,5 Capital expenditure, September 2018, page 5.38
[13] TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposals 2019-20 to 2023-24, p48
[14] Ibid, p47

"based on the information available, we are satisfied that the forecast capex for this category is efficient and prudent and would form part of a total forecast capex allowance that reasonably reflects the capex criteria."[15]

The TSBC finds that conclusion impossible to fathom and contends that a further increase of $15.2 million (transmission and distribution) above TasNetworks' January proposal, including a $3.9 million increase for transmission, is inconceivable. Total combined revised expenditure for 2019-24 for operational support systems would be $49.4 million.

The TSBC argues that the AER should revisit the revised proposed expenditure for both transmission and distribution and reduce it below what was proposed in TasNetworks' January proposal. A rolling, five year combined expenditure level close to $50 million, or $10 million per year, implies the total replacement of very expensive (tier one) systems to provide operational support on a five yearly basis (noting that operational support systems are a relatively small part of a total ERP platform). The suggestion of a five year whole of life cycle (that is, total replacement after five years, as opposed to upgrade or update over a significantly greater period) for operational support systems cannot be justified and the TSBC continues to contend that the selection of a tier one ERP system similarly cannot be justified, given the size of TasNetworks' customer base and the resulting cost imposition on those customers.

TasNetworks has however opted to go down the tier one path (SAP), therefore any changes or upgrades will, by definition, be very expensive and should be kept to the barest minimum.

2.2.4.2 IT and Communications

TasNetwork's statement in its revised proposal at page 38 does not appear to be correct:

"…. revised forecast transmission IT & Communications capital expenditure. Our forecasts are unchanged from our original Regulatory Proposal and the AER's draft decision".

Year one, 2019-20, expenditure in TasNetworks January proposal was $3 million, therefore the revised proposal is $1.1 million more than was proposed in January, without explanation for the increase.

That proposed increase should be rejected.

[15] AER - DRAFT DECISION, TasNetworks Distribution Determination 2019 to 2024, Attachment 5, Capital expenditure, p65

2.2.5 Contingent projects

In its January 2018 Regulatory Proposal[16], TasNetworks proposed five contingent projects, with the first, a second Basslink interconnector, being of major concern to the TSBC.

In its draft decision, the AER rejected TasNetworks' contingent project proposals on the basis that the project triggers were not sufficiently specific and the projects would probably not be required during the forthcoming regulatory period[17].

TasNetworks' revised proposal[18] now includes only three contingent projects, including a second Basslink interconnector, now labelled Project Marinus.

TasNetworks is progressing the case for the second Basslink interconnector and is applying the Regulatory Investment Test – Transmission (RIT-T) to the proposed project (Marinus).

TasNetworks' revised proposal includes additional background material relating to Project Marinus - TN006, Marinus Project Specification Consultation Report (also published by TasNetworks as *Project Marinus Project Specification Consultation Report (PSCR)*); and TN007, Marinus Link Contingent Project Explanatory Paper.

2.2.5.1 Second interconnector – Marinus project

The TSBC notes the inclusion of the construction of a second Basslink Interconnector in TasNetworks revised proposal and suggests there are four related issues which need to be considered – electricity price impacts and risks to consumers; lack of clarity around the project's objectives; limitations of the Regulatory Investment Test - Transmission (RIT-T); and trigger points/pre-conditions.

Electricity price impacts

The TSBC's May 2018 submission (reference) noted, at page 39:

"The benefits would be largely invisible to consumers, but the impact on electricity prices would not be. The TSBC therefore requests that information concerning the impact on prices should be made public and become part of the public discussion around the merits or otherwise of a second interconnector.

That information would include:

- *Updating figures 9, 10, 15.4 and 15.5 in the Transmission Revenue and Distribution Regulatory Proposals document (pages 19, 20, 189 and 190) to include the projected impact of including contingent project 1, based on a 50% cost sharing arrangement;*

[16] TasNetworks - Tasmanian Transmission Revenue and Distribution Regulatory Proposasl for the Regulatory Control Period 1 July 2019 to 30 June 2024, 31 January 2018, section 8.2.8
[17] AER - Draft Decision, TasNetworks Distribution Determination and Transmission Determination, 2019 to 2024, Overview, p14
[18] TasNetworks - Tasmanian Transmission and Distribution Revised Proposals 2019 – 2024, Regulatory Control Period 1 July 2019 to 30 June 2024, section 5.2.8

- *Updating figures 9, 10, 15.4 and 15.5 in the Transmission Revenue and Distribution Regulatory Proposals document (pages 19, 20, 189 and 190) to include the projected impact of all contingent projects;*
- *In addition to the average price impacts as presented, identifying the cost impact (network charges) to small business customers; and*
- *Extending the information presented as discussed above to any regulatory periods where capital expenditure related to the contingent projects will be incurred.*

Further, in its submission to the AER responding to TasNetworks' proposals, CCP13 noted:[19]

Page 43 - *The current RIT-T process involves an assessment of the costs and benefits of the contingent project. There is no guarantee that these benefits will actually occur. Consumers take the risk that the modelled benefits may not appear. The only guarantee if the project proceeds is that if it is part of the RAB then consumers will pay for it for its asset life – usually 40-50 years. The AER review of Regulatory Investment Test Guidelines is relevant to the interaction between the ISP and the RIT-T process".*

And, also at page 43 – *"It is particularly important that this price path information consider the impact on the 2025-2029 regulatory period given the large proportion of capex spend likely in that period. Implementation of the proposed contingent projects will have a substantial impact on increasing prices in the 2019-24 with further, additional increases in 2025-29".*

The TSBC considers the lack of such an analysis to be a major deficiency in the current RIT-T, which is not addressed in the recently completed review of Regulatory Investment Tests by the AER [20] and should be the subject of a rule change proposal to the AEMC, which the TSBC is prepared to sponsor.

The TSBC has undertaken a consumer focused assessment[21], including the impact on Tasmanian small business, of the Project Marinus Project Specification Consultation Report (PSCR) published by TasNetworks.

That assessment suggests, at page 5 –

"*As mentioned earlier, the RIT-T requires only the assessment and quantification of aggregated market benefits. Hence, there is no requirement to separately quantify individual market benefits although, in our view, it would be good practice to do so. The measurement of aggregate market benefits, albeit important from a regulatory standpoint, is not so meaningful to consumers, who wish to understand the impact of major network investments on them, especially their electricity bills, although this is not required under the RIT-T. The PSCR does not mention any intent to quantify small business and household impacts but, in our view, it would be good practice to include them. The RIT-T process does not require the reporting of regional benefits and costs to consumers. Consumers in Tasmania and Victoria will be more interested in the impacts on their region, especially electricity prices and it would be good practice to quantify this in the RIT-T as ElectraNet has done. There is little comment in the PSCR on who would pay the network charges for Project Marinus. In our view, they should be allocated according to who benefits, including renewable energy owners, consumers in Tasmania and consumers in Victoria.*
Risks

[19] Response to proposals from TasNetworks for a revenue reset for the 2019-24 regulatory period, AER CCP Sub-Panel 13, 16/05/2018
[20] AER - Final decision, Application guidelines for the regulatory investment tests, December 2018
[21] Refer - *http://goannaenergy.com.au/wp-content/uploads/Goanna-Report-TSBC-TasNetworks-Project-Marinus-Consultation-Oct-2018-Print-Version.pdf.*

Consumers, especially those in Tasmania and Victoria, could bear significant risks from the construction of a second Bass Strait interconnector, especially if it operates as a regulated link. Risks include stranding or underutilisation of the asset, uncompetitive markets so that benefits are not passed through and risks from government intervention and regulation."

Both the TSBC and CCP13 have highlighted the lack of any projection of the impact on network prices and thus the impact on consumer prices of the proposed (Marinus) project.

The TSBC's request that TasNetworks provide additional information in their revised proposal, to include the price impact of the Marinus project in projected annual indicative transmission charges and network charges, for the 2019-2024 regulatory period any other regulatory period where Marinus would have an impact, has not been addressed.

In the absence of that information consumers have no way of knowing what the price impacts might be. The comprehensive modelling required to determine the impact on transmission and network charges would be an extension of that required to demonstrate economic benefits, as required by the RIT-T.

Our assessment of project Marinus[22]also outlines at section 4.2 developments in the NEM which are related to project Marinus and the "order of merit" which AEMO considers apply to the project –

"a second interconnector between Tasmania and the mainland does not figure large in AEMO's ISP" (Integrated System Plan).

The TSBC notes the September 2017 study by the Australian National University[23] which identified 22,000 potential pumped hydro sites in Australia, with 67,000GWh of approximate energy storage capacity possible. Tasmania ranked a distant third in terms of approximate energy storage capacity, which the TSBC considers is relevant to the viability of the Marinus project and thus the risk to consumers should any substantial component of the required investment become part of TasNetworks' Regulated Asset Base.

Table 2: Pumped Hydro, Australia

	Approximate number of sites	Approximate energy storage capacity (GWh)	Head* (metres)
NSW/ACT	8,600	29,000	300
Victoria	4,400	11,000	300
Tasmania	2,050	6,000	300
Queensland	1,770	7,000	300
South Australia	185	500	300
Western Australia	3,800	9,000	200
Northern Territory	1,550	5,000	200
TOTAL	**22,000**	**67,000**	

Source - ANU -www.dropbox.com/s/hgkf8l26lbtjp2v/Press%20release%2020%20SEPTEMBER%20-%

[22] Refer - *http://goannaenergy.com.au/wp-content/uploads/Goanna-Report-TSBC-TasNetworks-Project-Marinus-Consultation-Oct-2018-Print-Version.pdf.*
[23] *http://re100.eng.anu.edu.au/research/phes/*

20HYDRO%20MR.docx?dl=0

The relative advantages and disadvantages of project Marinus compared to potential projects within the NEM with similar characteristics will be considered in the next stage of the RIT-T process, and the TSBC awaits with interest the results of the analysis which takes full financial account of those advantages and disadvantages.

Project objectives (Identified Need)

The TSBC is of the view that the Identified Need for Project Marinus required by the RIT-T and defined by TasNetworks lacks specificity:

> *The characteristics of customer demand, generation and storage resources vary significantly between Tasmania and the rest of the NEM. Increased interconnection capacity between Tasmania and the other NEM regions has the potential to realise a net economic benefit by capitalising on this diversity.*[24]

That Identified Need compares to, for instance, the Identified Need for Electranet's proposed Riverlink project[25]:

"…. reducing the cost of providing secure and reliable electricity to South Australia in the near term, while facilitating the longer-term transition of the energy sector across the National Energy Market (NEM) to low emission energy sources"

What is not clear for project Marinus is:

- which parties would benefit from the proposed Marinus link;
- the quantifiable financial value of those benefits;
- the quantifiable financial costs which would be incurred in delivering the benefits;
- the parties who would invest in Marinus and their respective share of costs and benefits; and
- as noted above, the impact on electricity prices for consumers in affected regions.

In the absence of a sufficiently specific project objective(s) it is therefore unclear to the TSBC whether project Marinus is expected to deliver against broad national objectives, with national beneficiaries, or against Tasmania specific objectives, benefitting Tasmanian consumers. Similarly the extent to which those objectives are complimentary or mutually exclusive is not clear.

Our assessment of project Marinus[26] provides at section 4.3 a detailed analysis of the Identified Need stated for project Marinus.

Without a more specific project objective (Identified Need) it is similarly unclear how credible options might be identified and assessed, however the number of credible options being considered, that is two cables versus one, at different locations, is patently inadequate.

If the objective was, for instance, to "*optimize Tasmania's renewable energy resources and ensure the lowest possible long term wholesale electricity prices for Tasmanian consumers*" then a credible

[24] TasNetworks, *Project Marinus* Project Specification Consultation Report, July 2018, p. 19.
[25] SA Energy Transformation RIT-T, Project assessment Draft Report, 29 June 2018
[26] Refer - *http://goannaenergy.com.au/wp-content/uploads/Goanna-Report-TSBC-TasNetworks-Project-Marinus-Consultation-Oct-2018-Print-Version.pdf.*

option would be to optimize the development of Tasmania's existing and potential renewable energy resources, including the interactions between hydro storages and non-hydro generation, and the role of Basslink (existing). The Marinus project could then be compared with a counter factual:- optimize the use of existing on-island resources and investments - and assessed against that option.

It is the TSBC's view that such an assessment must include auditable and verifiable modelling of the impact on consumer prices, as per our May submission[27], including assumptions which can be tested and sensitivity analysis using different parameter values.

If that cannot be provided it is the TSBC's view that project should not be considered for inclusion in TasNetworks' Regulatory asset Base.

Limitations of the Regulatory Investment Test, Transmission (RIT-T)

The TSBC's submission[28] on TasNetworks' Direction and Priorities Consultation Paper (August 2017) commented:

> *The TSBC notes the number and scale of transmission contingent capital projects (p19) totalling $768M, and the trigger events which would need to occur before any of those projects moved from being contingent to part of the capital expenditure program.*
>
> *The TSBC suggests the trigger of passing the AER's Regulated Investment Test should include an analysis of costs and quantifiable financial benefits which will accrue to each section of the Tasmanian electricity customer base, and that the project approval process should ensure that audited benefits exceed costs for any approved project.*

The TSBC notes, as mentioned at page 21 of our analysis of the Marinus project[29] that Tasmania is able to exploit its hydro storages to "soak up" excess renewable generation by holding back water when wind and solar generation is operating and making use of the stored water when wind and solar generation is not operating. That is, the need for expensive pumping is obviated, included the capital investment in pumped storage infrastructure and the (large) energy costs, including losses, associated with pumping water uphill.

