

Draft Decision

TasNetworks

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 6

Operating Expenditure

September 2023

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Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 3131
Canberra ACT 2601
Tel: 1300 585 165

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6 Operating expenditure

Operating expenditure (opex) refers to the operating, maintenance and other non-capital costs incurred in the provision of standard control services. Forecast opex for standard control services is one of the building blocks we use to determine a service provider's total regulated revenue requirement.

This attachment outlines our assessment of TasNetworks' proposed opex forecast for the 2024–29 regulatory control period.

6.1 Draft Decision

Our draft decision is to accept TasNetworks' total opex forecast of \$541.0 million (\$2023–24), including debt raising costs for the 2024–29 regulatory control period.¹ This is because our alternative estimate of \$540.9 million (\$2023–24) is not materially different from TasNetworks' proposed total opex forecast. Therefore, we consider that TasNetworks' total opex forecast satisfies the opex criteria, having regard to the opex factors.²

Our draft decision, which is TasNetworks' proposed total opex forecast, is:

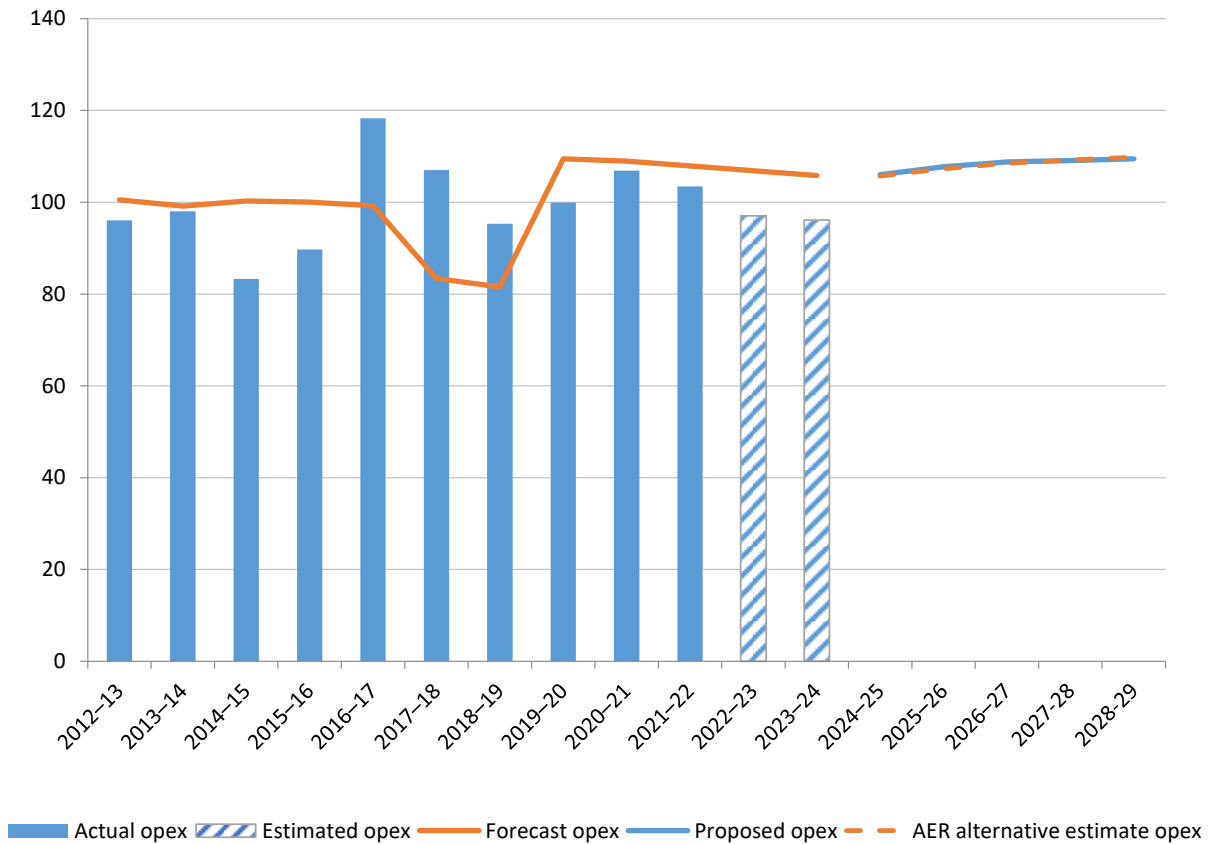
- \$1.9 million (\$2023–24) or 0.4% higher than the opex forecast we approved in our final decision for the 2019–24 regulatory control period.
- \$37.6 million (\$2023–24) or 7.5% higher than TasNetworks' actual (and estimated) opex in the 2019–24 regulatory control period.

In Figure 6.1 we compare our alternative estimate of opex to TasNetworks' proposal for the next regulatory control period. We also show the forecasts we approved for the last two regulatory control periods and TasNetworks' actual and estimated opex over these periods.

¹ Including debt raising costs; TasNetworks, *2024–2029 Post Tax Revenue Model (PTRM) – Standard control*, December 2022.

² NER, cl. 6.5.6(c)-(e).

Figure 6.1 Historical and forecast opex (\$million, 2023–24)



Source: TasNetworks, *Distribution economic benchmarking – regulatory information notice response (EB RIN) 2011–12 to 2021–22*; AER, *TasNetworks’ distribution revenue determination, PTRM – Final decision (multiple periods 2012–17, 2017–19, 2019–24)*; TasNetworks, *2024–2029 PTRM – Standard control, December 2022*; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control, December 2022*; AER analysis.

Note: Includes debt raising costs.

Table 6.1 sets out TasNetworks’ opex proposal, our alternative estimate for the draft decision and the differences between these forecasts.

Table 6.1 Comparison of TasNetworks’ opex proposal and our alternative opex estimate (\$million, 2023–24)

	TasNetworks’ proposal	AER alternative estimate - draft decision	Difference
Base opex (reported in 2021–22)	521.5	524.9	3.4
Final year increment 2021–22 to 2023–24	–10.5	–10.4	0.1
Remove category specific forecast	–47.3	–42.9	4.4

	TasNetworks' proposal	AER alternative estimate - draft decision	Difference
Output growth	7.6	7.8	0.2
Price growth	7.7	9.0	1.3
Productivity growth	-18.4	-7.1	11.3
Total Trend	-3.0	9.8	12.8
Insurance premiums	19.1	13.6	-5.5
Cyber security	3.9	2.8	-1.1
Total Step Changes	23.0	16.4	-6.6
Guaranteed Service Level (GSL) payments	19.8	12.1	-7.8
Electrical safety inspection (ESI) levy	25.5	25.3	-0.1
National Energy Market (NEM) levy	6.6	-	-6.6
Total category specific forecasts	51.9	37.4	-14.6
Total opex, excluding debt raising costs	535.6	535.1	-0.4
Debt raising costs	5.5	5.8	0.3
Total opex, including debt raising costs	541.0	540.9	-0.1
Percentage difference			0.0%

Source: TasNetworks, 2024–2029 PTRM – Standard control, December 2022; TasNetworks, 2024–2029 Operating Expenditure Model – Standard control, December 2022.

Note: Numbers may not add up to total due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

While there is not a material difference between our alternative estimate of total opex and TasNetworks' proposed opex, we have arrived at our alternative estimate in a different way to TasNetworks. The key differences between TasNetworks' opex proposal, which we have accepted, and our alternative estimate are that we have:

- Applied a lower productivity growth rate, consistent with our general approach for distribution³, which is \$11.3 million (\$2023–24) higher than that proposed by TasNetworks.

³ AER, *Final decision paper – Forecasting productivity growth for electricity distributors*, March 2019, p. 9.

- Included a \$13.6 million (\$2023–24) forecast for the insurance premium step change, which is \$5.5 million (\$2023–24) lower than TasNetworks’ proposal.
- Included a \$12.1 million (\$2023–24) forecast for GSL payments which is \$7.8 million (\$2023–24) lower than TasNetworks’ proposal.

We note that in Table 6.1 there is also a difference between TasNetworks’ proposal and our alternative estimate in relation to the inclusion of the NEM levy payments, which we have retained in the base year as opposed to including as a category specific forecast. As set out in section 6.4.2, this is primarily a categorisation difference rather than a difference in the opex forecast.

Table 6.2 also provides our assessment of TasNetworks’ proposal against the opex expectations included in the Better Reset Handbook.⁴

Table 6.2 Assessment of proposal against Better Reset Handbook opex expectations

Opex expectation	Our view about how the expectations have been met
1. Opex forecasting approach	TasNetworks met this expectation. It applied our standard base-trend-step forecasting approach to forecast opex and the opex used in the EBSS.
2. Base opex	TasNetworks met this expectation. It used 2021–22, the latest year for which actual data is available, and demonstrated it is not materially inefficient.
3. Trend	TasNetworks met this expectation. It broadly applied our standard approach to forecast the trend for price, output and productivity growth, but we identified some inconsistencies in the detailed application.
4. Step changes	TasNetworks largely met this expectation. It proposed a limited number of step changes (insurance premiums and cyber security) which at a high level are reasonably well justified. It does not appear to have consulted with customers on these step changes.
5. Category specific forecasts	TasNetworks met this expectation proposing debt raising costs as well as an addition three category specific forecast consistent with the historical treatment of these costs.
6. Genuine consumer engagement on operating expenditure forecasts	TasNetworks did not appear to consult widely on its opex proposal, but considered it responded to the ‘affordable for all’ theme customers raised via its efficient base year opex and 3.0% productivity growth improvements in 2024–25. The AER’s Consumer

⁴ AER, *Better Resets Handbook. Towards Consumers Centric Network Proposals*, December 2021.

