

# Issues Paper

TasNetworks

## Electricity Transmission and Distribution Determination

1 July 2024 to 30 June 2029

March 2023

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# 1 Introduction

The Australian Energy Regulator (AER) exists to ensure energy consumers are better off, now and in the future. Consumers are at the heart of our work, and we focus on ensuring a secure, reliable, and affordable energy future for Australia. We regulate electricity networks in all jurisdictions except Western Australia. Our primary role is in setting the maximum revenue that network businesses can recover from users of their networks. Our goal is to make decisions that ensure consumers pay no more than necessary for safe and reliable energy.

TasNetworks is the sole owner and operator of the monopoly electricity transmission and distribution networks in Tasmania. The networks comprise the towers, poles, wires and transformers used for transporting electricity to homes and business.

On 31 January 2023, TasNetworks submitted joint regulatory proposals covering both its transmission and distribution networks for the five years commencing 1 July 2024.<sup>1</sup> Its proposals set out the revenue it proposes to recover from its customers for the provision of electricity distribution and transmission services, and the methodology it proposes to use to set its prices each year.

Our Better Resets Handbook (Handbook), together with the regulatory framework, sets out our expectations for each network's revenue proposal. In addition to expectations on consumer engagement it sets out our expectations on the basis of estimation of the key revenue components, such as capital and operating expenditure (capex and opex), depreciation and tariff structure statements (TSS). These expectations and the regulatory framework provide the framework for our assessment of the revenue components and may help guide stakeholders' submissions on the proposal. As we stated in the Handbook:

As the economic regulator of energy networks, we are required to make decisions that best advance the long-term interests of consumers, as expressed in the National Electricity Objective and National Gas Objective. If a network business meets our expectations this will increase the likelihood that its regulatory proposal advances the long-term interests of consumers, giving us the confidence to rely on a more targeted assessment to meet our obligations.<sup>2</sup>

Although TasNetworks has submitted joint regulatory proposals for its transmission and distribution networks, under our legislative framework we must undertake separate assessments and make separate transmission and distribution determinations.

However, over the 2024–29 period, there are several additional factors that may affect the total revenue that TasNetworks will recover from its consumers, including:

- contingent projects that have been put forward by TasNetworks as part of its 2024–29 proposal that may trigger
- projects defined by the Australian Energy Market Operator (AEMO) as necessary to the Integrated System Plan (ISP) or Rewiring the Nation such as Marinus Link
- Renewable Energy Zone (REZ) projects under the Hydrogen Hub outlined by the Tasmanian government.
- cost pass through events defined in the National Electricity Rules (NER or Rules) and our decision.

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<sup>1</sup> [TasNetworks Combined Regulatory Proposal Overview](#)

<sup>2</sup> AER, *Better Resets Handbook*, December 2021, p.3.

## 1.1 How can you get involved?

This issues paper highlights some of the key elements of the proposals, and identifies issues that on preliminary review, are likely to be the focus of our assessment.<sup>3</sup> Consumer engagement is a valuable input to our determinations. When we receive stakeholder submissions that articulate consumer preferences, address issues in a revenue proposal, and provide evidence and analysis, our decision-making process is strengthened.

You can contribute to our assessment by:

- making a written submission on TasNetworks proposals to [AERresets2024-29@aer.gov.au](mailto:AERresets2024-29@aer.gov.au) by **12 May 2023**.<sup>4</sup>
- joining us, TasNetworks and our Consumer Challenge Panel (CCP27)<sup>5</sup> at an online public forum on **4 April 2023**. Details of how to register for this forum are available on our website [Eventbrite](#) (external link).<sup>6</sup>

Table 1 sets out the key milestones planned for this review.