Section 3.3 of our analysis[30] suggests:

"Whilst its application to regulated investments is useful to consumers, the RIT-T has a number of shortcomings that do not guarantee that the NEO, i.e. the long term interests of electricity consumers, will always be satisfied through its application" and lists ten such shortcomings (page 15).

[27] TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposal, 2019-20 to 2023-24, May 2018, section 4.2.3

[28] https://www.tasnetworks.com.au/TasNetworks/media/pdf/customer-engagement/Direction%20and%20Priorities%20submissions%202015/TSBC-Submission-TN-Directions-and-Priorities-Consultation-Paper.pdf.

[29] Refer - *http://goannaenergy.com.au/wp-content/uploads/Goanna-Report-TSBC-TasNetworks-Project-Marinus-Consultation-Oct-2018-Print-Version.pdf.*

[30] Ibid

In particular the TSBC notes the lack of a requirement to identify specific benefits which accrue to different types of consumers (for example small business or households), and further, the lack of any requirement to identify the impact on consumer prices flowing directly from the proposed investment.

As noted above the TSBC considers the latter to be a major deficiency in the current RIT-T, which is not addressed in the recently completed (December 2018) review of Regulatory Investment Tests (application guidelines) by the AER [31] and should be the subject of a rule change proposal to the AEMC, which it is prepared to sponsor.

The TSBC notes that the December review addresses the application of the existing RITs, not the RITs themselves, and contends that the above mentioned failings are not addressed.

The December review does provide, at section 10.3, that *"the identified need should be articulated in a customer-focussed manner",* however the TSBC contends that does not adequately address the issue of customer impacts identified above.

The TSBC also notes one outcome from the December review, being the introduction of guidance on how to account for external capital contributions. The RIT guidelines clarify that a RIT is not required where the external financial contribution results in the project falling below the cost threshold. The RIT guidelines also now set out how external contributions should be treated in the RIT market-wide cost benefit analysis.

The TSBC considers that whilst there may be some logic in this approach, there is also a potential two-edged sword for consumers if, for example, the government contribution is poorly founded or politically based. The external contribution could help the project pass the RIT-T even though it would not have done so without such a contribution. Electricity consumers/ taxpayers (virtually the same people) would be left with a suboptimal investment to pay for by one means or another.

The potential for such outcomes is heightened in the absence of a comprehensive energy strategy at the federal government level, and in Tasmania's case the Government's energy strategy, (www.stategrowth.tas.gov.au/energy_and_resources/energy/strategy), which currently has different objectives to its election policy (www.tas.liberal.org.au/sites/default/files/Tasmanian%20First%20Energy.pdf).

Trigger points/pre-conditions.

The TSBC Notes that on the 18th December TasNetworks provided the AER with its Marinus Link Contingent Project Explanatory Paper[32] for its November 2018 Revised Revenue/Regulatory Proposals 2019–24. The explanatory paper was referred to in that document as TN 007, but was not provided at that time.

At page 11 of the explanatory paper TasNetworks suggests:

TasNetworks considers that the link should only proceed as a regulated service if the present pricing framework is modified and/or appropriate financial contributions to support the project are secured, recognising that Marinus Link benefits are principally to mainland National Electricity Market (NEM) customers.

[31] AER - Final decision, Application guidelines for the regulatory investment tests, December 2018
[32] Second Bass Strait interconnector TasNetworks Revised Revenue Proposal 2019-24

The TSBC notes two significant elements of that statement:

1. The principal beneficiaries of the proposed Marinus project are mainland National Electricity Market (NEM) customers; and
2. The link should only proceed as a regulated service if the present pricing framework is modified and/or appropriate financial contributions to support the project are secured.

The first element reflects TSBC concerns and hence our insistence, as highlighted elsewhere in this submission, that the benefits and costs accruing to Tasmanian electricity consumers and the impact on Tasmanian electricity prices be clearly identified before the project is considered as a contingent project.

The requirement that the link only proceed if the present pricing framework is modified is of major concern to the TSBC, as it is not at all clear what such modifications might entail; how they would be brought about; and what role consumers would play in scrutinizing the modifications.

Of similar major concern to the TSBC is the changes which have occurred over time to the project triggers.

TasNetworks' indicated in their January 2018 Transmission Revenue and Distribution Regulatory Proposals[33]:

> *"The proposed trigger event for the AER's assessment of this project as a regulated transmission service would be:*
> *1(a) Successful completion of a RIT-T; or*
> *1(b) A decision by a government, governments(s) or regulatory body that results in a requirement for a second Bass Strait interconnector.*
> *2. TasNetworks Board approval to proceed with the project subject to the AER amending the revenue determination pursuant to the Rules".*

The proposed trigger events for this contingent project are now[34]:

> *"1. Successful completion of a RIT-T demonstrating an overall network investment by all parties involved in the interconnector construction that maximises the positive net economic benefits from establishing a new high voltage interconnection between Tasmania and Victoria, and/or that addresses a reliability corrective action;*
> *2. Determination by the AER that the proposed investment satisfies the RIT-T; or*
> *3. TasNetworks Board commitment to proceed with the project subject to the AER amending the revenue determination pursuant to the Rules.*
>
> *Clauses 1 and 2 do not apply if a change occurs that allows the inclusion of the proposed investment in TasNetworks' maximum allowed revenue even if a RIT-T is not carried out".*

The reference to the possibility that the Marinus project might proceed without the completion (and approval) of a RIT-T is another major concern for the TSBC, and we note the trigger points proposed

[33] TasNetworks - Tasmanian Transmission Revenue and Distribution Regulatory Proposal 2019 to 2024,31 January 2018, p106
[34] TasNetworks, Second Bass Strait interconnector, TasNetworks Revised Revenue Proposal 2019-24, p15

in the April 2017 study by Dr John Tamblyn[35] into the feasibility of a second interconnector. The report recommends at page 72:

> *"the Tasmanian Government develop a detailed business case for a second Tasmanian interconnector when ongoing monitoring establishes that one or more of the following preconditions has been met:*
>
> 1. *The Australian Energy Market Operator, in consultation with Hydro Tasmania and TasNetworks, concludes in a future National Transmission Network Development Plan that a second interconnector would produce significant positive net market benefits under most plausible scenarios.*
> 2. *Additional interconnection is approved for construction between South Australia and the eastern states.*
> 3. *A material reduction occurs in Tasmanian electricity demand".*

The TSBC notes with concern the difference between Dr Tamblyn's pre-conditions and the proposed trigger events, on the basis that TasNetworks' current trigger event 3 could be subject to political whim, rather demonstration of genuine benefits to consumers. That concern is exacerbated by the recent changes to the RIT-T guidelines noted above concerning capital contributions, which may also be subject to political whim.

The TSBC notes the acknowledgement that the major beneficiaries of the Marinus project would be mainland NEM customers and its major concerns in relation to the proposed trigger points for the project are in summary:

- The requirement that the link only proceed if the present pricing framework is modified;
- Changes which have occurred over time to the project triggers;
- The possibility that the Marinus project might proceed without the completion (and approval) of a RIT-T; and
- The potential for investment based on political, rather than economic, motivation, and the associated risks to Tasmanian electricity consumers and taxpayers.

The TSBC sees the combination of those concerns as being very significant and expects that the AER will also regard them as being very significant.

2.2.5.2 Other contingent projects

The TSBC notes that the two other contingent projects in TasNetworks revised proposals are the Sheffield to Palmerston 220 kV augmentation, at an estimated cost of $120 million, and augmentation of the 220 kV transmission system between Sheffield and Burnie, at an estimated cost of $80 million.

Both projects may be required to support the development of wind generation resources in the north west of the state, and to support the operation of a second interconnector (Marinus) should that project proceed.

[35] Feasibility of a second Tasmanian Interconnector, Final study, Dr John Tamblyn, April 2017

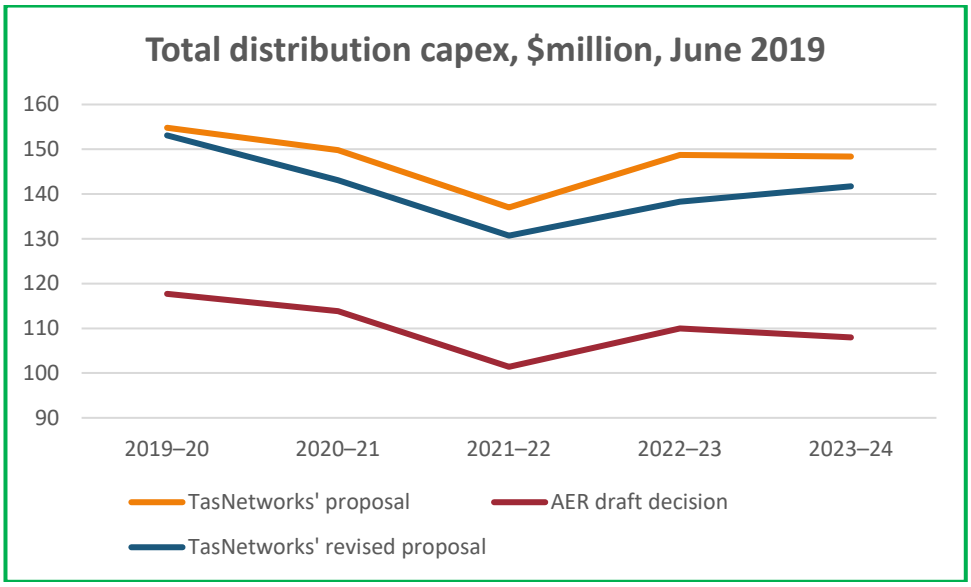
The benefits of those projects to wind generation proponents are readily apparent, however the benefits to Tasmanian electricity consumers, and the impact on electricity prices, are not at all clear.

Until that information is made available the TSBC does not support the inclusion of those projects as contingent projects.

2.3 Total Distribution Capex

We comment below on TasNetworks' response to the AER's draft decision on total distribution capex and then examine the main elements of the TasNetworks' distribution capex proposal – augmentation, replacement, other (including information technology (IT)) and contingent projects.

Figure 7: Total distribution capex



Source – Goanna Energy analysis

The AER's draft decision reduced TasNetworks proposed distribution capital expenditure (net of customer contributions) of $738.7 million by $156 million to $550.9 million, on the basis that TasNetworks had not justified that its total net capex forecast reasonably reflects the capex criteria as prescribed in the National Electricity Rules.

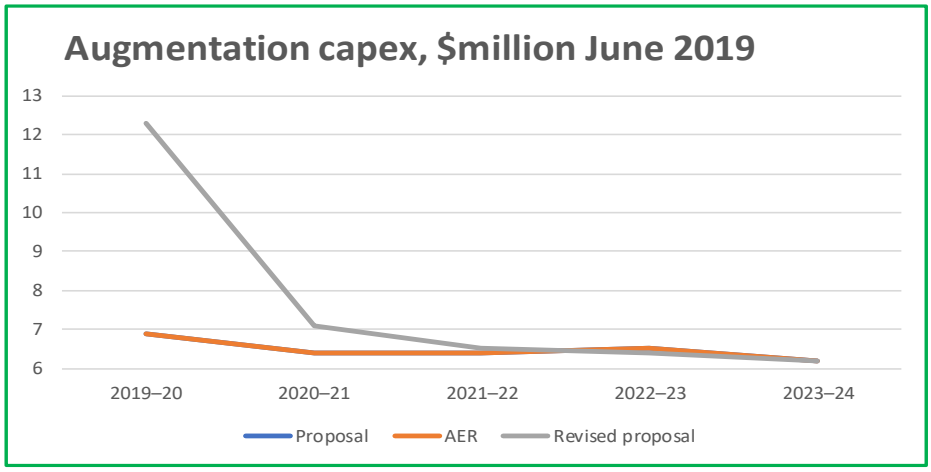
TasNetwork's revised forecast proposes expenditure totaling $706.9 million, which is $156 million more than the AER's draft decision, on the basis that the matters raised by the AER in their decision to substitute their own estimate have been addressed by TasNetworks in the revised proposal.

2.4 Comments on Elements of Proposed Distribution Capex

In this section, we comment on specific elements of the distribution capex forecasts..