Opex expectation	Our view about how the expectations have been met
	Challenge Panel 27 (CCP27) noted it was not aware of any in-depth engagement on opex step changes. ⁵

6.2 TasNetworks' proposal

TasNetworks' proposal applied a “base-step-trend” approach to forecast opex for the 2024–29 regulatory control period, consistent with our standard approach.⁶

In applying our base step trend approach to forecast opex, TasNetworks⁷:

- used reported opex in 2021–22 as the base from which to forecast (\$104.3 million (\$2023–24) or \$521.5 million (\$2023–24) over the next regulatory control period)
- adjusted its total base forecast opex by:
 - removing \$47.3 million (\$2023–24) for the following categories: GSL payments, the ESI levy and the NEM levy costs
- added an estimate of the difference between the base year opex and the opex it will incur in the final year of the current regulatory control period, decreasing opex by \$10.5 million (\$2023–24)
- applied its overall rate of change forecast to its final year adjusted opex estimate, decreasing opex by \$3.0 million (\$2023–24). This included:
 - output growth (\$7.6 million (\$2023–24))
 - price growth (\$7.7 million (\$2023–24))
 - productivity growth (–\$18.4 million (\$2023–24))
- added two step changes totalling \$23.0 million (\$2023–24) for:
 - insurance premiums (\$19.1 million (\$2023–24))
 - cyber security costs (\$3.9 million (\$2023–24))
- added \$51.9 million (\$2023–24) for a GSL payments, the ESI levy and NEM levy costs, accounted for as category specific forecasts
- added \$5.5 million (\$2023–24) for debt raising costs to arrive at a total opex forecast of \$541.0 million (\$2023–24) over the 2024–29 regulatory control period as set out in Table 6.3.⁸

⁵ Consumer Challenge Panel 27 (CCP27), *Advice to AER – 2024–29 Combined Regulatory Proposal – TasNetworks*, May 2023, p. 19.

⁶ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 3.

⁷ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, pp. 5–13.

⁸ TasNetworks, *2024–2029 PTRM – Standard control*, December 2022.

Table 6.3 TasNetworks’ proposed opex for the 2024–29 period (\$million, 2023–24)

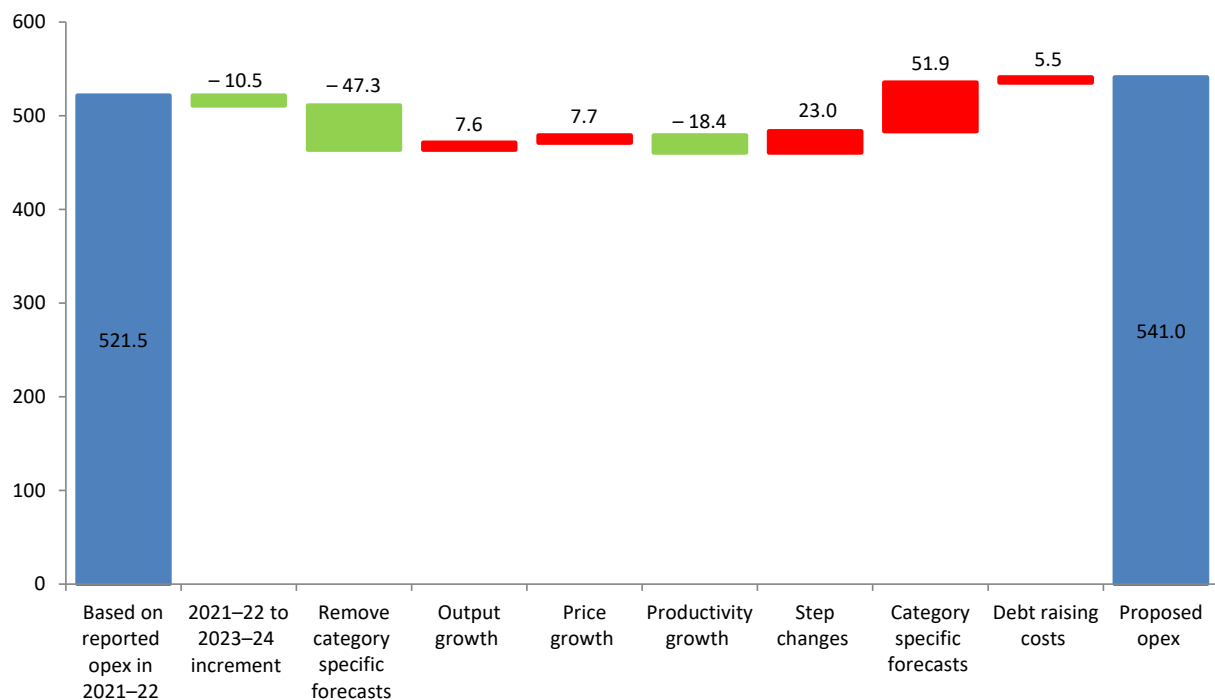
	2024–25	2025–26	2026–27	2027–28	2028–29	Total
Opex excluding category specific forecasts	94.4	96.1	97.3	97.7	98.1	483.6
Debt raising costs	1.1	1.1	1.1	1.1	1.1	5.5
GSL payments	4.0	4.0	4.0	4.0	4.0	19.8
ESI levy payments	5.1	5.1	5.1	5.1	5.1	25.5
NEM levy payments	1.5	1.5	1.4	1.2	1.2	6.6
Total opex	106.0	107.7	108.8	109.1	109.4	541.0

Source: TasNetworks, 2024–2029 PTRM – Standard control, December 2022; TasNetworks, 2024–2029 Operating Expenditure Model – Standard control, December 2022.

Notes: Numbers may not add up to total due to rounding.

Figure 6.2 shows the different components that make up TasNetworks’ opex forecast for the 2024–29 period.

Figure 6.2 TasNetworks’ opex forecast (\$million, 2023–24)



Source: TasNetworks, 2024–2029 PTRM – Standard control, December 2022; TasNetworks, 2024–2029 Operating Expenditure Model – Standard control, December 2022; AER analysis.

Notes: Numbers may not add up to total due to rounding.

6.2.1 Stakeholder views

We received four submissions on TasNetworks' proposal which discussed opex issues related to total opex, productivity growth, step changes and consumer engagement.

We have taken these submissions into account in developing the positions set out in this draft decision. Table 6.4 summarises the stakeholder issues raised in the submissions in relation to opex.

Table 6.4 Submissions on TasNetworks' 2024–29 opex proposal

Stakeholder(s)	Issue	Description
Aurora Energy ⁹ , Tasmanian Small Business Council ¹⁰	Total opex	<p>Aurora Energy noted that the overarching real revenue (combined capital and operating expenditure) TasNetworks is proposing to recover from its distribution customers is 11% greater than what was proposed for the current 2019–24 regulatory control period. It considered this will place further pressure on retail prices for residential and business customers and may be exacerbated by movements in interest rates and inflation estimates between now and the time of the AERs final determination in April 2024.</p> <p>Tasmanian Small Business Council raised concerns over the real increases of TasNetworks' 2024–29 proposed total opex compared to that spent in the 2019–24 period. It considered this increasing opex needs to be adequately justified as small businesses are currently under cost pressures.</p>
Tasmanian Small Business Council ¹¹ , Tasmanian Minerals, Manufacturing & Energy Council ¹² , CCP27 ¹³	Rate of change / trend	Tasmanian Small Business Council welcomed TasNetworks' proposed productivity growth of 3.0% in 2024–25 and 0.5% per annum for the remainder of the regulatory control period, but it questioned

⁹ Aurora Energy, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received 12 May 2023, p. 1.

¹⁰ Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

¹¹ Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

¹² Tasmanian Minerals, Manufacturing & Energy Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received 11 May 2023, p. 2.

¹³ Consumer Challenge Panel 27, *Advice to the AER on TasNetworks' Combined Revenue Reset Proposal*, received 7 May 2023, pp. 5–19.

Stakeholder(s)	Issue	Description
		<p>the lower rate in years 2–5, which is below the transmission sector average of 0.6%.</p> <p>Tasmanian Minerals, Manufacturing & Energy Council was also concerned the 3.0% productivity growth in 2024–25 decreased to 0.5% in subsequent years, noting that TasNetworks has significant restructuring and role reductions are underway.</p> <p>CCP27 questioned whether the 3.0% productivity growth in 2024–25 adequately reflects savings achieved by TasNetworks through their transformation programs.</p>
Tasmanian Small Business Council ¹⁴	Step changes	The Tasmanian Small Business Council noted the step changes for insurance premiums and cyber security need to be examined in detail to ensure that they are prudent and efficient.
CCP27 ¹⁵	Consumer engagement	<p>CCP27 noted that TasNetworks genuinely engaged with its customers and stakeholders, and this highlighted the affordability concern of consumers.</p> <p>CCP27 also note that it was unaware of any in-depth engagement with consumers or other consumer representatives on opex forecasts, including opex step changes and were unable to comment further in this regard.</p>

6.3 Assessment approach

Our role is to decide whether to accept a business's total opex forecast. We are to form a view about whether a business's forecast of total opex 'reasonably reflects the opex criteria'.¹⁶ In doing so, we must have regard to the opex factors specified in the National Electricity Rules (NER).¹⁷

¹⁴ Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

¹⁵ Consumer Challenge Panel 27, *Advice to the AER on TasNetworks' Combined Revenue Reset Proposal*, received 7 May 2023, pp. 5–19.

¹⁶ NER, cl. 6.5.6(c).

¹⁷ NER, cl. 6.6.6(e).

The Expenditure forecast assessment guideline (the Guideline), together with an explanatory statement, sets out our assessment approach in detail.¹⁸ While the Guideline provides for greater regulatory predictability, transparency and consistency, it is not mandatory. However, if we make a decision that is not in accordance with the Guideline, we must state the reasons for departing from the Guideline.¹⁹

Our approach is to assess the business's forecast opex over the regulatory control period at a total level, rather than to assess individual opex projects. To do so, we develop an alternative estimate of total opex using a 'top-down' forecasting method, known as the 'base-step-trend' approach.²⁰ We compare our alternative estimate with the business's total opex forecast to form a view on the reasonableness of the business's proposal. If we are satisfied the business's forecast reasonably reflects the opex criteria, we accept the forecast.²¹ If we are not satisfied, we substitute the business's forecast with our alternative estimate that we are satisfied reasonably reflects the opex criteria.²²

In making this decision, we take into account the reasons for the difference between our alternative estimate and the business's proposal, and the materiality of the difference. Further, we take into consideration interrelationships between opex and the other building block components of our decision.²³

Figure 6.3 summarises the 'base-step-trend' forecasting approach.

¹⁸ AER, *Expenditure forecast assessment guideline for electricity distribution*, November 2013; AER, *Explanatory statement – Expenditure forecast assessment guideline*, November 2013.

¹⁹ NER, cl. 6.2.8(c).

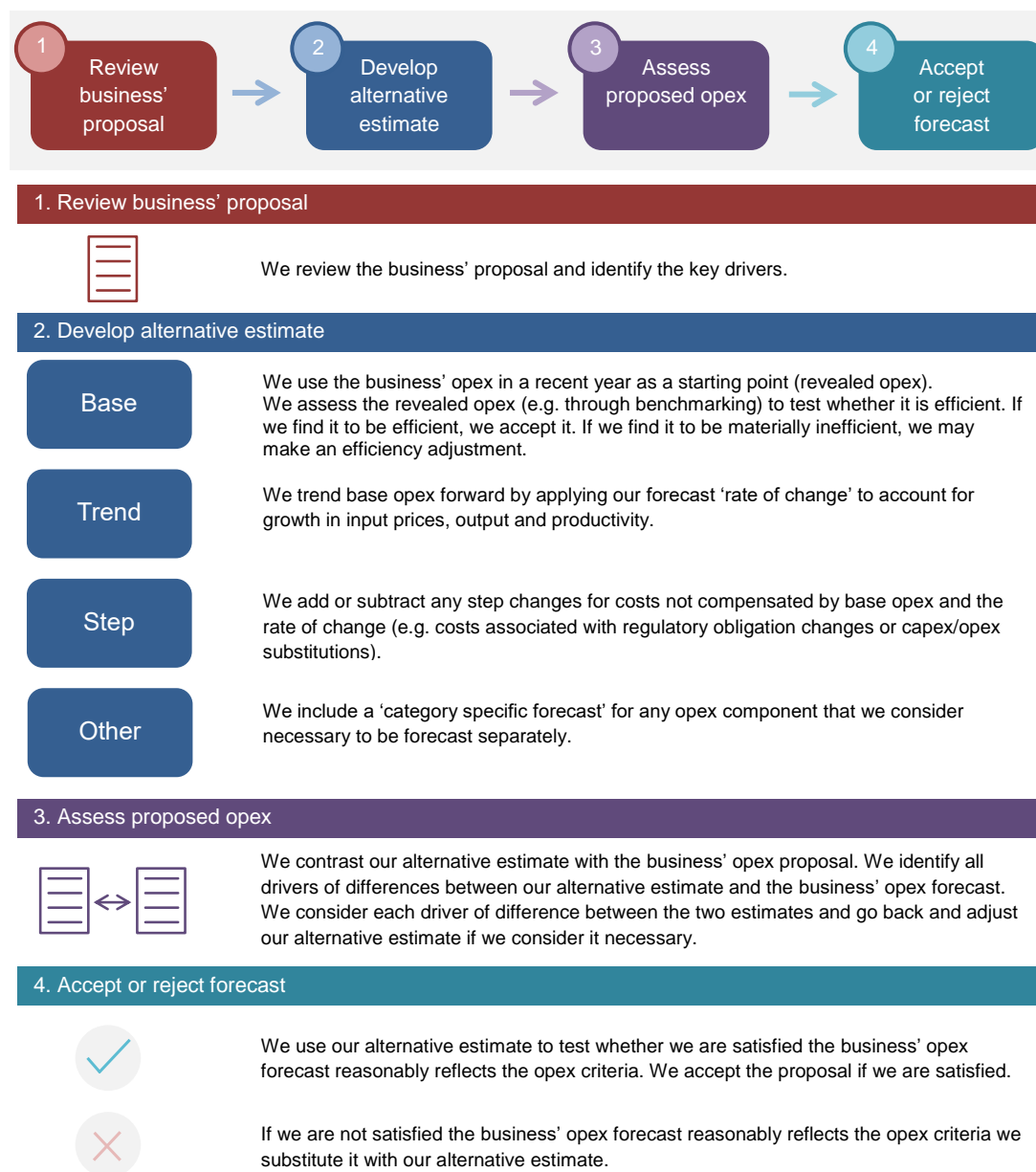
²⁰ A 'top-down' approach forecasts total opex at an aggregate level, rather than forecasting individual projects or categories to build a total opex forecast from the 'bottom up.'

²¹ NER, cl. 6.5.6(c).

²² NER, cl. 6A.5.6(d).

²³ NEL, s. 16(1)(c).

Figure 6.3 Our opex assessment approach



6.3.1 Interrelationships

In assessing TasNetworks' total forecast opex, we also take into account other components of its proposal that could interrelate with our opex decision. The matters we considered in this regard included:

- the EBSS carryover—the estimate of opex for 2023–24 (the final year of the current regulatory control period) that we use to forecast opex should be the same as the level of opex used to calculate EBSS carryover amounts. This consistency ensures that the business is rewarded (or penalised) for any efficiency gains (or losses) it makes in the final year the same as it would for gains or losses made in other years
- the operation of the EBSS in the 2019–24 regulatory control period, which provided TasNetworks an incentive to reduce opex in the base year

- the impact of cost drivers that affect both forecast opex and forecast capital expenditure (capex). For instance, forecast labour price growth affects forecast capex and our forecast price growth used to estimate the rate of change in opex
- the approach to assessing the rate of return, to ensure there is consistency between our determination of debt raising costs and the rate of return building block
- the outcomes of TasNetworks' engagement with consumers and stakeholders in developing its proposal and any feedback we have had.

6.4 Reasons for draft decision

Our draft decision is to accept TasNetworks' total opex forecast of \$541.0 million (\$2023–24), including debt raising costs, for the 2024–29 regulatory control period.²⁴ Our alternative estimate of \$540.9 million (\$2023–24) is not materially different (\$0.1 million (\$2023–24) or 0.0% lower) from TasNetworks' total opex forecast proposal. Therefore, we are satisfied that TasNetworks' total opex forecast satisfies the opex criteria, having regard to the opex factors.²⁵

Table 6.1 above sets out TasNetworks' proposal, our alternative estimate that has informed this draft decision, and the difference between our alternative estimate and the proposal. The main drivers for the differences are also set out in Section 6.1 and we discuss each of the components of our alternative estimate, and our assessment of TasNetworks' proposal, below. Full details of our alternative estimate are set out in our opex model, which is available on our website.

In terms of TasNetworks' total opex proposal, Aurora Energy noted that despite customer concerns of 'affordability for all', TasNetworks' total revenue has increased above the levels approved in the current regulatory period, placing further pressure on residential and business customers.²⁶ Similarly the Tasmanian Small Business Council, raised concerns over the real increase in total opex and the cost pressures this would give small businesses.²⁷ In assessing the prudence and efficiency of TasNetworks' proposal we have taken this into account in developing our alternative assessment for the draft decision.