2.4.1 Augmentation

Figure 8: Augmentation capex, distribution



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

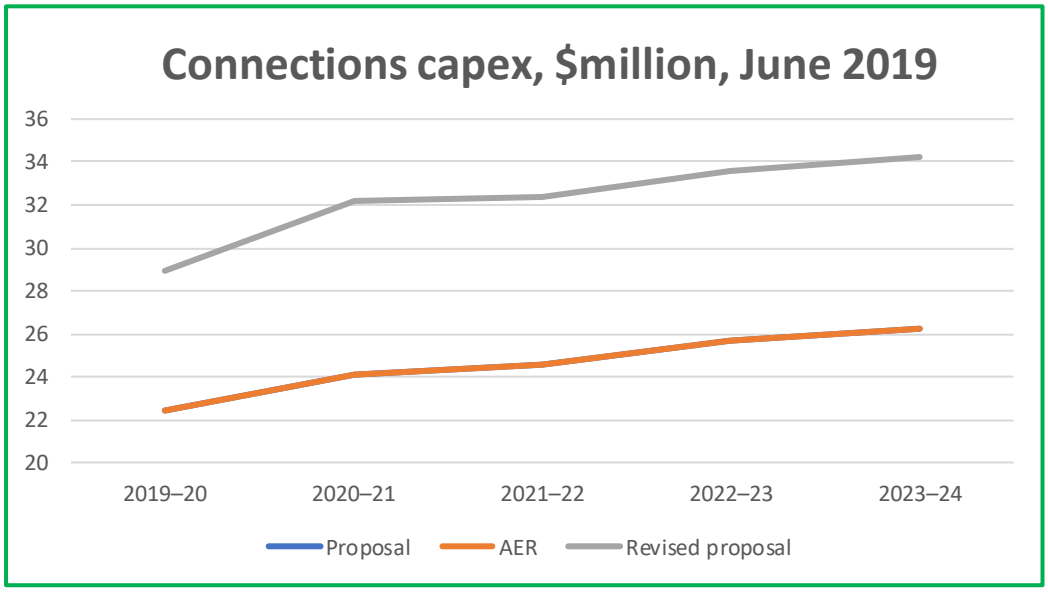
The TSBC notes that the AER accepted TasNetworks' proposal for augmentation expenditure. We also note TasNetworks' reference in its revised proposal (page 46) to the inclusion of an additional allowance of $1.3 million for the cost of an additional project to provide supply to Crotty Dam.

As shown in Figure 8 above however, TasNetworks revised proposal includes increases of $5.4 million in 2019-20 and $0.7 million in 2020-21.

The TSBC wishes to understand the reasons for those increases.

2.4.2 Connections

Figure 9: Connections capex, distribution



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

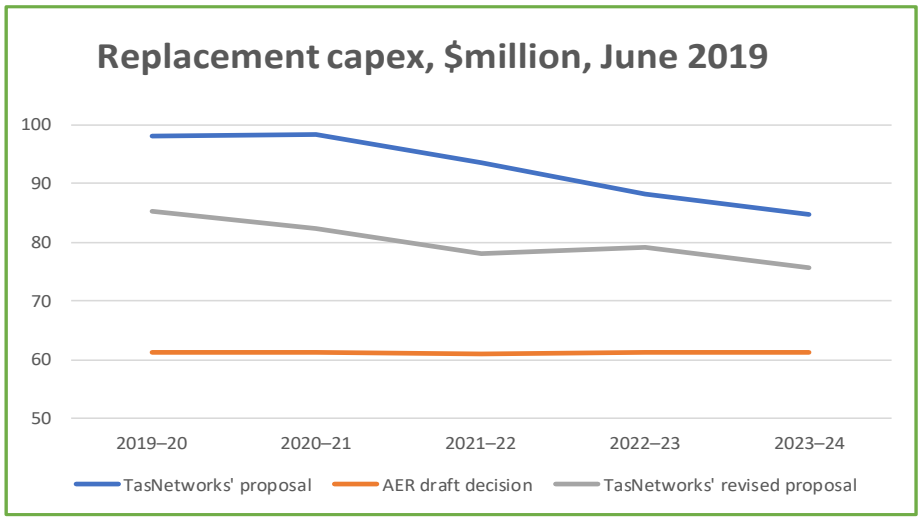
The TSBC notes that the AER accepted TasNetworks proposal for connections expenditure, and also notes TasNetworks' reference in its revised proposal to the fact that overhead costs had not been included in its proposed estimates.

Figure 9 above shows the revised forecast compared to the proposed and AER accepted forecast, being a 31% increase of $38.3 million on a total of $123 million.

The TSBC seeks AER confirmation that the increased forecast for connections expenditure is appropriate.

2.4.3 Renewal (replacement)

Figure 10: Replacement capex, distribution



Source – Goanna Energy analysis

In its draft decision (page 37) the AER did not accept that TasNetworks' proposed replacement capex (repex) of $463.0 million ($2018-19, including overheads) would form part of a total capex forecast that reasonably reflects the capex criteria. The AER's substitute forecast was $306.4 million.

TasNetworks' revised forecast is $400.3 million, $93.9 million (or 30%) greater than the AER's substitute forecast.

From the explanations provided by the AER and its appointed experts in its draft decision and the comments provided by TasNetworks in its revised proposal, the TSBC sees no reason for the AER to vary its draft decision and re-iterates the point made in its May submission[36] that, in a mature network business, we would expect to see a relatively stable level of replacement expenditure, and in fact, against the reality of significant previous overinvestment, an observable reduction.

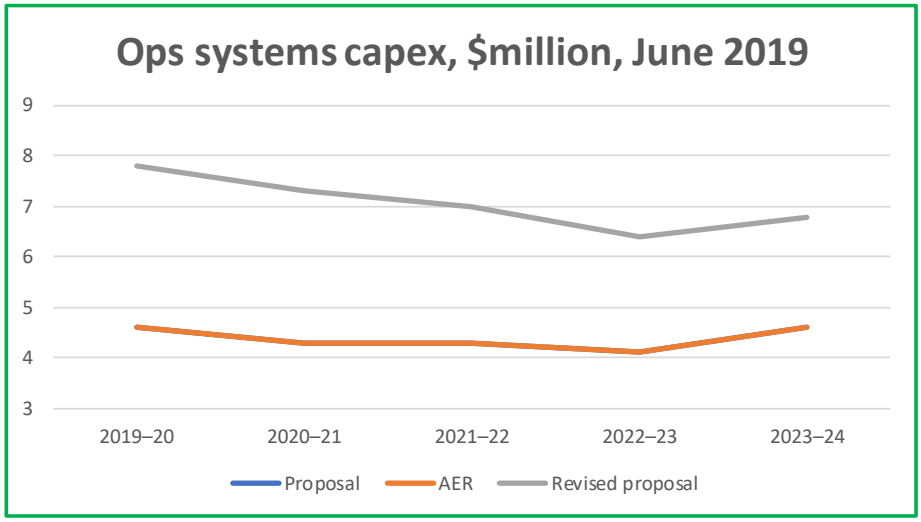
We refer to comments in section 2.2.3 of this submission concerning previous over investment, replacement expenditure, and the varying methods used to calculate replacement expenditure forecasts. In particular we refer to the expectation that TasNetworks should opt for less conservative

[36]TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposal, 2019-20 to 2023-24, May 2018

parameter values when undertaking risk assessments and assigning net present values in order to derive replacement expenditure forecasts.

2.4.4 Operational support systems

Figure 11: Operational support systems capex, distribution



Source – Goanna Energy analysis (proposal and AER draft decision lines are the same)

The TSBC is not able reconcile the information provided in table 5.15 of TasNetworks' revised proposal and Table 8.22 in its January 2018 proposal, as shown in Table 3 below:

Table 3: Operational support systems capex including historic data

Table 5-15: Distribution Operational Support Systems capital expenditure (June 2019 $m)

Category	2012-13	2013-14	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24
Distribution Network Control	1.2	2.5	3.8	2.0	0.8	1.0	2.0	0.8	0.9	0.8	0.5	2.4
Distribution Asset Management Systems	1.6	1.7	0.7	1.3	2.3	3.7	2.9	7.0	6.5	6.2	5.8	4.4
Total distribution Operational Support Systems	2.8	4.2	4.4	3.2	3.1	4.7	4.9	7.8	7.3	7.0	6.4	6.8

Table 8-22: Distribution Operational Support Systems capital expenditure (June 2019 $m)

Category	2012-13	2013-14	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24
Distribution Network Control	1.2	2.5	3.8	2.0	0.8	3.3	2.0	0.8	0.8	0.8	0.5	2.4
Distribution Asset Management Systems	1.6	1.7	0.7	1.3	2.3	12.9	2.9	3.9	3.5	3.6	3.6	2.2
Total distribution Operational Support Systems	2.8	4.2	4.5	3.3	3.1	16.3	5.0	4.6	4.3	4.3	4.1	4.6

The expenditure relating to distribution asset management systems in 2017-18 included in the former is $3.7 million, in the latter it is $12.9 million.

In its draft decision the AER noted at page 64:

"TasNetworks proposed operational support systems capex of $22.0 million for the 2019–24 regulatory control period, an average of $4.4 million per year. This is a 31 per cent reduction from the average annual operational support systems capex of $6.4 million for the previous five year period.

The AER based that assessment on the 2017-18 historic expenditure being $12.9 million.

It is the TSBC's understanding that the $12.9 million included the replacement/upgrading of asset management information systems, which obviates the need to repeat that process during the 2019-24 period.

We consider the average of $4.4 million per year proposed by TasNetworks as excessive on that basis, contrary to the AER's draft decision. An increase to over $7 million per year, as is forecast in the revised proposal[37] (table 5.15) is therefore unacceptable.

The TSBC seeks clarification by the AER of past and proposed expenditure levels, noting our comments at section 2.2.4.1 of this submission concerning the proposed total expenditure (transmission and distribution) on operational support systems of $49.4 million over five years.

2.4.5 Innovation

The TSBC notes the addition of $4.7 in "innovation" expenditure in its revised proposal, with that expenditure over and above that forecast in its January proposal.

TasNetworks suggest in their revised proposal (page58) that:

"we have now explicitly identified our distribution innovation capital expenditure in response to customer feedback".

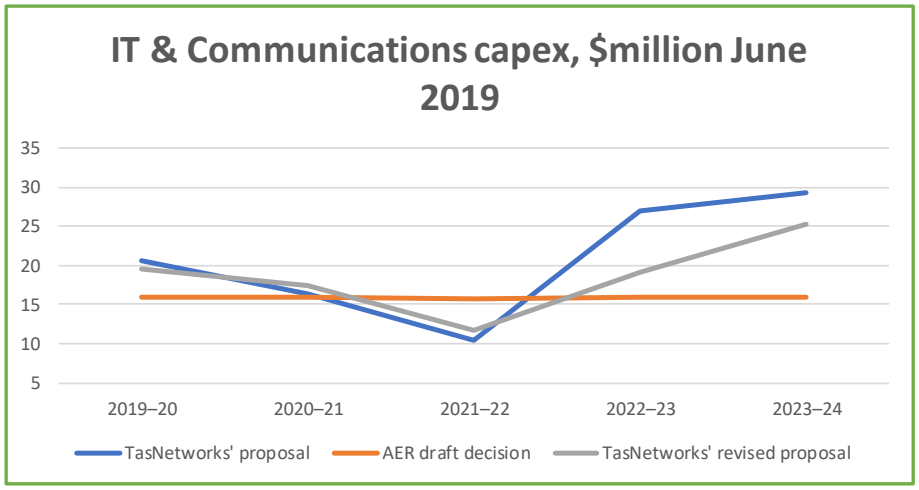
The TSBC expects that all of TasNetworks' expenditure categories will incorporate innovative thinking and the adoption of new technologies as appropriate and does not accept that consumers should pay for any additional amount to enable that to happen.

The proposed $4.7 expenditure should be rejected by the AER.

[37] TasNetworks - Tasmanian Transmission and Distribution Revised Proposals 2019 – 2024, Regulatory Control Period 1 July 2019 to 30 June 2024, 29 November 2018

2.4.6 Information technology and communications

Figure 12: Information technology and communications capex



Source – Goanna Energy analysis (note – the AER's draft decision provided only a total for the five years, which has been allocated evenly to each year)

In its May submission[38] the TSBC suggested:

"The TSBC contends that it is not possible to justify the level of expenditure proposed at more $1,000 per customer over ten years, given TasNetworks' very small customer base of around 250,000, and urges the AER to scrutinise the proposed expenditure with the assistance of experts competent in the field, in order to determine an appropriate amount for consumers to pay on the basis that systems are fit for purpose and have not been the subject of poor management decisions, for which consumers should not bear the costs".

We applaud the AER for seeking technical assistance from Arup to provide the scrutiny we proposed, and note the AER's conclusion in its draft decision (page 54):

"TasNetworks has not demonstrated that its proposed non-network ICT capex of $103.8 million is efficient and prudent and would form part of a total forecast capex allowance that reasonably reflects the capex criteria. We have instead provided an alternative estimate of $79.4 million for this draft decision, which is 24 per cent below TasNetworks' forecast".

Noting the detailed analysis undertaken by the AER and by Arup, we endorse the AER's draft decision, however we note the following:

- The AER in its draft decision endorsed the level of expenditure on operational support systems included by TasNetworks' in its January proposal (refer section 2.4.4 above). The TSBC does not support that level of expenditure and submit that it forms part of total proposed IT expenditure.
- TasNetworks made the strategic decision to migrate its systems to a Tier One ERP platform. That decision results in a cost platform which the TSBC contends is far in excess of what is efficient and delivers a substantial cost burden to all Tasmanian electricity consumers.

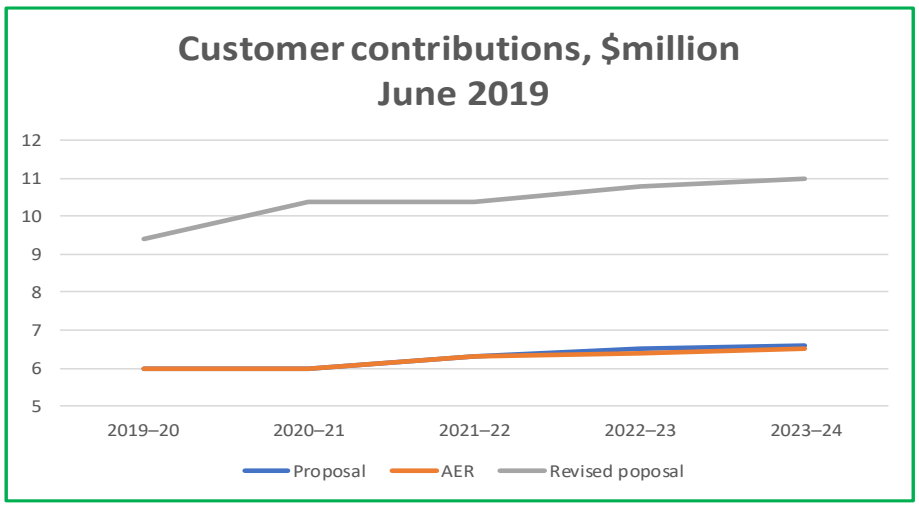
[38] TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposal, 2019-20 to 2023-24, May 2018, p49

- The AER's draft decision identified[39] that *"Arup noted that the alternative option provides a strong argument as it is lower cost, has less risk, is less complex, has lower business impact and can be delivered in a more effective time*". Arup's conclusion, in relation to the proposed Meter Data Management system replacement, aligns with the TSBC's cost burden contention.
- Having locked in to a Tier One strategy, the options available to TasNetworks to minimize IT costs will reduce, and every effort must be made to make the most of such opportunities as they arise.

We therefore urge the AER not to vary its draft decision in relation to ITC capex, and to reduce its draft decision in relation to systems operational support expenditure.

2.4.7 Customer capital contributions

Figure 13: Customer contributions (capex)



Source – Goanna Energy analysis

The TSBC notes TasNetworks' reference in its draft proposal (page 48):

"As indicated in the AER's draft decision, we have amended our forecast capital contributions upwards in light of our latest information from 2017-18."

The AER noted in its draft decision (page 29) that TasNetworks' January proposal included a forecast for customer capital contributions which, at $31.4 million, was 47 per cent less than actual and estimated customer contributions for the five year period 2014–19 and expected that forecast to be updated.

We note that TasNetworks' revised proposal includes an updated forecast for customer capital contributions totalling $52.0 million, which is in line with the previous five year period totalling $57.1 million.

[39] AER - TasNetworks Distribution Determination, 2019 to 2024, Attachment 5 Capital expenditure, September 2018, p58

3

RAB

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3 Regulatory Asset Base (RAB)

The value of TasNetworks' Regulatory Asset Base, combined with the allowed rate of return (WACC), represent the greatest contribution to TasNetworks revenues and thus electricity consumer prices.

Previous over-investment, which has been allowed by the AER and incorporated into TasNetworks RABs, is contributing to electricity prices for all Tasmanian electricity consumers which are higher than they should be, given the level of service which the relevant assets deliver (under utilization).

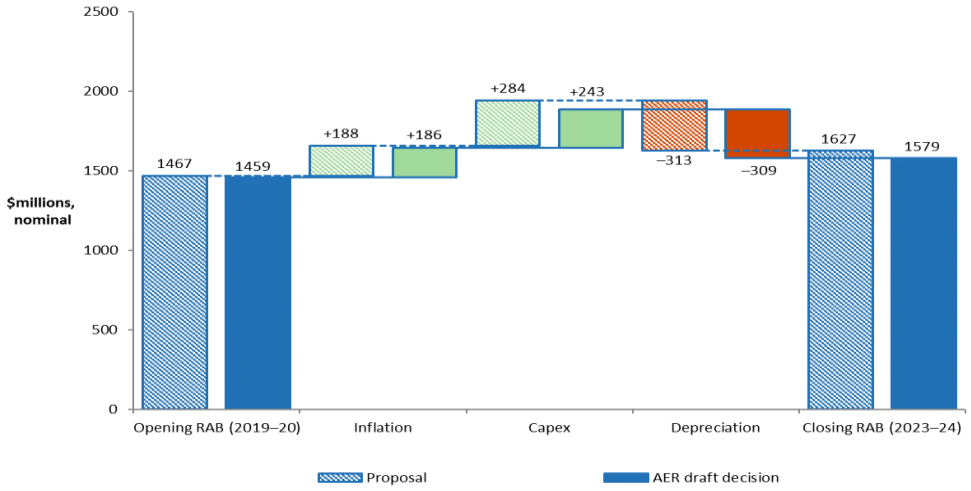
It is therefore imperative that, in the absence of any current mechanism to reduce the value of the RABs to what would be representative of an efficient level of investment, no value is added to the existing RAB values beyond what is demonstrably efficient and in the best long term interests of consumers.

In this section the TSBC puts forward its views on TasNetworks' proposed increases to the transmission and distribution RABs.

3.1 Transmission

In its draft decision[40] the AER compared the opening and closing values and the key drivers of the change in TasNetworks' transmission RAB over the 2019–24 regulatory control period - TasNetwork's January proposal versus the AER's draft decision, as shown in figure 14 below.

Figure 14: Drivers of RAB changes - transmission



Source – AER

Figure 14 above shows that under TasNetworks' January proposal, the value of the transmission RAB would decrease slightly in real terms, from $1,467 million to $1,439 million ($1,627 million closing RAB, less inflation of $188 million).

That slight reduction in the value of the transmission RAB would occur at a time when total Tasmanian electricity demand, demand, as indicated in AEMO's 2017 Electricity Statement of

[40] AER – Draft Decision, TasNetworks Transmission Determination, 2019 to 2024, Attachment 2, Regulatory asset base, September 2018, page 2.17

Opportunities (ESOO)[41] shown at table 4 below, is projected to fall, and is commensurate with that fall.

The AER's draft decision shows TasNetworks' transmission RAB decreasing in real terms from $1,459 million to 1,393 million ($1,579 million less $186 million inflation) – a slightly larger reduction.

The reduction in transmission RAB value represented in TasNetworks' revised proposals and the AER's draft decision is welcome, but fails to address the current over-investment, which is discussed at section 3.3

Table 4: Forecast demand, AEMO's 2017 ESOO

Forecast regional maximum operational demand (10% POE), Neutral scenario (MW)

	NSW		QLD		SA		TAS		VIC	
	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter
2016–17	14,096	13,104	9,354	8,334	3,099	2,716	1,416	1,765	9,477	7,801
2021–22	13,902	12,954	9,546	8,574	2,947	2,674	1,398	1,741	9,340	7,712
2026–27	14,171	13,153	9,929	8,868	2,925	2,702	1,409	1,754	9,330	7,515

Forecast regional maximum operational demand (50% POE), Neutral scenario (MW)

	NSW		QLD		SA		TAS		VIC	
	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter	Summer	Winter
2016–17	13,157	12,630	8,700	7,964	2,925	2,623	1,377	1,718	8,869	7,520
2021–22	12,891	12,522	8,910	8,161	2,783	2,591	1,361	1,699	8,662	7,463
2026–27	12,914	12,699	9,442	8,517	2,752	2,604	1,375	1,711	8,618	7,258

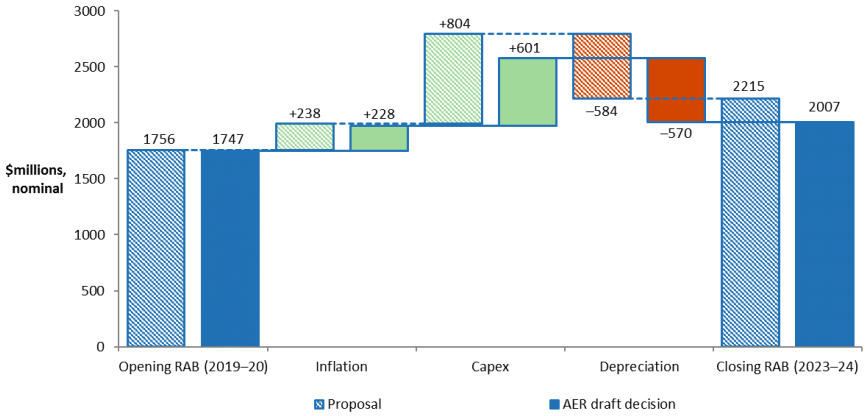
Source - AEMO

[41] AEMO – Electricity Statement of Opportunities for the National Electricity Market, September 2017, p15

3.2 DISTRIBUTION

In its draft decision[42] the AER also compared the opening and closing values and the key drivers of the change in TasNetworks' distribution RAB over the 2019–24 regulatory control period - TasNetwork's January proposal versus the AER's draft decision, as shown in figure 15 below.

Figure 15: Drivers of RAB changes - distribution



Source - AER

Figure 15 also shows the comparison between the changes in RAB under TasNetworks' January proposal, the value of the distribution RAB would increase in real terms, from $1,756 million to $1,977 million ($2,215 million closing RAB, less inflation of $238 million), a real increase of around 12.6%.

The AER's draft decision shows TasNetworks' transmission RAB increasing slightly in real terms from $1,747 million to 1,779 million ($2,007 million less $228 million inflation).

The real increase in the value of the distribution RAB proposed by TasNetworks would occur at a time of projected decreasing demand, as discussed above.

Any increase in TasNetworks' RABs during a period of declining demand would result in itself in an increase in network prices, as a result of the application of RAB X WACC to derive allowed returns.

Any increase is therefore not acceptable to Tasmanian small business customers, let alone a real increase in the order of 12.6%.

3.3 RAB REDUCTION

The TSBC's May submission[43] discussed at section 7 the growth over time in TasNetworks' transmission and distribution RABs, the impact on prices and the case for a reduction in the value of those RABs.

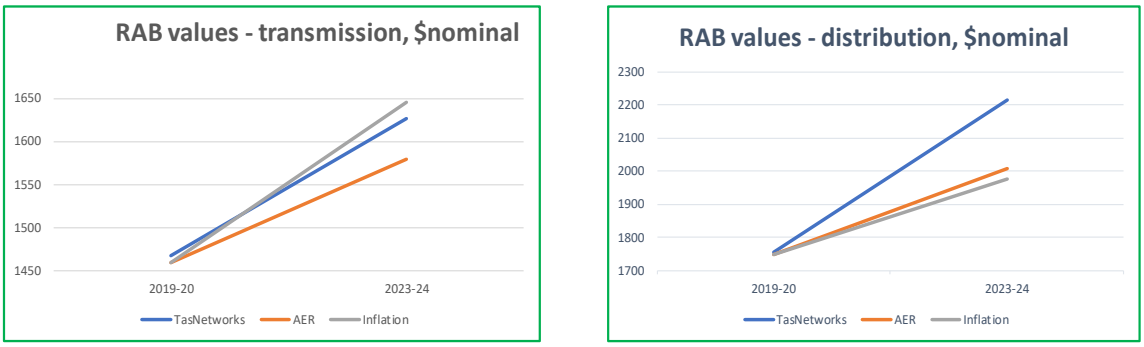
[42] AER – Draft Decision, TasNetworks Distribution Determination, 2019 to 2024, Attachment 2, Regulatory asset base , September 2018, page 2.17

[43] TSBC - TasNetworks Transmission Revenue & Distribution Regulatory Proposal, 2019-20 to 2023-24, May 2018

Figure 16 below compare the increases in the value of TasNetworks' transmission and distribution RABs in its revised proposals, compared to inflation, over the Regulatory Control Period 2019-20 to 2023-24.

The combined RAB values in the TasNetworks' proposals would result in an increase above inflation from June 2019 levels of around $193 million, during a period when total demand is expected to fall:

Figure 16: Growth in RAB values



Source – Goanna Energy analysis

The fact that TasNetworks are proposing capital expenditure which would result in such an increase, against a reduction in expected demand, despite the recent focus on inflated RABs,[44] suggests that something in the regulatory regime is not working as it should. The regime clearly provides insufficient incentive for electricity network companies to address previous over-investment and the resulting price penalty consumers are paying as a result of that over-investment.

The ACCC recommended at page 171 of its recent report into Retail Electricity Pricing[45]:

"Recommendation 11. The governments of Queensland, NSW and Tasmania should take immediate steps to remedy the past over-investment of their network businesses in order to improve affordability of the network. With appropriate assistance from the Australian Government, this can be done: in Queensland, Tasmania and for Essential Energy in NSW, through a voluntary government write-down of the regulatory asset base ……."

That recommendation has not been adopted.

In this submission we have proposed at Section 2.2.3 a mechanism which would reduce the value of the RABs over time, by linking the regulatory approval of capital expenditure to defined improvements in/levels of asset utilization.

The TSBC suggests that the AER and the AEMC should consider such a mechanism, or mechanisms which would achieve the same outcome, in the expectation that the ACCC's recommendation noted above continues to be not acted upon.