6.4.1 Base opex

This section provides our view on the prudent and efficient level of base opex that we consider TasNetworks needs for the safe and reliable provision of electricity services over the 2024–29 regulatory control period. We discuss the choice of base year in section 6.4.1.1 and set out our analysis of the efficiency of base year opex in section 6.4.1.2.

²⁴ TasNetworks, *2024–2029 Post Tax Revenue Model (PTRM) – Standard control*, December 2022.

²⁵ NER, cl. 6.5.6(c)-(e).

²⁶ Aurora Energy, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received 12 May 2023, p. 1.

²⁷ Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

6.4.1.1 Proposed base year

TasNetworks proposed a base year of 2021–22 and base year opex of \$104.3 million (\$2023–24) or \$521.5 million (\$2023–24) over the next regulatory control period.²⁸

TasNetworks' base year actual opex is \$3.6 million (\$2023–24) or 3.4% lower than the allowance approved for that year and \$0.9 million (\$2023–24) or 0.8% higher than the average actual opex over the period 2019–20 to 2021–22.²⁹ TasNetworks' submitted that 2021–22 is the most suitable base year because the level of opex represents a reasonable and efficient level of expenditure based on historic benchmarking outcomes and is not impacted by one-off costs.³⁰

Consistent with our preferred approach, we consider 2021–22 is an appropriate base year. This is because it is based on actual opex and we consider it is representative of base opex required for the next regulatory control period. While there will be year to year fluctuations in reported opex over the current regulatory control period, due to the interaction with the EBSS, we do not have concerns with the choice of base year, provided we find TasNetworks' opex in the base year to be efficient.

In our alternative estimate we have updated the opex for 2021–22 to \$105.0 million (\$2023–24) or \$524.9 million (\$2023–24) over the next regulatory control period. This is due to:

- the use of different actual and forecast inflation. We have used the latest inflation forecasts published by the Reserve Bank of Australia (RBA) and actual inflation published by Australian Bureau of Statistics.³¹ We consider these inflation values are the best inflation values possible in the circumstances because they are the most up-to-date information available at the time.
- updated opex to include movement in provisions used to determine actual / estimated opex.

6.4.1.2 Efficiency of TasNetworks' base opex

As summarised in section 6.3, and in the Guideline, our preferred approach for forecasting opex is to use a revealed cost approach. This is because opex is largely recurrent and stable at a total level. Where a distribution business is responsive to the financial incentives under the regulatory framework, the actual level of opex it incurs should provide a good estimate of the efficient costs required for it to operate a safe and reliable network and meet its relevant regulatory obligations. However, we do not rely on the a priori assumption that the business's revealed opex is efficient. We examine the trend in opex and use our top-down

²⁸ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 3.

²⁹ TasNetworks, *Distribution EB RIN 2011–12 to 2021–22*; AER, *TasNetworks' distribution revenue determination, PTRM – Final decision (multiple periods 2012–17, 2017–19, 2019–24)*; TasNetworks, *2024–2029 PTRM – Standard control, December 2022*; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control, December 2022*; AER analysis.

³⁰ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, pp. 6–8.

³¹ Australian Bureau of Statistics (ABS), *Consumer Price Index, Australia, released on 26 July 2023* (Accessed on 27 July 2023: <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/jun-quarter-2023>); Reserve Bank of Australia (RBA), *Statement on monetary policy, August 2023* (Accessed on 4 August 2023: <https://www.rba.gov.au/publications/smp/2023/aug/forecasts.html>).

benchmarking tools, and other assessment techniques, to test whether the business is operating efficiently historically and particularly in the base year.

We consider 2021–22 opex is relatively efficient as indicated by its opex trend over time and our benchmarking results, and we have used the 2021–22 revealed cost to develop our alternative estimate.

In terms of the trend in opex, Figure 6.1 shows TasNetworks' opex forecast for the next regulatory control period, its actual opex in previous regulatory control periods and our previous regulatory decisions.

Overall we have seen a fluctuation in TasNetworks' opex over time.³² In the current regulatory control period TasNetworks' actual average annual opex (2019–20 to 2021–22) of \$103.4 million (\$2023–24) is \$2.2 million (\$2023–24) higher than actual average annual opex for the 2017–19 regulatory control period and \$6.4 million (\$2023–24) higher than that for the 2012–17 regulatory control period.

While gradually increasing over time, TasNetworks' actual and estimated opex in the current regulatory control period (2019–24) is \$35.7 million (\$2023–24) or 6.6% below our opex forecast.³³ TasNetworks' actual opex in the base year (2021–22) of \$104.3 million (\$2023–24) is \$3.6 million (\$2023–24) or 3.4% below our allowance for that year. TasNetworks' actual opex is also below our forecast for the first and second year (–8.7% and –1.9% respectively) of the current regulatory control period.

In line with our standard approach, we have used our benchmarking tools and other cost analysis to assess and establish whether TasNetworks is operating relatively efficiently, both over time and in the base year. We conclude that TasNetworks performs well compared to other networks and is not materially inefficient.

6.4.1.2.1 Benchmarking the efficiency of TasNetworks' opex over time and in the base year

We have used a variety of economic benchmarking tools to test the efficiency of TasNetworks' opex. Benchmarking broadly refers to the practice of comparing the economic performance of a group of service providers that provide the same service as a means of assessing their relative performance. Our *2022 Annual Benchmarking Report* for distribution includes information about the use and purpose of economic benchmarking, and details about the techniques we use to benchmark the efficiency of distribution businesses in the NEM.³⁴

While opex at the total level is generally recurrent, year-to-year fluctuations can be expected. To shed light on DNSP's general level of operating efficiency, we first look at the efficiency of DNSP's opex over a period of time, using our top-down benchmarking tools, as well as other

³² TasNetworks, *Distribution EB RIN 2011–12 to 2021–22*; AER, *TasNetworks' distribution revenue determination, PTRM – Final decision (multiple periods 2012–17, 2017–19, 2019–24)*; TasNetworks, *2024–2029 PTRM – Standard control, December 2022*; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control, December 2022*; AER analysis.

³³ AER, *TasNetworks 2019–24, Distribution – Final decision – PTRM*, April 2019; TasNetworks, *Distribution EB RIN 2019–20 to 2021–22*; AER analysis.

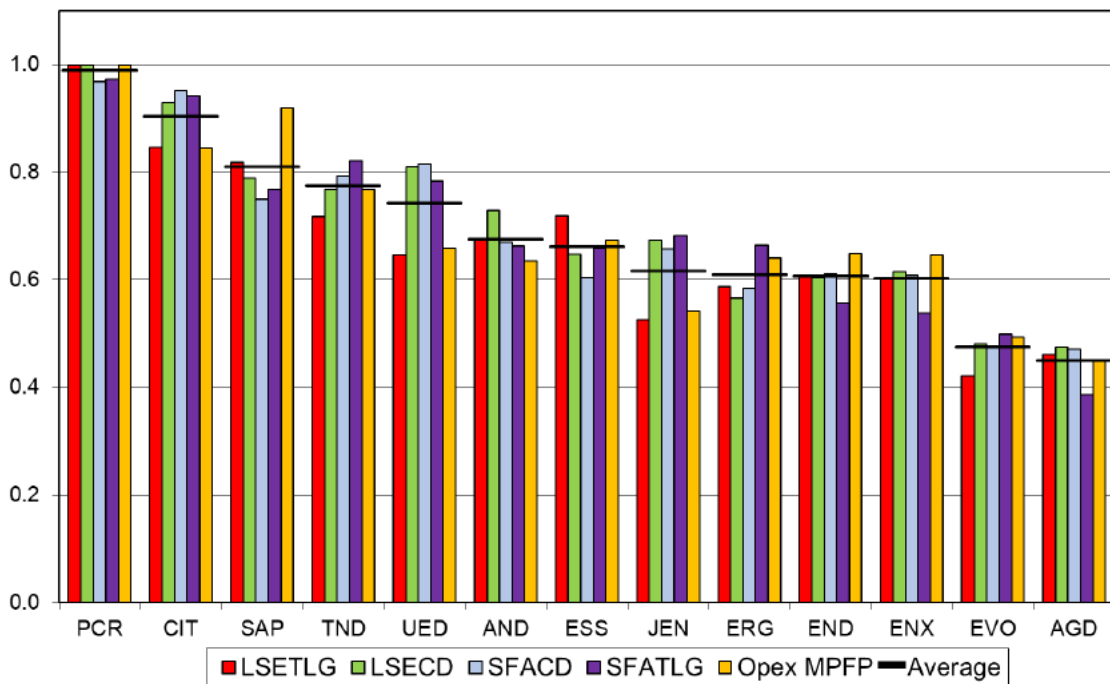
³⁴ AER, *2022 Annual Benchmarking Report, Electricity distribution network service providers*, November 2022.

supporting techniques. This is followed by looking at the efficiency of opex in the base year (2021–22).