We believe that the current cost of accessing the electricity network (network charges) encourages consideration of off-grid solutions which are becoming increasingly affordable to all electricity

[44] For example Grattan - see https://grattan.edu.au/report/down-to-the-wire/
[45] ACCC - Restoring electricity affordability and Australia's competitive advantage Retail Electricity Pricing Inquiry, Final Report, June 2018

consumers, including small business, with a corresponding risk to network operators, investors and consumers.

4

WACC

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4 Weighted Average Cost of Capital (WACC)

Since TasNetworks submitted its Tasmanian Transmission Revenue and Distribution Regulatory Proposals in January 2018[46] there have been a series of key milestones relevant to the WACC which will apply to TasNetworks revenues. Those are:

- COAG Energy Council agreement to the proposed legislative package to implement a binding rate of return instrument, June 2018 (giving the AER and the WA ERA the power to implement a legislative instrument that sets out the approach they will use to determine the rate of return and the value of imputation credits[47];
- AER draft decision, Rate of Return Guideline, July 2018[48];
- AER draft decision, TasNetworks' Proposals, rate of return;[49] and
- AER final decision, Rate of Return Instrument, December 2018[50].

The TSBC notes the AER's position in its draft decisions on TasNetworks proposals[51] to apply the (then) draft decision on the Rate of Return Guideline:

"The legislation to create a binding guideline has not yet been passed and as such we are still operating under the current rules of a 2013 non-binding Guidelines. As such we have considered TasNetworks' proposal under this framework, but for the reasons set out in the explanatory statement to the draft 2018 Guidelines have determined to apply the draft 2018 Guidelines. This is, in a sense, a departure from the 2013 Guidelines itself.

In its Revised Proposals[52] TasNetworks acknowledged that position along with the fact that the AER's draft Rate of Return Guideline decision would be updated and the final decision applied to its final decision in relation to TasNetworks Proposals:

"It should be noted that we accept the rate of return in the AER's draft decision on the basis that:

- *it will be updated to reflect the AER's finalised 2018 Guidelines; and*
- *legislation is enacted requiring the Guidelines to apply for the 2019-24 regulatory period.*

For the purpose of this revised Regulatory Proposal, and subject to the caveats set out above, we accept the draft decision that the rate of return for transmission is 5.77 per cent (nominal vanilla, indicative) and for distribution is 5.51 per cent (nominal vanilla, indicative), for the first year of the 2019–24 regulatory control period. As explained in our original Regulatory Proposal, the rate of return will be updated annually to reflect the updated cost of debt".

[46] TasNetworks - Tasmanian Transmission Revenue and Distribution Regulatory Proposals for the Regulatory Control Period 1 July 2019 to 30 June 2024, 31 January 2018
[47] COAG Energy Council Senior Committee of Officials - BULLETIN, Binding Rate of Return Guideline, June 2018
[48] AER - Draft Rate of return guidelines Explanatory Statement, July 2018
[49] AER - Draft Decision, TasNetworks Distribution Determination and Transmission Determination, 2019 to 2024 Attachment(s) 3, Rate of return, September 2018
[50] AER - Rate of return instrument, Explanatory Statement, December 2018
[51] AER - Draft Decision, TasNetworks Distribution Determination and Transmission Determination, 2019 to 2024, Attachment(s) 3, Rate of return, September 2018, page 3.5 in each attachment
[52] TasNetworks - Tasmanian Transmission and Distribution Revised Proposals 2019 – 2024, Regulatory Control Period 1 July 2019 to 30 June 2024, 29 November 2018, p89

The TSBC notes the AER's final decision on the Rate of Return instrument and its application to TasNetworks Proposals, with the key elements being[53]:

Table 5: AER final decision, rate of return

Indicative rate of return	5.36%
Indicative return on equity	6.36%
Indicative return on debt	4.70%
Value of imputation credits	0.585

Source - AER

4.1 WACC – TRANSMISSION AND DISTRIBUTION, TASNETWORKS' PROPOSALS

In its January Proposals[54], TasNetworks indicated:

"For the forthcoming regulatory period, we have decided to respond to the affordability concerns raised by customers by proposing to align the transmission and distribution WACC estimates to reflect the lower figure, being 5.89 per cent for distribution".

In the Proposals TasNetworks calculated the WACC to apply to the transmission RAB as 6.15% and the WACC to apply to the distribution RAB as 5.89%.

With an average transmission RAB of $1.5 billion over the period 2019-20 to 2023-24, TasNetwork's concession would have resulted in a saving to electricity consumers over the five years of around $20 million.

4.2 WACC – AER DRAFT DECISION

In its draft decision[55] the AER allowed a WACC of 5.77% on the transmission RAB and 5.51% on the distribution RAB.

Had the AER accepted the position proposed by TasNetworks in their January Proposals, that is a WACC of 5.51% to apply to both RABs, electricity charges over the five years 2019-20 to 2023-24 paid by Tasmanian electricity consumers would be around $20 million lower than in its draft decision.

The TSBC wishes to understand why the AER did not adopt the position put forward by TasNetworks, and why that position should not apply in the AER's final determination.

[53] AER - Rate of return instrument, Explanatory Statement, December 2018
[54] TasNetworks - Tasmanian Transmission Revenue and Distribution Regulatory Proposal for the Regulatory Control Period 1 July 2019 to 30 June 2024, 31 January 2018, p170
[55] AER - Draft Decision, TasNetworks Distribution Determination and Transmission Determination, 2019 to 2024 Attachment(s) 3, Rate of return, September 2018, p36

5

OPEX

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5 Operating & Maintenance Expenditure (Opex)

We comment below on certain aspects of TasNetworks' operating expenditure (opex) forecasts for the 2019-24 regulatory period based on the AER's Draft Determination and TasNetworks' Revised Proposal. We cover the following areas of interest to Tasmanian small businesses:

- Comments on the overall opex forecasts for transmission and distribution.
- Changes in the allocation of transmission and distribution opex across their various categories.
- Choice of a base year for the opex forecasts.
- Treatment of productivity growth in the forecasts for distribution.
- Implications for the opex forecasts of the recently released AER 2018 transmission and distribution benchmarking reports.

5.1 Comments on Overall Opex Forecasts

We note that the AER's Draft Decisions have accepted without change the transmission and distribution opex forecasts originally proposed by TasNetworks. In this regard, we note again our concern that the AER has consistently produced forecasts for TasNetworks' opex using its opex forecasting model that are higher than the forecasts proposed by TasNetworks. This was the case for its previous transmission and distribution determinations and is again the case for this joint draft determination. This is a surprising outcome of the model and may be indicative of shortcomings within it. We comment on this matter further below in the section dealing with the treatment of productivity growth in the forecasts (Section 5.4).

In the meantime, TasNetworks' Revised Proposal contains an opex forecast for the next regulatory period across the business (transmission and distribution combined) of $588.8 million, compared to $602.6 million in its original Proposal. This is a welcome, albeit quite modest, reduction of $13.8 million, or 2.3 per cent. We note that this outcome goes some way towards meeting the concern, expressed in our submission responding to TasNetworks' proposal, that its opex forecasts remained high and did not contribute enough to the affordability priority of Tasmanian small business consumers.

We also observe that this is made up of a $45.5 million reduction in transmission opex and a $31.7 million increase in distribution opex. Whilst this is a welcome overall reduction in combined opex, it appears that small consumers will be almost $7 million worse off as a result of these combined effects, given that they pay around 55 per cent of transmission opex but all of distribution opex.

5.1.1 Transmission Opex

The TSBC welcomes the significant $24.1 million, or 14 per cent, reduction in TasNetworks transmission opex forecast for the next regulatory period of $146.6 million, compared to $170.7 million for the current period ($2018-19). We also welcome that this amount is $45.5 million below the $192.1 million originally proposed by TasNetworks and accepted by the AER in its Draft Decision. Notwithstanding this outcome, it remains of concern to us that TasNetworks' annual transmission opex over the next regulatory period (expressed in constant dollars) is forecast to remain virtually unchanged from its level of $29.5 million in 2017-18 (the most recent year for which audited actual opex is available). The expectation of the TSBC is that TasNetworks will continue to find ways to reduce the aggregate level of its opex over time through efficiencies and other cost savings rather than settle on a steady state.

5.1.2 Distribution Opex

The overall opex forecast for distribution for the 2019-24 regulatory period in TasNetworks' Revised Proposal is rather disappointing to small business. TasNetworks' revised proposal is for distribution opex of $442.2 million over the whole period compared to $423.3 million over the previous five years and $410.5 million originally proposed, which was accepted by the AER in its Draft Decision. This represents an increase of $18.9 million, or 4.5 per cent over the previous five years; and $31.7 million, or 7.7 per cent, over TasNetworks' original proposal.

We believe that TasNetworks needs to provide clear and acceptable justifications for this increase and urge the AER to ensure that this happens. We find it somewhat incongruous that TasNetworks original proposal put forward a lower level of opex as being prudent and efficient but it now suggests that a materially higher level is needed, notwithstanding that there are substitution possibilities between transmission and distribution opex, and that the combined level of forecast opex is lower than originally proposed.

5.2 Changes in the Opex Category Forecasts

We appreciate that the AER is focused on an assessment of TasNetworks' opex forecasts that emphasise the efficiency of its overall opex rather than a category assessment, but it is also useful to examine the latter to help to understand where increases in costs are coming from.

Examining TasNetworks' Revised Proposal compared to its original Proposal reveals that forecast distribution opex in the category Emergency Field Operations has increased from $43 million under TasNetworks' original Proposal to $92.8 million under its revised proposal, an increase of $49.8 million or 116 per cent. This is a very significantly increase and is the main driver behind the significantly higher distribution opex in the Revised Proposal. The forecast for the category Distribution Asset Services has increased by $11.5 million to $54.5 million, or 21 per cent. On the other hand, the category 'Other' Operating Expenditure has decreased from $74.1 million originally to $57.5 million.

For transmission opex, significant differences in TasNetworks' Revised Proposal compared to its original forecasts are also apparent. Maintenance and Vegetation Management Services have reduced from $93.9 to $64 million, a reduction of $29.9 million or 32 per cent, while Business Services have gone from $70.4 million originally to $47.4 million, a reduction of $23 million or one-third. However, 'Other' Operating Expenditure has risen by $8.7 million to $29.3 million (from $20.6 million).

TasNetworks has provided insufficient explanation for these significant category changes and variations in its Revised Proposal. To some extent, TasNetworks may have simply moved opex from its transmission business to its distribution business, perhaps for justifiable reasons? However, the wide ranging nature and magnitude of changes in the category forecasts is a matter of concern to us and *prima facie* causes us to question the veracity of TasNetworks' opex forecasts and its internal approach to forecasting opex.

We suggest that the AER undertake a thorough assessment of the reasons for the increases and changes in TasNetworks' distribution and transmission opex in its Revised Proposal compared to its original Proposal and seek further advice from the business as necessary.

5.3 Choice of Base Year

The choice of a base year for the opex forecasts is an important part of the process of forecasting TasNetworks' opex for the 2019-24 regulatory period. The choice made is meant to reflect an efficient level of opex for TasNetworks.

TasNetworks proposed that 2017-18 should be chosen as the base year for both its transmission and distribution opex and the AER accepted this. TasNetworks' Revised Proposal also nominated 2017-18 as its base year.

The TSBC did not support the choice of 2017-18 as an appropriate base year. We felt that 2016-17 provided a better choice for the transmission opex base year as it was more reflective of TasNetworks' underlying efficient transmission opex. In addition, we felt that 2014-15 (or perhaps 2015-16) better reflected the underlying efficient opex of the TasNetworks distribution network, which increased significantly in the following year due to increased expenditure on vegetation management associated with claimed heightened bushfire risks based on Victorian information. We did not see the overriding need to have a common base year for both transmission and distribution opex.[56]

TasNetworks has included in its Revised Proposal actual (audited) opex for 2017-18 and used this as the basis for its revised opex forecasts. These numbers are reproduced in Table 6 below.

Table 6: Base Year Opex, $million June 2019

	Proposal (Est)	Revised Proposal (Actual)	Difference $	Difference %	TSBC Original Submission	Difference from Revised Proposal
Transmission	38.40	29.50	(8.90)	-23.2%	34.00	4.50
Distribution	82.10	90.20	8.10	9.9%	69.90	(20.30)
Total	120.50	119.70	(0.80)	-0.7%	103.90	(15.80)

Source: Goanna Energy Consulting

We note that the actual outcomes for transmission opex in 2017-18 produced a significantly lower level of opex than TasNetworks' original estimate and also lower than for 2016-17 (which we initially supported). On this basis and as 2017-18 is the latest year for which actual opex is now available, we now support its use as a suitable base year for the transmission opex forecasts.

In relation to the distribution opex forecasts, the actual outcome for 2017-18 is higher than both the estimate for this year proposed by TasNetworks and substantially higher than for 2014-15, the year supported by us as an appropriate base. In fact, whilst it is 9.1 per cent lower than in 2016-17, it is 19.9 per cent higher than in 2015-16 and 29 per cent higher than in 2014-15. Such a significant increase in opex, justified by TasNetworks as due to assessed higher bushfire risks based on Victorian assessments, should be thoroughly assessed by the AER. TasNetworks has stated that it expects the level of opex in this category to reduce over time and is forecasting a small 1.5 per cent reduction from the end of this regulatory period to the end of the next. Whilst we welcome the downwards trend, in our view it does not yet provide convincing support for its claims about reductions over time in this category of opex.

[56] The reasons for our positions are elaborated on in our May submission.

We acknowledge the point made by the AER in its Draft Decision that:

> *"… given we consider revealed expenditure to be not materially inefficient (see below), and we are not making an efficiency adjustment, the choice of base year has little impact on the net revenue allowance. This is because any increase in opex is counteracted by a decrease in the EBSS carryover. These two effects cancel each other out from a net revenue allowance perspective."*[57]

However, we contend that on the basis of the points made in the previous paragraph and in our submission on TasNetworks' original Proposal, there is reason to suspect that TasNetworks' distribution base year opex may well be materially inefficient and that the EBSS provides only a partial countervailing force.[58] The AER should therefore re-examine the choice of an appropriate base year for distribution opex in its Final Decision.

5.4 Treatment of Productivity in the Distribution Opex Forecasts

The TSBC believes that it is important for the regulatory process to ensure that network service providers continue to pursue greater efficiencies through productivity growth and that the associated benefits flow through to customers, thus helping to keep network prices affordable. We therefore support the inclusion of a productivity factor in opex forecasts.

We did not comment on this matter in our previous submission responding to TasNetworks' regulatory Proposal, as TasNetworks included a 1 per cent per annum efficiency factor in its opex proposals for both transmission and distribution, although we did point out that there was little explanation for the 1 per cent number chosen and queried why it applied a lower efficiency factor in 2020-21 (0.5 per cent) and no efficiency factor in 2019-20. Whilst we welcome TasNetworks' inclusion of an efficiency factor in its 2019-24 opex, from our perspective, in the long term, it would be better if a transparent approach to productivity growth were applied by the regulator which ensures that further productivity growth is a feature of TasNetworks' future opex. The TSBC would like to see continuous improvement in relation to TasNetworks' opex outcomes and the application of measures by both TasNetworks and the regulator that ensure this.

To this end, the AER has been undertaking a review of its current approach to opex productivity, which assumes zero growth. We note that this is based on empirical observations that the productivity of NEM distribution businesses has been improving in recent years and the AER's expectation that this will continue, albeit at a slower pace.

The AER has recently published a Draft Decision Paper[59] on this matter, which proposes to apply a 1 per cent productivity growth factor to opex forecasts in its distribution decisions beginning from April 2019, which will include this determination. We support this but query whether the application of 1 per cent opex productivity growth is sufficient. The AER's Draft Decision Paper appears to err overly on the side of caution and its expectation that future productivity growth in the distribution sector will slow down is a matter of concern to the TSBC. As already mentioned, our expectation is the TasNetworks distribution will continue to pursue productivity gains with vigour.

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[57] AER, *Draft Decision – TasNetworks Transmission Determination 2019-24*, Attachment 6 – Operating Expenditure, p. 6-13.

[58] We note that CCP 13 in its submission on TasNetworks' Proposal raised a concern about the lack of clarity in the use of the term "not materially inefficient" in the AER's benchmarking of opex.

[59] AER, *Draft Decision Paper, Forecasting Productivity Growth for Electricity Distributors*, November 2018.

TasNetworks commented on the AER intended approach to forecasting opex productivity for distributors in its Revised Proposal. It comments that:

> *"Our view is the [sic] productivity growth should reflect the particular circumstances for each distributor, rather than adopting a 'one size fits all' approach. In our case, we have proposed productivity savings, in addition to a reduced claim for the costs of 'step changes' and absorbing the costs associated with projected growth.*
>
> *The combined effect of these commitments exceed the 1 per cent per annum savings indicated in the AER's draft decision paper."*[60]

If it is TasNetworks' view that it can continue to exceed the 1 per cent per annum productivity growth rate the AER proposes to apply, then we welcome that. However, we expressed disappointment in our earlier submission that TasNetworks' own benchmarking report questioned if it could pursue the same level of efficiency savings into the future.[61] The AER's proposed productivity factor therefore provides additional certainty to Tasmanian small business that TasNetworks' distribution opex will continue to be subjected to further productivity improvements in future, although we do not expect its application in the Final Determination for the 2019-24 regulatory period to have much impact given that TasNetworks' proposed efficiency factor exceeds the AER's productivity growth rate.

Finally, we note that the future application of the AER's proposed productivity factor may help to overcome the curious outcome whereby the AER has been forecasting opex at higher levels than TasNetworks' proposals for some time. Goanna Energy raised this matter on behalf of the TSBC at the AER's stakeholder forum on its Draft Decision in Hobart on 23 October 2018 and the AER's response indicated this to be the case.

5.5 Implications of the AER's 2018 Economic Benchmarking Reports

Economic benchmarking by the AER is an important tool to assist it to determine an efficiency level of opex in transmission and distribution regulatory determinations. The publication of annual economic benchmarking reports by the AER also provides consumers, including small business, with important information to help them reach a position on the efficiency of opex proposals put forward by network businesses. Having access to this information has assisted the TSBC to make a more robust assessment of the efficiency of TasNetworks' opex proposals for this determination.
We made use of the AER's 2017 Economic Benchmarking Reports for transmission and distribution in assessing TasNetworks' opex proposal in our original submission. The recent publication of the AER's 2018 Economic Benchmarking Reports for transmission and distribution[62] allows us to update our assessment to include outcomes for 2016-17 and apply these to TasNetworks' revised opex proposals. We comment below on the implications of the latest reports on TasNetworks' revised opex proposals for transmission and distribution.

5.5.1 Transmission Opex

The AER's 2018 Economic Benchmarking Report for transmission shows TasNetworks to be a leading performer in that it ranks first in terms of Multilateral Total Factor Productivity (MTFP). TasNetworks also improved its MTFP by 6 per cent between 2016 and 2017, although it was outperformed by three other NEM transmission businesses. The main reason for TasNetworks' good

[60] TasNetworks, Revised Proposal, 29 November 2018, p. 76.
[61] TSBC, Submission on TasNetworks Transmission and Distribution Regulatory Proposals, 2019/20 to 2023/24, May 2018, p.74.
[62] AER, *Annual Benchmarking Report, Electricity transmission network service providers* and *Annual Benchmarking Report, Electricity distribution network service providers*, November 2018.

performance was a 4.1 per cent contribution of opex, followed by energy throughput (1.5 per cent). TasNetworks' opex Multilateral Partial Factor Productivity (MPFP) has improved for most of the time from 2008 and improved again from 2016 to 2017. These are pleasing outcomes that have now been sustained over a significant period, although the essentially steady level of transmission opex over the next regulatory period contained in TasNetworks' Revised Proposal could bring this pleasing tend to an end.

The results in the AER's 2018 Economic Benchmarking Report for transmission support the view that TasNetworks' opex is relatively efficient and has been on a long term improving trend. This tends to support its view that its base year opex is relatively efficient but we note that the trend of transmission opex over the next five years contained its it Revised Proposal could bring its strong performance to an end. Moreover, other transmission entities have also improved their performance over time (noting that AusNet and Transgrid already rank higher than TasNetworks in opex MPFP and outperformed TasNetworks in opex productivity and MTFP from 2016 to 2017).

5.5.2 Distribution Opex

TasNetworks distribution business has delivered a generally disappointing outcome in terms of productivity. According to the AER's Economic Benchmarking Report for distribution, TasNetworks has lagged in MTFP since the beginning of the AER's data set (2006) such that TasNetworks has been one of the worst performing distribution businesses in the NEM. Moreover, there has been a significant deterioration in its MTFP performance since 2015. TasNetworks distribution MTFP score fell by a further 8 per cent from 2016 to 2017 so that its ranking slipped from 10th to 12th out of 13 NEM distributors (only Ausgrid performed worse).

Opex productivity fell significantly and contributed 9.5 per cent to the overall 8 per cent fall in MTFP from 2016 to 2017. According to the AER:

> *"TasNetworks experienced some of the largest improvements in productivity of any DNSP between 2012 and 2015, due to improvements in its opex efficiency. However, large increases in opex in 2016 and 2017 have now eroded most of these prior gains.[63]"*

TasNetworks' opex MPFP has deteriorated significantly since 2015 to again sit at its 2012 level and includes a 27 per cent deterioration from 2016 to 2017. We have already noted earlier in this submission that TasNetworks attributes these significant increases in opex to its need to respond to increased bushfire risk based on Victorian information.

The generally poor productivity performance of TasNetworks' distribution network is a matter of concern to the TSBC. It is clear from the recent increases in distribution opex, the fall in opex MPFP since 2015 and the major contribution of falling opex productivity to the decline in MTFP that its opex is far from efficient. Moreover, the AER's2018 Economic Benchmarking Report for distribution points out that several jurisdictions are in the process of reforming and restructuring their distribution businesses with increases in productivity expected to follow. This could place TasNetworks' distribution arm in an even worse relative position in future unless steps are taken to address this threat.

Seen in this light, the choice of 2017-18 as a base year for 'efficient' distribution opex, the significant further increase in distribution opex proposed in TasNetworks' Revised Proposal and the continuing high levels of opex over the next regulatory period are of major concern to the TSBC. This strongly suggests that distribution prices will be higher than they should be and challenge TasNetworks' affordability claim.

[63] AER, *Annual Benchmarking Report, Electricity distribution network service providers*, November 2018, p. 11.

6

Annual Revenue Requirement

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6 Annual Revenue Requirement

In this section of our submission we discuss the Annual Revenue Requirements (AAR) of the AER's transmission and distribution Draft Decisions and TasNetworks Revised Proposal.

6.1 Transmission

The AER Draft Decision is for a total AAR of $787.8 million ($nominal) for the 2019–24 regulatory control period. This represents a reduction of $16.9 million or 2.1 per cent compared to TasNetworks' Proposal ($799.6 million) and reflects the impact of the draft decision on the various building block costs (discussed below). We welcome the reductions made by the AER to TasNetworks' proposal which go some way towards addressing issues the TSBC raised in its original submission and assists in the task of keeping prices for small business lower than would otherwise be the case.

Returning to the building blocks we offer the following comments:

- The return on capital allowance adjustment made by the AER of $14.9 million, or 3.3 per cent, accounts for 88 per cent of the reduced total AAR and is a welcome outcome for small business in Tasmania. This is mainly due to the application of the WACC parameters contained in the AER's final decision, Rate of Return Instrument [64].
- The AER has imposed a reduction in the cost of corporate income tax allowance of $9.2, million or 45.7 per cent, on TasNetworks' proposal. This comprises 54 per cent of the reduced total AAR. We also welcome this.
- The impacts of these on the total AAR are partly offset by an increase in the revenue adjustments of $8.6 million. We recognise that this is to compensate TasNetworks for greater efficiencies in its capex and opex which is intended to ultimately benefit customers.
- However, we are disappointed that the AER has accepted without any changes the opex proposed by TasNetworks, which we questioned in our earlier submission. We continue to believe that there is scope to further reduce the transmission opex proposed by TasNetworks and have raised in Section 5.4 of this submission our concerns about the AER's current modelling of TasNetworks' opex proposals.

The AER's Draft Decision refers to an issue raised in our earlier submission regarding TasNetworks' smoothing profile proposal, where we commented that it is possible customers will prefer the certainty of lower network charges up front.65 We note the AER's response that its profile of 'X' factors for revenue smoothing results in expected revenue in the last year of the regulatory control period that is as close as reasonably possible to the annual building block revenue requirement for that year given the regulatory requirements in this area. We observe that the AER's smoothed revenues for TasNetworks' transmission shown in Figure 1.2 in Attachment 1 of its Transmission Draft Decision addresses the point we raised in that Tasmanian consumers, including small business, will see larger reductions in transmission charges up front under the Draft Decision.

Turning to TasNetworks' Revised Proposal, we note that its total AAR (unsmoothed) is now $785.8 million, which is $2 million below the AER's Draft Decision ($787.8 million) and $18.9 million below TasNetworks' original Proposal. The main reason for the differences in TasNetworks' Revised Proposal compared to its original Proposal and the Draft Decision are a significant reduction in

[64] AER - Rate of return instrument, Explanatory Statement, December 2018

[65] AER, *TasNetworks Transmission Draft Determination*, Attachment 1 – Annual Revenue Requirement, p. 1-16.

transmission opex of $75 million, which then translates into a higher efficiency carry-over of $45.4 million (compared to only $0.7 million originally proposed). We note that TasNetworks is the initial beneficiary of this higher opex efficiency carry-over, although it is intended that customers will eventually share in the gains. We have previously argued for a reduced transmission opex such as that now proposed by TasNetworks (see Section 5.1.1), which is, however, partly offset by a higher distribution opex and we will be keen to see the benefits of the lower transmission opex shared with TasNetworks' customers as provided for under the opex EBSS.

6.2 DISTRIBUTION

The AER Draft Decision is for a total AAR of $1,312.1 million ($nominal) for the 2019–24 regulatory control period. This represents a reduction of $83.3 million, or 6.0 per cent, compared to TasNetworks' proposal ($1,395.4million) and reflects the impact of the draft decision on the various building block costs (discussed below). We welcome the reductions made by the AER to TasNetworks' proposal, which go some way towards addressing issues the TSBC raised in its original submission and will assist in the task of keeping prices for small business lower than would otherwise be the case.