In terms of historical performance, our benchmarking results from the *2022 Annual Benchmarking Report*³⁵ for distribution indicate that TasNetworks' opex has been relatively efficient.

Figure 6.4 shows that over the period 2006–21 TasNetworks (TND in the chart) ranks fourth out of 13 distribution businesses based on the average efficiency scores from five economic benchmarking models. These include our econometric opex cost function models as well as the opex multilateral partial factor productivity (MPFP) index number model. TasNetworks' average efficiency score across the five models is above 0.75, against the best possible average score of 1.0. We use a 0.75 comparator point to assess the relative efficiency of distribution businesses, noting that when by comparison a DNSP's average opex efficiency score is below 0.75 we also take into consideration the operating environment factors (OEFs) not already captured in the modelling. Allowing for OEFs enables us to account for some factors beyond a distributor's control that can affect its benchmarking performance.

Figure 6.4 Distributors' average opex cost efficiency scores, 2006–21



Source: AER, *2022 Annual Benchmarking report - Electricity distribution network service providers*, November 2022, p. 34.

We consider 2021–22 opex is relatively efficient as indicated by the trend of TasNetworks' opex over time and our benchmarking results, and we have used the 2021–22 revealed cost to develop our alternative estimate.

³⁵ AER, *2022 Annual Benchmarking Report, Electricity distribution network service providers*, November 2022.

We did not receive any stakeholder submissions in terms of the efficiency of TasNetworks' opex in the base year.

6.4.2 Adjustments to base year opex

TasNetworks proposed adjustments to its base year opex of \$11.6 million (\$2023–24) or \$57.8 million (\$2023–24) over the regulatory control period.³⁶ These were for removing the final year increment (\$10.5 million (\$2023–24)) and category specific forecasts (\$47.3 million (\$2023–24)).

We have considered these proposed adjustments and in our alternative estimate we have adjusted opex in the base year by:

- removing \$2.1 million (\$2023–24) for the decrease in opex between base year 2021–22 and 2023–24 (final year increment). This decreases our alternative estimate by \$10.4 million (\$2023–24) over the 5 years. We explain this adjustment in 6.4.2.1.
- removing \$8.6 million (\$2023–24) for the category specific forecast (included in the 2019–24 regulatory control period) for GSL and ESI levy costs. This decreases our alternative estimate by \$42.9 million (\$2023–24) over the 5 years. We explain this adjustment in sections 6.4.2.2, 6.4.5.2 and 6.4.5.3.

We have not adjusted opex in the base year to remove NEM levy payments as a category specific forecast, but rather have retained these (\$0.8 million (\$2023–24) in the base year and \$3.9 million over the regulatory control period) on a revealed cost basis. We explain this adjustment in section 6.4.2.

6.4.2.1 Final year increment

Our standard practice to calculate final year opex is to add the estimated change in opex between the base year (2021–22) and the final year (2023–24) of the current regulatory control period to the base year opex amount.³⁷

We have removed \$2.1 million (\$2023–24) for the final year increment in our alternative estimate, decreasing our alternative estimate by \$10.4 million (\$2023–24) over the regulatory control period, which is \$0.1 million (\$2023–24) higher than TasNetworks' proposal.

6.4.2.2 Removal of category specific forecasts

In some circumstances, particularly where a category of opex is not being forecast on a revealed cost basis, it may be removed from the base year expenditure. We refer to these as 'category specific forecasts' (see section 6.4.4).

In our alternative estimate we have removed GSL and the ESI levy payments and debt raising costs from base opex. This is consistent with the approach we used in our last revenue determination as well as TasNetworks' proposal.

In our alternative estimate we have retained NEM levy cost in the base year on a revealed costs basis and not removed them as a category specific forecast. This reflects that there

³⁶ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, Table 1. p 3.

³⁷ AER, *Expenditure forecast assessment guideline for electricity distribution*, November 2013, pp. 24–25.

has been very little variation in these costs over time and TasNetworks agreed through the information request process that revealed costs were the best estimate of future costs and to the categorisation of these as base year costs.³⁸ As a result, our alternative estimate for NEM levy payments of \$3.9 million (\$2023–24) is \$2.8 million (\$2023–24) lower than the category specific forecast of \$6.6 million TasNetworks included in its proposal.³⁹

This has resulted in a minor difference between our alternative estimate and TasNetworks' proposal we have removed \$42.9 million (\$2023–24) from base opex to account for category specific forecasts, which is \$4.4 million (\$2023–24) less than TasNetworks' proposal. This difference is caused by recategorisation of the NEM levy payment as base year cost and updates to CPI forecasts.

6.4.3 Rate of change

Having determined an efficient starting point, or base opex, we trend it forward to account for the forecast growth in prices, output and productivity. We refer to this as the rate of change.⁴⁰

TasNetworks broadly applied our standard approach to forecasting the rate of change. It proposed⁴¹:

- **Price growth:** to adopt firm specific input price weightings of 59.2% labour and 40.8% non-labour and to forecast labour price growth using only BIS Oxford Economics' all industries real wage price index (WPI) growth forecasts. It also added the legislated superannuation guarantee increases to its labour price growth forecasts.
- **Output growth:** to apply the weights from our two Cobb Douglas econometric models, one of the Translog models and our opex MPFP models.
- **Productivity growth:** to apply a 3.0% productivity growth forecast in 2024–25 and to use our 0.5% per year productivity growth forecast for the remainder of the regulatory control period.

The rate of change proposed by TasNetworks reduces TasNetworks' opex forecast by \$3.0 million (\$2023–24) or 0.6% its total opex forecast of \$541.0 million (\$2023–24). This equates to opex decreasing by an average of \$0.6 million (\$2023–24) or 0.0% each year. We have included a rate of change in our alternative estimate that increases opex by an average 0.7% each year.

We compare TasNetworks and our alternative estimate forecasts in Table 6.5 and the reasons for the differences are set out below.

³⁸ TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecast and EBSS*, received 26 June 2023; TasNetworks, *AER information request meeting - TasNetworks response*, received 13 July 2023, pp. 4–5.

³⁹ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 13.

⁴⁰ AER, *Expenditure forecast assessment guideline for electricity distribution*, November 2013, pp. 22–24.

⁴¹ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, pp. 10–13.

Table 6.5 Forecast annual rate of change in opex (%)

	2024–25	2025–26	2026–27	2027–28	2028–29
TasNetworks’ proposal					
Price growth	0.8	0.7	0.4	0.2	0.3
Output growth	0.6	0.6	0.6	0.6	0.6
Productivity growth	3.0	0.5	0.5	0.5	0.5
Rate of change	-1.7	0.8	0.4	0.2	0.4
AER alternative estimate - draft decision					
Price growth	0.6	0.8	0.5	0.5	0.6
Output growth	0.6	0.6	0.5	0.5	0.6
Productivity growth	0.5	0.5	0.5	0.5	0.5
Rate of change	0.7	0.8	0.6	0.6	0.7
Difference	2.3	0.1	0.2	0.4	0.3

Source: TasNetworks, *2024–2029 PTRM – Standard control*, December 2022; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; AER, *TasNetworks 2024–29 – Distribution – Draft decision – Opex model*, September 2023; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small nonzero amounts and '-' represents zero.

6.4.3.1 Forecast price growth

TasNetworks proposed an average annual price growth of 0.5% which increased its total opex forecast by \$7.7 million (\$2023–24).⁴² We have used an average annual price growth of 0.6% which increases our total opex alternative estimate by \$9.0 million (\$2023–24). This is \$1.3 million (\$2023–24) higher than the price growth dollar impact proposed by TasNetworks.

Both we and TasNetworks forecast price growth as a weighted average of forecast labour price growth and non-labour price growth:

- both we and TasNetworks applied a forecast non-labour real price growth rate of zero
- both we and TasNetworks have applied the same weights to account for the proportions of opex that is labour and non-labour, 59.2% and 40.8%, respectively.

Consequently, the key difference between our alternative estimate of real price growth forecasts and TasNetworks’ is that we have used our standard approach of an average of two real WPI growth forecasts for the for the electricity, gas, water and waste services

⁴² TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022.

(EGWWS) or utilities industry in Tasmania. Specifically, we have used an average of the Tasmanian utilities WPI forecasts from TasNetworks’ consultant BIS Oxford Economics and from our consultant KPMG. This differs from TasNetworks who applied an estimate from its consultant, BIS Oxford Economics, in relation to the all industries WPI for Tasmania. For this draft decision we engaged KPMG to provide the latest available WPI growth forecasts for the Tasmanian utilities industry.⁴³

Table 6.6 compares our forecast labour price growth with TasNetworks’ proposal.