Returning to the building blocks we offer the following comments:

- The return on capital allowance adjustment made by the AER of a reduction of $60.1 million, or 10.5 per cent, which accounts for 72 per cent of the reduced total AAR, is a welcome outcome for small business in Tasmania. As with transmission, this is mainly due to the application of the WACC parameters contained in the AER's final decision, Rate of Return Instrument.
- The AER has imposed a reduction in the cost of corporate income tax allowance of $17.3 million, or by 31.0 per cent, which accounts for 21 per cent of the reduced total AAR. We support this outcome.
- However, less welcome is that the AER has accepted without any changes the opex proposed by TasNetworks, which we questioned in our earlier submission. We continue to believe that there is scope to further materially reduce the distribution opex proposed by TasNetworks and have raised in Section 5.1.2 of this submission our concerns about the AER's current modelling of TasNetworks' opex proposals.

The AER's Draft Decision for distribution refers to an issue raised in our earlier submission regarding TasNetworks' smoothing profile proposal, where we commented that it is possible customers will prefer the certainty of lower network charges up front.[66] We note that AER's response that its profile of 'X' factors for revenue smoothing results in expected revenue in the last year of the regulatory control period that is as close as reasonably possible to the annual building block revenue requirement for that year given the regulatory requirements in this area and aligns with the AER's target band of 3 per cent. We observe that the AER's smoothed revenues for TasNetworks' distribution shown in Figure 1.2 in Attachment 1 of its Distribution Draft Decision addresses the point we raised in that Tasmanian consumers, including small business, will face smaller increases in distribution charges up front and lesser increases for the remainder of 2019-24 regulatory period under the Draft Decision compared to TasNetworks' proposal.

Turning to TasNetworks' Revised Proposal, we note that its total AAR (unsmoothed) is now $1,351.5 million, which is $39.4 million above the AER's Draft Decision ($1,312.1 million) but $43.9 million

[66] AER, *TasNetworks Distribution Draft Determination*, Attachment 1 – Annual Revenue Requirement, p. 1-11.

below TasNetworks' original Proposal. The main reason for the differences in TasNetworks' Revised Proposal compared to the Draft Decision is a significant increase in opex of $39.1 million. There is also a substantial difference in the efficiency carry-over (-$44.5 million in the AER draft decision, compared to -$64.9 million in the Revised Proposal), reflecting the higher opex. Whilst TasNetworks initially bears this cost, customers will eventually do so. As discussed in Section 5.1 we do not support the higher opex proposal by TasNetworks and are concerned that it will merely add to the inefficiencies that TasNetworks' distribution opex already exhibits, notwithstanding that we recognise there is some trade off involved with TasNetworks' lower transmission opex.

6.3 Risks and Uncertainties for Small Business Customers

There are certain risks and uncertainties for customers, including small business, associated with the TasNetworks determinations to be issued by the AER. These include:

- The possibility that TasNetworks' revised list of three contingent projects could come to fruition and find their way into the approved transmission capex budget (and subsequently, the transmission RAB), in either the 2019-24 regulatory period or beyond. This is probably the biggest risk exposure facing consumers and especially applies to Project Marinus, for which a RIT-T is already underway, which (on present indications) could involve expenditure of up to $2.7 billion. As explained in the Goanna Energy report supporting our recent submission to TasNetworks on Project Marinus, we have some misgivings about the current proposal and are seeking rigorous application of the RIT-T.[67] Significant uncertainty still surrounds this project, including its costs and who will bear them (and in what proportion). We appreciate that the RIT-T is intended to provide safeguards to consumers by establishing the market benefits of large transmission investments, but these safeguards are by no means perfect, with consumers still exposed to the potential residual risks of poor decisions. We are, however, supportive of the issues raised by the AER in its draft decision about TasNetworks' proposed contingent projects; and welcome TasNetworks' trimmed down contingent project list and its responses to the AER's issues in its Revised Proposal although it continues to list three projects, including Project Marinus, which account for the great majority of its initial contingent project proposal.
- Uncertain impacts of interregional settlement residues (IRSR) and interregional Transmission Use of System (TUOS) charges, which can have either an upside or downside impact on transmission charges.
- The annual adjustments that the AER will make to TasNetworks return on debt (noting that interest rates may have bottomed out and could therefore increase in future).
- The possibility that TasNetworks may seek to pass through additional costs it is required to incur over the next regulatory period (overwhelmingly an upside risk).
- The possibility that TasNetworks may over- or under-recover revenue over the course of the 2019-24 regulatory period and have to adjust its AAR for transmission or distribution in subsequent years with flow-on effects to network charges.

[67] See Goanna Energy Consulting, *TasNetworks'* Project Marinus *Project Specification Consultation Report – Small Business and Consumer Impacts*, October 2018.

With small reductions in transmission charges and increases in distribution charges forecast over the next regulatory period, these risks represent a real threat to higher small business network charges over the next five years. However, we are also mindful that the Tasmanian Government has capped regulated tariffs for small business consumers at not greater than the CPI, at least until the end of 2021-22, although this still contains an exposure to network price increase above CPI for the last two years of the regulatory period. Of course, small business customers who are on market offers will be exposed to the risk of higher network charges for the entire 2019-2024 regulatory control period.

7

INDICATIVE NETWORK PRICES

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7 Indicative Network Prices

In this section we discuss the indicative price impacts of the AER's Draft Decisions on TasNetworks transmission and distribution determinations and TasNetworks' Revised Proposal, especially as they relate to small business.

7.1 Transmission

The AER estimates that average transmission charges (real) are expected to decrease from around $16.2 per MWh in 2018–19 to $13.9 per MWh in 2023–24, or by 16.5 per cent, under its Draft Decision. On this basis, average small business network charges will decline by 4.2 per cent over the period and retail prices by 1.8 per cent. The decline is mostly confined to 2019-20, with a flat transmission price path thereafter. We note that, according to TasNetworks' Revised Proposal, transmission charges are expected to fall by 20 per cent from 2018–19 to 2023–24, suggesting a 5.1 per cent fall in network charges and 2.2 per cent reduction in retail prices.

In nominal terms, however, transmission prices would decline by total of only 3.8 per cent under the AER's Draft Decision. This translates to a 0.97 per cent reduction in network charges and 0.42 per cent reduction in retail prices.

These changes represent a welcome, albeit fairly modest, decline in the electricity prices of Tasmanian small businesses over the five years from 1 July 2019.

7.2 Distribution

The AER estimate that its draft decision will result in a real increase to average distribution charges of about 0.1 per cent per annum over the 2019–24 regulatory control period. It further notes that this compares to the real average increase of approximately 2.0 per cent per annum proposed by TasNetworks over the 2019–24 regulatory control period. The nominal increase in average distribution prices would be 13.6 per cent over the regulatory period compared to 24.5 per cent under TasNetworks' original proposal and 18 per cent under TasNetworks' Revised Proposal.[68] This would translate to a 3.8 per cent increase in retail prices over the 2019-24 regulatory control period under the Draft Decision and 5.8 per cent increase under the Revised Proposal.

The nominal increases in distribution charges over the next regulatory control period are a matter of concern to the TSBC. Whilst they may be tempered by the Tasmanian Government's decision to cap regulated retail tariffs, including for small business, to the CPI until the end of 2021-22, small business will be exposed to increased distribution prices for the final two years of the regulatory control period (noting 40 per cent of the distribution price increases occur in these two years). Moreover, small and medium size businesses on market offers will be exposed for the entire regulatory control period.

7.3 Changes in Network Charges and Their Impacts on Small Business

We note that the impact of the increase in distribution prices forecast under the Draft Decision would more than outweigh the reduction in transmission prices, leaving retail prices around 3.4 per cent higher in nominal terms. Under the Revised Proposal the increase would be closer to 4 per cent.

[68] These are high-level estimates that reflect the aggregate change across the entire network and do not reflect the particular tariff components for specific end users, including small business tariffs.

Even with the Tasmanian Government's price cap in place, small businesses on regulated tariffs still face the prospect of a 4.5 per cent nominal increase in their distribution charges with transmission charges about 2 per cent higher over the final two years of the next regulatory period under the AER Draft Decision and the average small business will be paying $250 more a year for its electricity by then. Retail prices would increase by 3.3 per cent. These are still disappointing outcomes for small business in Tasmania.

7.4 Impacts on Small Business Electricity Bills

The AER Draft Decision estimates that an electricity bill for an average small business customer would decrease by about $35 ($nominal) from the 2018–19 level in 2019-20 (0.5 per cent), followed by average annual increases of $72 ($nominal) over the remaining regulatory years of the 2019–24 regulatory control period (2020–21 to 2023–24), or 1.1 per cent. By comparison, under TasNetworks' proposals, the average small business electricity bill in 2019–20 would increase by about $70 ($nominal) from the 2018–19 level, followed by average annual increases of $86 ($nominal) over the remaining regulatory years. Under TasNetworks' Revised Proposal, these increases would be tempered somewhat.

These overall increases in electricity bills likely to be faced by small business over the term of the 2019-24 regulatory control period as a result of increases in network charges are a further indication of the overall disappointment that the Tasmanian small business sector is likely to feel about the outcome of the AER's regulatory determination for TasNetworks.

As these increases are below the expected CPI, the Tasmanian Government's cap limiting increases in regulated electricity tariffs for small business to no more than the CPI until the end of 2021-22 could seek to use them to offset any above CPI increases in other electricity cost components. Small and medium size businesses on market rates will feel the full force of the network charge increases in their bills, except for a small reduction in 2019-20.

As mentioned in the previous section however, under the AER's draft decisions 40 per cent of the increases in distribution charges occur in the final two years of the 2019-24 regulatory period and transmission prices also increase during this time when the price cap may no longer be in place.

Small and medium size businesses on market rates will feel the full force of the network charge increases in their bills, except for a small reduction in 2019-20.

7.5 Network price risks and uncertainties

The changes in network prices resulting from the AER Draft Decision and TasNetworks' Revised Proposal are susceptible to risks and uncertainties including:

- The flow on to network prices from the points raised in the earlier section on risks and uncertainties (Section 6.3).
- Uncertainties around what will happen to the other components of the electricity price stack for small business, which could outweigh the changes in network prices.
- Uncertainties around how the changes in network charges will be treated under the Tasmanian Government's regulated retail price cap for small business and what transpires after this expires at the end of 2021-22.

8

TARIFF STRUCTURE STATEMENT AND NETWORK TARIFF REFORM

Goanna Energy Consulting Pty Ltd

Tasmanian Small Business Council
Uniting Small Business

8 Tariff Structure Statement and Network Tariff Reform

Below we comment on:

- Our response to changes proposed by TasNetworks in its Tariff Structure Statement (TSS), the AER's response to these and TasNetworks' revised TSS and its Tariff Structure Explanatory Statement (TSES).
- The impact of the TSS and TasNetworks' tariff reforms on the cross-subsidies that are present in small business network tariffs, especially the commonly used TAS22.
- The slow pace of retail tariff reform as an impediment to network price reform
- Market feedback on the take up of new Time-of-Use (ToU) small business tariffs.
- The impact of TasNetworks' time of use (ToU) network tariffs on small business.

8.1 AER TSS Issues and TasNetworks Revised TSS

This section outlines the changes proposed by TasNetworks in its initial TSS, associated issues raised by the AER in its Draft Decision, TasNetworks' response in its revised TSS and our position on these matters.

8.1.1 Removing Cross-subsidies

The AER proposed that TasNetworks should consider accelerating the unwinding of cross subsidies by providing price relief to non-discounted tariffs rather than just focusing on unwinding longstanding discounts associated with some tariffs, e.g., uncontrolled low voltage heating tariff (TAS41). Moreover, TasNetworks should also improve transparency by providing forecasts of the change in revenue recovered from tariffs due to this unwinding.

In its revised TSS TasNetworks says it has added explanatory information to better demonstrate how the continuing, but gradual, increases in discounted tariffs proposed over the 2019-24 regulatory period will contribute to a reduction in cross subsidies. It also says that it will reduce the prices of non-discounted tariffs "*as long as doing so does not shift the recovery of Total Efficient Cost (TEC) for particular tariffs or tariff classes in ways that create new cross subsidies.*" It further notes that *"consideration must also be given to the pricing relationships that exist between tariff classes, such as the residential and small business tariff classes, in order to avoiding distorting those relationships through the use of discounting."*

The TSBC strongly supports the points made by the AER and generally welcomes the response of TasNetworks. The additional information the AER has requested is needed to better demonstrate the impact of the gradual removal of cross-subsidies in legacy tariffs. Unfortunately, we did not find the information provided by TasNetworks in response to be as clear as we would have liked. TasNetworks should ensure that it regularly provides information that clearly demonstrates to consumers and their advocates, such as the TSBC, the progress being made in removing cross-subsidies in both discounted and non-discounted tariffs. It should also regularly update the PRWG on this as updated information becomes available.

We strongly support the unwinding (and its acceleration) of cross subsidies in non-discounted tariffs, including the general small business tariff (TAS22). We believe that small business continues to pay a significant cross-subsidy through TAS22, notwithstanding some unwinding in recent years.

To be clear, in response to TasNetworks' concern about creating new distortions in the relationship between household and small business tariffs, we do not seek the creation of new distortions, but rather the faster removal of existing ones.