Table 6.6 Forecast labour price growth (%)

	2024–25	2025–26	2026–27	2027–28	2028–29
TasNetworks’ proposal					
BIS Oxford Economics*	0.8	0.7	0.6	0.3	0.5
Superannuation guarantee increases	0.5	0.5	0.0	0.0	0.0
BIS Oxford Economics, including superannuation guarantee increases	1.3	1.2	0.6	0.3	0.5
AER’s alternative estimate					
KPMG	0.0	0.6	1.0	1.2	1.3
BIS Oxford Economics**	1.1	1.1	0.8	0.6	0.8
Average	0.5	0.8	0.9	0.9	1.0
Superannuation guarantee increases	0.5	0.5	0.0	0.0	0.0
Average, including superannuation guarantee increases	1.0	1.3	0.9	0.9	1.0
Overall difference	-0.3	0.1	0.3	0.6	0.5

Source: KPMG, *WPI forecast report*, September 2023, p. 38; TasNetworks, *2024–2029 PTRM – Standard control*, December 2022; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; AER, *TasNetworks 2024–29 – Distribution – Draft decision – Opex Model*, September 2023; AER analysis

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero. *All Industry – real wage changes – WPI – Tasmania. **EGWWS – real wage changes – WPI – Tasmania.

We will receive updated labour price growth forecasts for the purpose of our final decision, and will update our price growth forecasts in the final decision to reflect this update.

⁴³ KPMG, *WPI forecast report*, September 2023, p. 38.

6.4.3.2 Forecast output growth

TasNetworks' proposed average annual output growth of 0.6%, which increased its proposed opex forecast by \$7.6 million (\$2023–24) or an average \$1.5 million (\$2023–24) per annum.⁴⁴ We have forecast average annual output growth of 0.5%. This increases our alternative estimate of total opex by \$7.8 million (\$2023–24).

We forecast output growth by:

- forecasting the growth rates for three outputs (customer numbers, circuit line length, and ratcheted maximum demand).
- Calculating four weighted average overall output growth rates using the output weights from the four econometric opex cost function benchmarking models in our *2022 Annual Benchmarking Report* for distribution.
- Averaging the four-model specific weighted overall output growth rates.

This approach is slightly different to that used by TasNetworks who also took account of forecast growth in the energy throughput output and used a different combination of output weights from our econometric opex cost function and opex MPFP benchmarking models from an earlier *Annual Benchmarking Report* for distribution.

We discuss these approaches below.

6.4.3.2.1 Forecast growth of the individual output measures

We are satisfied that TasNetworks' forecast of the growth in customer numbers, circuit length and ratcheted maximum demand reflect a realistic expectation and are largely consistent with forecast trends from external sources that have been previously tested and validated from or historical growth rates. The percentage growth for each output measure is line with our alternative estimate. Specifically:

- **Customer numbers:** TasNetworks proposed forecast growth in customer numbers (annual average 1.0%) based on historical trends. However, it incorrectly included unmetered supplies in the annual customer numbers used in its opex model.⁴⁵ TasNetworks subsequently advised that the correct annual customer numbers were included in TasNetworks' Regulatory Information Notice workbook 1 submitted with the reset.⁴⁶ We have included these forecast customer numbers in our alternative assessment.
- **Circuit length:** TasNetworks forecast growth in its circuit length (average of 0.5% per year) consistent with its historical growth rate.
- **Ratcheted maximum demand:** TasNetworks forecast ratcheted maximum demand based on 2007 maximum demand forecasts at the transmission connection point. TasNetworks did not forecast demand to surpass its historic peaks in the 2024–29

⁴⁴ TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022.

⁴⁵ TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022.

⁴⁶ TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecast and EBSS*, received 9 June 2023, TasNetworks, *2024–2029 Distribution RIN Workbook 1 – Table 6.2.4*, December 2022.

regulatory control period, indicating no growth in ratcheted maximum demand. We consider this outcome reasonable as it is consistent with the central scenario in the Australian Energy Market Operator’s (AEMO’s) 2023 Electricity Statement of Opportunities,⁴⁷ which forecast maximum demand in Tasmania to remain relatively flat in the short to medium term. We discuss our maximum demand forecasts further in Attachment 5.

6.4.3.2.2 Output weights

The output weights that we have used in our alternative estimate are set out in Table 6.7 and are based on the output weights published in our *2022 Annual Benchmarking Report* for distribution.⁴⁸ These are different to those proposed by TasNetworks as a result of TasNetworks using the output weights from our *2020 Annual Benchmarking Report* for distribution. TasNetworks agreed to our decision to update the output weights based on the latest available values.⁴⁹

Table 6.7 Output weights (%)

	Cobb-Douglas SFA	Cobb Douglas LSE	Translog LSE	Translog SFA	MPFP*	AER alternative estimate Average	TasNetworks’ Estimate average
Customer numbers	43.1	60.9	45.1	47.6	18.8	49.2	45.6
Circuit length	10.8	15.7	17.2	8.4	38.8	13.0	21.7
Ratcheted maximum demand	46.1	23.4	37.6	43.9	33.8	37.8	30.5
Energy throughput*	–	–	–	–	8.8	–	8.8

Source: AER, *2022 Annual Benchmarking report – electricity distribution network service provider*, November 2022, p. 23; TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; AER analysis.

Note: Amounts of '0.0' and '-0.0' represent small non-zero values and '-' represents zero. *Our alternative estimate for the draft decision did not include the MPFP opex benchmarking model or the forecast growth in the energy throughput output. TasNetworks in calculating the average opex weights did not use the Translog SFA model and instead used the weights from the opex MPFP benchmarking models from an earlier Annual Benchmarking Report for distribution.

We will publish our *2023 Annual Benchmarking Report* for distribution in late November 2023. In our final decision, we will update our output growth rate forecasts to reflect the

⁴⁷ AEMO, *2023 Electricity Statement of opportunities*, August 2023, pp. 147–48.

⁴⁸ AER, *2020 Annual Benchmarking Report – Electricity distribution network service provider*, November 2020, p. 32.

⁴⁹ TasNetworks, *Response to information request #036 – Opex, base, trend, category specific forecast and EBSS*, received 9 June 2023.

output weights in the *2023 Annual Benchmarking Report*. Full details of our approach to forecasting output growth are set out in our opex model, which is available on our website.

6.4.3.3 Forecast productivity growth

TasNetworks proposed average productivity growth of 3.0% in 2024–25 followed by 0.5% per year for the remaining four years of the regulatory control period, resulting in an annual average forecast of 1.0% per annum.⁵⁰ TasNetworks stated that the 3.0% productivity growth in 2024–25 represents forecast opex reductions from its transformation program being implemented in 2022–23 and 2023–24. This resulted in an annual average decrease of \$3.7 million (\$2023–24) or \$18.4 million (\$2023–24) over the regulatory control period.

We have forecast a lower average productivity growth of 0.5% per year, which reflects our standard approach. This decreases our alternative opex estimate an annual average of \$1.4 million (\$2023–24) or \$7.1 million (\$2023–24) over the regulatory control period. This is \$11.3 million higher than the \$18.4 million (\$2023–24) productivity reduction proposed by TasNetworks.

Our productivity growth forecast of 0.5% reflects our expectation of the opex productivity growth an efficient service provider in the distribution industry can achieve. It was identified in our 2019 review of productivity growth for electricity distributors as the best estimate of the opex productivity growth that an electricity distributor on the efficiency frontier should be able to achieve going forward.⁵¹ It was informed by a variety of sources, including our electricity benchmarking, gas benchmarking, labour productivity forecasts for utilities and productivity growth in other sectors and countries.

In terms of stakeholder submissions, the Tasmanian Small Business Council noted that TasNetworks had proposed productivity growth of 3.0% but questioned the lower rate (0.5%) in years 2 to 5.⁵² A similar concern was noted by the Tasmanian Minerals, Manufacturing and Energy Council who noted that the headline 0.5% productivity change in years 2 to 5 does not factor in TasNetworks reported lower employee costs.⁵³

We note that TasNetworks proposed average annual productivity growth of 1% over the next regulatory control period is higher than the average annual productivity growth of 0.5% we use in our alternative estimate. Therefore, TasNetworks is proposing productivity growth greater than our best estimate. Further both we and TasNetworks have used our standard method of calculating the dollar impact of productivity growth in the base step trend. This method uses an accumulating productivity growth calculation, meaning that the higher productivity growth set by TasNetworks in year one 'accumulates' in years 2 to 5.

⁵⁰ TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 12.

⁵¹ AER, *Final decision – forecasting productivity growth for electricity distributors*, 8 March 2019, p. 9.

⁵² Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

⁵³ Tasmanian Minerals, Manufacturing & Energy Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received 11 May 2023, p. 2.

6.4.4 Step changes

In developing our alternative estimate for the draft decision, we include prudent and efficient step changes for cost drivers such as new regulatory obligations or efficient capex / opex trade-offs. As we explain in the Guideline for electricity, we will generally include a step change if the efficient base opex and the rate of change in opex of an efficient service provider does not already include the proposed cost for such items and they are required to meet the opex criteria.⁵⁴

TasNetworks' proposal included two step changes totalling \$23.0 million (\$2023–24) or 4.2% of its proposed total opex forecast.⁵⁵ These are shown in Table 6.8 along with our alternative estimate for the draft decision, which is to include step changes totalling \$16.4 million (\$2023–24). This is \$6.6 million (\$2023–24) lower than TasNetworks' proposal. While we consider these step changes are prudent, we consider our lower alternative estimates better reflect the efficient costs associated with these step changes we discuss this below.

Table 6.8 TasNetworks' proposed step changes and the AER's alternative estimate (\$million, 2023–24)

Step change	TasNetworks' proposal	AERs alternative estimate - draft decision	Difference
Insurance premiums	19.1	13.6	-5.5
Cyber security	3.9	2.8	-1.1
Total step changes	23.0	16.4	-6.6

Source: TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 3; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

6.4.4.1 Insurance premiums step change

TasNetworks proposed a step change of \$19.1 million (\$2023–24) for an increase in insurance premiums over the 2024–29 regulatory control period.⁵⁶ This was for the significant forecast increases of insurance premiums, which TasNetworks considered were not captured in opex in the base year or the forecast rate of change. Our alternative estimate for the final decision includes a forecast of \$13.6 million (\$2023–24) for the insurance premiums step change, which is \$5.5 million (\$2023–24) lower than TasNetworks' proposal.

We have included this step change in our alternative estimate as we consider the insurance premium increases results in forecast expenditure that is likely to be prudent and efficient.

⁵⁴ AER, *Expenditure forecast assessment guideline for electricity distribution*, August 2022, p. 26.

⁵⁵ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, pp. 9–10.

⁵⁶ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 9.

Table 6.9 TasNetworks' Insurance premiums step change (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks' proposal	2.8	3.5	4.1	4.3	4.4	19.1
AER alternative estimate - draft decision	1.9	2.5	3.0	3.1	3.1	13.6
Difference	-0.8	-1.0	-1.1	-1.2	-1.3	-5.5

Source: TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 9; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

TasNetworks noted that like other DNSP's, it has experienced significant increases in insurance premiums in recent years due to continued extreme fire and flooding events and cyber security threats. TasNetworks engaged Lockton to provide insurance premium cost forecasts for the full spectrum of its insurance program, with Lockton expecting the trend of premium increases to continue over the 2024–29 regulatory control period across all risk classes given the prevailing insurance market conditions.⁵⁷

TasNetworks calculated the step change amount as the difference between the cost forecasts prepared by Lockton and the insurance cost in the base year (2021–22).⁵⁸

We recently engaged Taylor Fry to assess the prudence and efficiency of forecast insurance premiums for our 2023–28 ElectraNet and Transgrid revenue proposal determinations. We consider TasNetworks' forecast insurance premiums, prepared by Lockton, are consistent with Taylor Fry's expectation of future premiums in that context, given prevailing market conditions. However, TasNetworks' insurance premium forecasts also factor in price growth for the property component of its insurance. That is, the premium increases are applied to property values escalated for non-labour (materials) increases. Step changes should not double count expenditure increases that are already compensated under the other components of opex (e.g. input price growth).

Our alternative estimate has therefore adjusted Lockton's projection of total insurance premium costs by removing the price growth being applied to property values. We have also applied our standard approach for the escalation of annual costs to real dollars, which TasNetworks agreed should be applied.⁵⁹

Our assessment also considers the rate of change forecast, which includes an allowance for non-labour price growth of CPI, which covers any potential increases in costs like insurance premiums. We expect some non-labour components in opex will increase by more than CPI and some less than CPI. To the extent that higher insurance premiums rise by more than CPI, we expect this will to an extent be offset by other non-labour costs rising by less than

⁵⁷ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 9.

⁵⁸ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 9.

⁵⁹ TasNetworks, *Response to information request #039 – Insurance Question. 2*, received 26 June 2023.

CPI. We note, however, that there may be specific circumstances where it is appropriate to consider increasing costs of individual cost categories as they are increasing by more than CPI, particularly where they represent a material proportion of opex.

Our insurance premium step change alternative estimate of \$13.6 million (\$2023–24) represents 2.5% of our forecast alternative estimate of total opex. We consider this represents a material proportion of opex that is not captured in the forecast rate of change.

In terms of stakeholder submissions, Tasmanian Small Business Council noted the step change for insurance premiums needs to be examined in detail to ensure that the costs are prudent and efficient costs.⁶⁰ As set out above, we assessed the reasonableness of Lockton's forecast premium increases against our own independent forecasts prepared by Taylor Fry, and considered the expectations of future premium increases to be reasonable. We are therefore satisfied the proposed costs are efficient. Our assessment also considers the step change is prudent as the cost increases are a material proportion of opex, which are not captured in the rate of change.

6.4.4.2 Cyber security step change

TasNetworks proposed a step change of \$3.9 million (\$2023–24) for cyber security over the 2024–29 regulatory control period.⁶¹ This relates to TasNetworks uplifting its cyber security maturity under the Australian Energy Sector Cyber Security Framework (AESCSF) within the 2024–29 regulatory control period. Our alternative estimate for the draft decision includes a forecast of \$2.8 million (\$2023–24) for the cyber security step change, which is \$1.1 million (\$2023–24) lower than TasNetworks' proposal.

We have included this step change in our alternative estimate. We consider that, within the context of the elevated and increasing cyber threat landscape, TasNetworks proposed approach to invest in prioritised cyber security practices that go beyond Security Profile (SP) 2 maturity is prudent and consistent with good industry practice when assessed against the AESCSF's Electricity Critical Assessment Tool (E-CAT) criticality band ratings. We also consider, based on advice from our technical consultant EMCa, that our alternative estimate is likely to reasonably reflect efficient costs.

⁶⁰ Tasmanian Small Business Council, Submission on TasNetworks' 2024–29 Combined Regulatory Proposal, received May 2023, p. 24.

⁶¹ TasNetworks, *Combined proposal 2024-2029 Attachment 8 – Operating expenditure*, January 2023, p. 10.

Table 6.10 TasNetworks' cyber security step change (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks' proposal	0.4	0.7	0.9	0.9	0.9	3.9
AER alternative estimate - draft decision	0.3	0.5	0.6	0.7	0.7	2.8
Difference	–0.2	–0.2	–0.2	–0.2	–0.2	–1.1

Source: TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 9; EMCa, *TasNetworks 2024 to 2029 Regulatory Proposal – Review of proposed expenditure on ICT cyber security*, August 2023; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '–0.0' represent small non-zero amounts and '-' represents zero.

TasNetworks proposed a \$3.9 million (\$2023–24) step change for the increase in costs it considered was required in cyber tool subscription models and additional full time equivalent (FTE) roles to maintain and grow its cyber security capability.⁶² TasNetworks stated that this will allow compliance with the enhanced cyber security obligations set out in the *Security of Critical Infrastructure Act 2018*.⁶³ TasNetworks engaged PwC to assist in its analysis of the cyber security uplift requirement, including assessing the proposed expenditure against industry benchmarks and best practices.

In April 2022 the *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022* amended the *Security of Critical Infrastructure Act 2018*, requiring responsible entities to have and comply with a critical infrastructure risk management program (RMP). The RMP requires energy providers to meet obligations set out in Australian Energy Market Operator's (AEMO) 2020–21 AESCSF Version 1 (V1) Framework Core, which requires entities to meet a cyber maturity level of SP-1.⁶⁴

AEMO's AESCSF V1 program also includes the E-CAT, which is designed to assess the relative criticality of network service providers and other participants in the electricity sector. E-CAT's criticality banding for the electricity sub-sector rates a distribution business with a medium to high criticality rating.⁶⁵ The medium criticality rating translates to guidance that a business should be achieving a SP-2 maturity level and high criticality rating SP-3. AEMO also states that the E-CAT should be treated as general guidance only and that results obtained from the E-CAT do not indicate that an entity has obligations under or is compliant with applicable Commonwealth legislation.⁶⁶ AEMO has indicated it will be releasing AESCSF Version 2 (V2) in September 2023, where it is likely that upon release, there will be

⁶² TasNetworks, *TN402 TasNetworks – Cyber Security Program of Work Investment Evaluation Summary - Oct 22 – Public*, October 2022, p. 20.

⁶³ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 10.

⁶⁴ Australian Government, *Security of Critical Infrastructure (Critical infrastructure risk management program) Rules (LIN 23/006)*, February 2023, Section 8.4.

⁶⁵ AEMO, *AESCSF Electricity Criticality Assessment Tool (E-CAT)*, AESCSF V1.

⁶⁶ AEMO, *AESCSF Framework Overview - 2022 program*, p. 3.

increased hurdles (number of practices) to achieve each of the SP maturity levels compared to AESCSF V1.

The AER's most recent assessments of cyber security step changes for distribution businesses have been determined on the basis of the businesses legislative obligations under the *Security of Critical Infrastructure Act 2018*, *Security Legislation Amendment (Critical Infrastructure Protection) Act 2022* and the RMP requirements.⁶⁷ Therefore our assessments considered that for a distribution business, there was no new regulatory obligation for the business to achieve a maturity level greater than SP-1. We now consider, within the context of the elevated and increasing cyber threat landscape, that it is prudent and good industry practice to achieve a SP level that corresponds to a business's E-CAT criticality ratings guidance for SP maturity levels.