8.1.2 New Demand Based Time of Use Tariffs for Households and Small Businesses with Distributed Energy Resources

The AER accepted TasNetworks' proposal to offer ToU demand tariffs to residential and small business customers on an opt-in basis to encourage customer uptake of distributed energy resources (DER), such as solar PV, batteries or energy management devices. The AER approved these tariffs because they will be priced at the same rate as apply to the residential and small business demand tariffs that are available to all households and small businesses with appropriate (interval) metering, not just customers with DER.

The TSBC supports the AER's proposal noting that it is effectively technology neutral and the new tariffs will be provided on an opt-in basis. We also note that the take up of PV amongst small business is impacted by issues such as the common practice of leasing premises.

8.1.3 Opt-out Assignment for Cost Reflective Tariffs

The AER required TasNetworks to adopt an 'opt out' arrangement, whereby retailers face a cost reflective network tariff by default when a customer meets the trigger for tariff assignment or reassignment. It was not satisfied that TasNetworks' reliance on retailers 'opting-in' to discounted cost reflective network tariffs provided an adequate pace of reform.

TasNetworks has accepted the AER's request and will apply an opt-out arrangement from 1 July 2019 to household customers.

We note that small business customers will continue to be provided with an opt-in arrangement due to the lack of supporting data and information about the impacts of TasNetworks cost reflective tariffs on small business customers. We further note that the PRWG supported both the opt-out arrangement for households and the opt-in arrangement for small business.

8.1.4 Triggers for Opt-out Assignment

The AER expressed a strong preference for a change in the 'trigger' for opt-out in regards to assignment of households to ToU tariffs. Specifically, it preferred a delay such that customers whose meters fail would remain on their current network tariff(s) following meter replacement for 12-months after the installation of an advanced meter. The AER felt that, as these customers had no choice about the installation of the new meter, they should not be forced into an opt-out arrangement immediately.

TasNetworks does not believe that the 12-month delay proposed by the AER will deliver better outcomes given the very small subset of the customers to which opt out tariff assignment is

intended to apply[69], while also being unjustifiably costly and inefficient to implement and requiring costly changes to its systems or manual handling.[70]

TasNetworks, therefore, proposes to depart from the AER's preferred solution in this regard, and will assign customers who have a failed meter replaced with an advanced meter to a cost reflective network tariff, effective immediately from the installation of the new meter.[71]

Although this issue only applies to household tariffs, it could be relevant to small business tariffs in future. Whilst recognising the merit of the preference the AER has expressed, we also recognise the practical implementation difficulties and costs that TasNetworks has raised. On balance, and given the small number of customers likely to be involved, we support TasNetworks' position.

8.1.5 Introductory Discount for Demand Based Time of Use Tariffs for Residential and Small Business Customers

TasNetworks proposed – and the AER supported – the application of a discount to all demand based ToU small business and residential tariffs.

Given that the discount is intended to further incentivise customers to switch to the new tariffs and that TasNetworks will fund the cost of the discounts, the TSBC supports TasNetworks' proposal. We also note that the take-up of TasNetworks' demand based ToU tariffs by the small business community may be assisted by the application of an introductory discount.

8.1.6 Time of Use Charging Windows and Seasonal Pricing

The AER accepted TasNetworks' proposal to adopt ToU tariff design for residential and small business customers which only has peak and off-peak (but not shoulder) charging windows. It also accepted that the peak demand charging windows of 7-10am and 4-9pm contained in the TSS is likely to align with periods of network stress, and felt that these windows are wide enough to discourage customers shifting load and creating new peaks at other times. The AER also suggested that TasNetworks should consider seasonal based pricing, particularly as there is a distinct seasonal (i.e., winter) aspect to Tasmanian peak demand. The AER argued that, as a market with a distinct winter peak, Tasmanian customers would be better off in the long run with lower "off peak" seasonal pricing in the warmer parts of the year and that uniform pricing year round means that winter peaking customers are benefiting at the expense of summer peaking customers.

TasNetworks proposes not to add a seasonal component to its ToU tariffs at this stage given that it would add complexity at a time of already significant tariff change, it would be more difficult for customers to understand and it was not supported in TasNetworks' discussions with customers. TasNetworks appears more amendable to adding a seasonal component in a future regulatory period.

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[69] TasNetworks currently replaces less than 150 Type 6 electronic or disk meters a year because of failure.

[70] TasNetworks estimates it would cost in the order of $0.9 million in IT development costs, which has not been budgeted for in TasNetworks' regulatory proposal and would cost nearly $1,200 per customer in system development costs alone.

[71] We note that the AER subsequently put forward a modified approach to TasNetworks (being proposed to other networks) that involves the application of a 12-month delay to *all* new and modified residential customers before re-assigning them to a default ToU consumption-based network tariff. TasNetworks does not support this modification as it will delay reform, it notes that a 'one size fits all' approach to assignment does not permit variations to suit jurisdictional circumstances and it also notes that electricity market conditions vary from jurisdiction to jurisdiction.

The TSBC recognises the logic in the AER's suggestion that seasonal pricing would contribute to cost reflectivity. However, on balance, it agrees with TasNetworks about the timing of such a change in Tasmania and we believe that it is more important, at this time, to focus on implementing the cost reflectivity steps already being pursued.

To this end, we support the continued consideration of seasonal pricing through the PRWG over the course of the 2019-24 regulatory period and suggest that TasNetworks also testing seasonal pricing.

8.1.7 New Tariffs for Embedded Network Operators

The AER rejected TasNetworks' proposal to offer two new network tariffs specific to embedded networks, one for Low Voltage (LV) connection and another for High Voltage (HV) connection. The AER required TasNetworks' to provide further justification for these tariffs and to include more detail on its assignment process. TasNetworks has removed the proposed tariffs in its revised TSS. The TSBC does not object to the removal of these tariffs.

8.1.8 Treatment of Long-run Marginal Cost

The AER requested that TasNetworks' revised TSS describe more comprehensively how its long run marginal cost (LRMC) estimates translate into its indicative price schedule. It assessed the Average Incremental Cost approach used by TasNetworks to calculate LRMC as fit for purpose and that the forecast horizon of ten years as the minimum timeframe needed to capture the 'long run'. The AER further felt that TasNetworks' proposal LRMC estimates included replacement capital expenditure (repex) projects or programs that would increase the capacity of the network, without being responsive to changes in demand.

TasNetworks has included additional explanatory material in its TSES which explains the means by which it allocates Total Economic Cost (TEC) and LRMC to tariff classes and individual tariffs. TasNetworks has also amended its estimates of LRMC to take into account the AER's direction on repex.

We support the AER's position on LRMC and welcome the associated changes TasNetworks has made to its revised TSS.

8.1.9 Restructured TSS

The AER requested that TasNetworks adopt a two document approach to structuring its TSS as part of its revised proposal. The first document should only include the elements of the TSS listed in the National Electricity Rules (NER), with a second document containing TasNetworks' reasons for each of the proposed elements in the TSS. TasNetworks has provided two revised documents, the TSS and a TSES, also noting that it was not in receipt of the AER's advice about this new requirement prior to lodging its original TSS.

The TSBC does not oppose the two document structure and recognises the AER's reasons for this new approach. However, we do express a concern about the growing length and complexity of the TSS documentation, which would be extremely difficult for small business to understand and absorb. Given that the TSS process in intended to better inform customers about new tariffs, their reasons for being and their impacts on them, we would encourage TasNetworks to undertake communications and outreach with small business to overcome this information gap.

8.2 Unwinding Distribution Cross-subsidies

The TSBC has been a long, strong and consistent supporter of the need to remove cross-subsidies from Tasmanian distribution (and retail) tariffs. We support the application of cost reflective network pricing in Tasmania as soon as possible. In doing so, we note that small business tariffs such as TAS22 (and its T22 retail equivalent) are not cost reflective so that small business is forced to bear the costs of a cross-subsidy to other tariffs, which disadvantages the sector. We also note that tariffs such as the popular uncontrolled load heating tariff (TAS41), are not only inefficient but also inequitable (given they are also available to wealthy households). Furthermore, there are other more targeted ways to support low income households in meeting their heating costs, such through the Tasmanian Government electricity concessions or through more targeted tariffs. We therefore strongly support the additional changes to TasNetworks' TSS along these lines that the AER requested (see Section 8.1.1) and welcome TasNetworks' constructive response of to a number of these. Nevertheless, we continue to oppose the overly lengthy transition period of 15 years to remove cross-subsidies from legacy tariffs.

It has been somewhat frustrating to the TSBC that clear information about the unwinding of cross-subsidies in legacy tariffs, including TAS22, has been difficult to come by. We therefore welcome the AER's requests – and TasNetworks' generally positive responses – regarding the provision of additional information relating to the unwinding of cross-subsidies in non-discounted network tariffs. However, the more qualified response of TasNetworks to the AER suggestion that TasNetworks consider accelerating the time to unwind non-discounted tariffs remains a concern to us.

8.3 The Slow Pace of Retail Tariff Reform in Tasmania

We observe that it is important for retail tariff reform to accompany network tariff reform and that most small customers remain assigned to consumption based regulated retail tariffs. Unfortunately, the pace of retail tariff reform in Tasmania has been extremely slow to date and has lagged behind the reforms in network charges. We hope that ways can be found to improve this in the next regulatory period.

The constraints imposed by Tasmanian Government price regulation make retail tariff reform more difficult. The price cap currently in place, which limits regulated retail price increases to the CPI, has undoubtedly benefitted small consumers in Tasmania, including small business, in that it has shielded them from some large increases in NEM wholesale prices. However, one impact of this has been to limit the ability of retail prices to reflect network price reform. Price capping and regulation also limits the ability of small business to benefit from the removal of cross-subsidies in TAS22 and its retail equivalent T22, and to gain access to other cost reflective tariffs.

Under these circumstances, Aurora Energy has been more reluctant to proactively pursue retail price reform, perceiving (with some justification) that the risks it would be exposed to in doing so are unacceptable. The AER, in its Draft Decision on distribution, has sought to encourage Aurora to support price reform at the retail level and noted that Aurora has the ability to provide market offers that include cost reflective pricing. The TSBC would also welcome a more positive response from Aurora to retail price reform whereby small business could benefit from more cost reflective retail prices and the removal of cross-subsidies.

8.4 Market Feedback on New Demand Based Network Tariffs for Small and Medium Firms

Goanna Energy Consulting (Goanna), who assisted us in the preparation of this submission, undertakes significant work with small and medium size businesses in Tasmania, including in advising them on retail and network tariffs. Tas Energy Brokers, a subsidiary of Goanna, offer electricity price optimisation services to small and micro businesses in Tasmania and have provided the following observations about network tariff reform and the availability of ToU tariffs to small businesses based on their work with Tasmanian small and medium size businesses from across different industries:

- *Irrigators* – there is low knowledge, low interest and poor take up of new Low Voltage Maximum Demand tariffs (TAS88 & TAS89). Goanna, through the Stakeholder Engagement process, has lobbied for the option of a "No Regrets" 12 Month trial of the new Demand Based Tariffs, where after the 12 month period consumers can compare outcomes between the old and new tariff. Where the new tariff has proven costlier, they receive a "No Regrets" rebate to the value of the old tariff and are then free to make an informed decision, to commit to one tariff or another.
- *Private schools* – there is a very low take up due to their day time demand profile based around school hours which limits their ability to benefit from the new Demand Based Tariffs (unless the school has an electric heat pump heated pool, where the flat load profile shows a benefit on the Demand Based Tariffs).
- *Nursing homes* – the take up and interest has been progressing as they have 24/7 operations with relatively flat load which is rewarded by the Demand Tariffs.
- *Other SMEs* – there is a low take up and interest for various reasons, including lack of awareness, lack of understanding, lack of time to find out and reluctance to pay the costs of being better informed. It is also worth noting that Demand Based tariffs in general represent a higher risk to business consumers in that they are effectively punished heavily for quite short increases in load. Where businesses naturally assume their suppliers will help them to "Grow the Business", they fear Demand Tariffs do the opposite.
- *Micro businesses* – there is a very low take up, as there are no Standing Offer Tariffs for these new Demand based network Tariffs and market offers are currently unattractive, due to high wholesale commodity costs.
- *General small and micro businesses* – face risks and have limited incentives and means to pay for the analysis that will assist them to determine the benefits to them of switching tariffs.
- As *Aurora Energy* offers limited cost reflective retail tariffs the incentives for small business to switch tariffs are further blunted.

8.5 Impacts of ToU Network Tariffs on Small Business

TasNetworks has helpfully provided in its TSES the results of modelling suggesting that small business could benefit from assignment to its ToU and (even more so) its demand based ToU network tariffs. However, we also observe that this modelling is for small or medium size businesses at higher electricity consumption levels. Presumably, the benefits to low or medium consumption small businesses are less apparent. It would be useful if TasNetworks could confirm this and provide associated modelling results.

The TSBC notes that the AER has requested TasNetworks to amend its TSS in several ways intended to improve transparency, information provision and clarity in regards to ToU network tariffs, including those available to small business. TasNetworks has generally responded positively to these requests which we welcome. In our view, it would also be advantageous if TasNetworks were to carry out additional proactive communication and outreach with small businesses on its new tariff offerings and how they impact small business.

End of document