To assist our assessment, we engaged EMCa to provide a technical review of TasNetworks' proposal. EMCa's overall finding is that it considered TasNetworks' cyber security program objectives were reasonable and its targets adequately justified. EMCa also considered that TasNetworks' cost forecasts were reasonably derived, however, it considered that it had included some expenditure items that are not cyber security related.⁶⁸

EMCa considered the inclusion of additional FTE roles for physical security and personnel vetting to be not appropriate for the cyber security opex step change, as they relate to other aspects of the *Security of Critical Infrastructure Act 2018* RMP rules.⁶⁹ EMCa also considered that it was reasonable to include a real cost escalation of an average of 20% over the next regulatory control period, to account for TasNetworks likely costs in recruiting and retaining scarce cyber security FTEs. This was in lieu of TasNetworks' proposed 30% contingency.

The RMP rules contain obligations relating to protections with four key hazard vectors being physical security, cyber and information security, personnel and supply chain.⁷⁰ We agree with EMCa that TasNetworks' proposed FTE roles for physical security and personnel vetting relate to other vectors of the RMP rules and are not required for TasNetworks to achieve its proposed maturity level relating to the cyber and information security vector. Therefore, we have not included these costs in our alternative estimate as TasNetworks has not provided sufficient information or evidence of these roles being prudent or required in order to meet obligations under the *Security of Critical Infrastructure Act 2018*.

We consider, based on our review, EMCa's findings and AESCSF's E-CAT criticality rating guidance, that it is prudent and good industry practice for TasNetworks as both a distribution and transmission business to uplift its cyber security levels by investing in prioritised cyber security practices that go beyond the SP-2 maturity level in the 2024–29 regulatory control period. However, we are not satisfied that TasNetworks' proposal reflects the efficient costs required. We agree with EMCa's consideration that the real cost escalation of an average of

⁶⁷ AER, *MGN 2023–28 – Draft decision – Attachment 6 – Operating expenditure*, December 2022, pp. 24–27. AER, *AGN 2023–28 – Draft decision – Attachment 6 – Operating expenditure*, December 2022, pp. 30–33.

⁶⁸ EMCa, *TasNetworks 2024 to 2029 Regulatory Proposal – Review of proposed expenditure on ICT cyber security*, August 2023, p. 18.

⁶⁹ EMCa, *TasNetworks 2024 to 2029 Regulatory Proposal – Review of proposed expenditure on ICT cyber security*, August 2023, p. 25.

⁷⁰ Australian Government, *CISC Factsheet – Risk Management Program*, August 2022, p. 2.

20% over the next regulatory control period, to account for TasNetworks likely incurred costs in recruiting and retaining scarce cyber security FTE's, is a reasonable cost escalation rate to apply and more likely to reflect efficient costs.

Our alternative estimate of \$2.8 million (\$2023–24) has removed the expenditure related to the physical security and personnel vetting costs and also applied a cost escalation of 20% to calculate incremental FTE costs. We have also corrected TasNetworks' inflation indexation, to apply the correct inflation rates to convert TasNetworks' proposed expenditure costs into \$2023–24.

In terms of stakeholder submissions, the Tasmanian Small Business Council noted the step change for cyber security needs to be examined in detail to ensure that the costs are prudent and efficient costs.⁷¹

6.4.5 Category specific forecast

TasNetworks' proposal included four category specific forecasts, which were not forecast using the base-step-trend approach.⁷² These were for debt raising costs, GSL payments, ESI levy payments and NEM levy payments. We have included category specific forecasts for debt raising costs, GSL and ESI levy payments in our alternative estimate of total opex. As we consider the best forecast of the NEM levy payments is on a revealed cost basis, we have retained them as a part of opex in the base year. This is discussed in Section 6.4.2.2.

6.4.5.1 Debt raising costs

We have included debt raising costs of \$5.8 million (\$2023–24) in our alternative estimate. This is \$0.3 million (\$2023–24) higher than the \$5.5 million (\$2023–24) proposed by TasNetworks.

Table 6.11 Debt raising costs (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks' proposal	1.1	1.1	1.1	1.1	1.1	5.5
AER alternative estimate - draft decision	1.2	1.2	1.2	1.2	1.2	5.8
Difference	0.1	0.1	0.1	0.1	0.1	0.3

Source: TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; AER, *TasNetworks 2024–29 – Distribution – Draft decision - Opex model*, September 2023; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Debt raising costs are transaction costs incurred each time a business raises or refinances debt. Our preferred approach is to forecast debt raising costs using a benchmarking approach rather than a service provider's actual costs in a single year. This provides consistency with the forecast of the cost of debt in the rate of return building block.

⁷¹ Tasmanian Small Business Council, *Submission on TasNetworks' 2024–29 Combined Regulatory Proposal*, received May 2023, p. 24.

⁷² TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 13.

We used our standard approach to forecast debt raising costs, which is discussed further in Attachment 3 to the draft decision.

6.4.5.2 ESI levy payments

TasNetworks proposed category specific forecast for the ESI levy payments of \$25.5 million (\$2023–24).⁷³ TasNetworks also proposed to adjust annually the difference between forecast and actual levies as part of the standard control services revenue formula and pricing adjustments⁷⁴, which is consistent with the treatment of these costs in the 2019–24 regulatory control period.⁷⁵

We have included the ESI levy payments of \$25.3 million (\$2023–24) as category specific forecasts consistent with TasNetworks' proposal.

6.4.5.3 GSL payments

TasNetworks proposed a category specific forecast of \$19.8 million (\$2023–24) for GSL payments. TasNetworks also proposed to adjust annually the difference between forecast and actual levies as part of the standard control services revenue formula and pricing adjustments⁷⁶, which is consistent with the treatment of these costs in the 2019–24 regulatory control period.⁷⁷

We have included a category specific forecast for GSL payments of \$2.4 million (\$2023–24) per year or \$12.1 million (\$2023–24) for the next regulatory control period in our alternative estimate. This is \$7.8 million (\$2023–24) lower than TasNetworks proposed. This is because we have forecast GSL payments as the average of GSL payments made by TasNetworks over the most recent five years for which we have actual data⁷⁸, consistent with how we forecast GSL payments in the 2019–24 regulatory control period.⁷⁹

⁷³ TasNetworks, *Response to information request #015 – Opex base, category specific forecasts, rate of change and EBSS*, received 12 April 2023.

⁷⁴ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 13.

⁷⁵ AER, *Final Decision – TasNetworks distribution determination 2019–24 – Attachment 6 – Operating expenditure*, April 2019, p. 30.

⁷⁶ TasNetworks, *Combined proposal 2024–2029 Attachment 8 – Operating expenditure*, January 2023, p. 13.

⁷⁷ AER, *Final Decision – TasNetworks distribution determination 2019–24 – Attachment 6 – Operating expenditure*, April 2019, p. 30.

⁷⁸ The five years are 2017–18 to 2021–22. We will update this for the final decision for when we have 2022–23 data.

⁷⁹ AER, *Final Decision - TasNetworks distribution determination 2019–24 – Attachment 6 – Operating expenditure*, April 2019, p. 29.

Table 6.12 GSL payments (\$million, 2023–24)

	2024–25	2025–26	2026–27	2027–28	2028–29	Total
TasNetworks' proposal	4.0	4.0	4.0	4.0	4.0	19.8
AER alternative estimate – draft decision	2.4	2.4	2.4	2.4	2.4	12.1
Difference	–1.6	–1.6	–1.6	–1.6	–1.6	–7.8

Source: TasNetworks, *2024–2029 Operating Expenditure Model – Standard control*, December 2022; AER, *TasNetworks 2024–29 – Distribution – Draft decision – Opex model*, September 2023; AER analysis.

Note: Numbers may not add up to totals due to rounding. Values of '0.0' and '-0.0' represent small non-zero amounts and '-' represents zero.

Shortened forms

Term	Definition
ABS	Australian Bureau of Statistics
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulatory
AESCSF	Australian Energy Sector Cyber Security Framework
capex	capital expenditure
CCP27	Consumer Challenge Panel, sub-panel 27
DNSP or distributor	Distribution Network Service Provider
EB	Economic benchmarking
EBSS	efficiency benefit sharing scheme
EMCa	Energy Market Consulting associates
ESI	Electrical Safety Inspection
GSL	Guaranteed Service Level
the Guideline	the Expenditure forecast assessment guideline
ICT	information and communication technologies
LSE	Least Squares Econometrics
LSECD	Cobb-Douglas Least Squares Econometrics
LSETLG	Translog Least Squares Econometrics
MPFP	Multilateral Partial Factor Productivity
NEL	National Electricity Laws
NEM	National Electricity Market
NER	National Electricity Rules
OEF	operating environment factors
Opex	operating expenditure
PTRM	post tax revenue model
RIN	regulatory information notice
SFA	Stochastic Frontier Analysis
SFACD	Cobb-Douglas Stochastic Frontier Analysis
SFATLG	Translog Stochastic Frontier Analysis
SCS	standard control service
WPI	Wage price index