**Table 1 Key dates for TasNetworks' 2024–29 revenue determinations**

| Milestone  | Date           |
|--|----------------|
| AER publishes Issues Paper on TasNetworks proposal                     | 28 March 2023  |
| AER holds public forum on Issues Paper and TasNetworks proposal        | 4 April 2023   |
| Submissions due on TasNetworks proposal & Issues Paper                 | 12 May 2023    |
| AER publishes draft decision   | September 2023 |
| AER holds public forum on draft decision (predetermination conference) | October 2023   |
| TasNetworks submits revised proposal to AER                            | December 2023  |
| Submissions due on draft decision and TasNetworks revised proposal     | January 2024   |
| AER publishes final decisions  | April 2024     |

Note: Timelines are indicative and subject to change

<sup>3</sup> As required under the NER, cl. 6A.11.3(b1)

<sup>4</sup> See [TasNetworks Submission](#) for full details on making a submission. For further information regarding the AER's use and disclosure of information provided to it, see the [ACCC/AER Information Policy](#).

<sup>5</sup> The role of the Consumer Challenge Panel is to assess and advise the AER on the quality of engagement undertaken by network businesses and whether the interests of customers are adequately reflected in regulatory proposals.

<sup>6</sup> Register for TasNetworks' public forum through [Eventbrite](#) (external link).

## 2 Our initial observations

TasNetworks' proposals would allow it to recover \$1714.5 million (\$nominal, smoothed) from its customers over the 2024–29 period for its distribution network. This is 35.4% higher than what we approved for the 2019–24 period.<sup>7</sup> We estimate this would flow through to customers as a nominal increase of \$45 per year for residential electricity consumers, and \$62 per year for small businesses.<sup>8</sup>

For the transmission network, TasNetworks is proposing to recover \$866.9 million from its customers over the 2024–29 period. This is 17.8% higher than what we approved for the 2019–24 period.<sup>9</sup> Transmission customers are likely to see a decrease in charges of 1% (real terms) in 2024–25 and small increases of 1.5% in the remaining years of the period.<sup>10</sup>

The electricity consumed by Tasmanian households and businesses is supplied through a network of “poles and wires” divided into:

- transmission – the high voltage electricity network connecting generators, distributors, and major end users
- distribution – the lower voltage electricity network carrying electricity from the points of connection with the transmission network to virtually every residence and building.

Retail prices for electricity consumers in Tasmania include the costs associated with operating and maintaining the transmission and distribution (38%) networks, and also costs of generation (35%), renewable energy certificates (9%), metering (5%), and costs incurred by retailers in selling electricity (12%).<sup>11</sup>

The cost of the network components of the electricity supply chain are ultimately recovered through electricity retail charges. The AER is not responsible for the regulation of electricity retail prices in Tasmania. The Office of the Tasmanian Economic Regulator is responsible for setting maximum retail prices for the sale and supply of electricity services to (regulated) standing offer customers.

TasNetworks proposal is the first step in a 15-month review process. Over the course of this process, as we move from proposal to draft decision, and then to revised proposal and final decision, components of forecast revenue are likely to change. These changes may result from our taking a different view on proposed revenue to TasNetworks. In addition, a standard part of our process is to update the forecast revenue for movements in market variables such as interest rates, bond rates and inflation. Movements in these market variables can have a material impact on the final revenue and, therefore, consumer bills. Therefore, projected bill impacts at this stage should be treated as no more than potential impacts subject to changes in interest rates and inflation.

TasNetworks submits that it has used its 18 months of consumer engagement to prepare a regulatory proposal reflective of customer preferences with affordability being their primary concern. TasNetworks' customers value long term investments in the future of the network that deliver on the renewable energy capability of the State, but also unlock community benefits. Further details on how TasNetworks has responded to these priorities is covered in section 3.

<sup>7</sup> In real terms (\$2023–24), proposed total revenue is \$118 million (11 per cent) higher than approved for 2019–24 period.

<sup>8</sup> [TasNetworks, Combined Regulatory Proposal, January 2023, Overview p. 4](#)

<sup>9</sup> In real terms (\$2023–24), proposed total revenue is \$34.3 million (4.3 per cent) lower than approved for 2019–24 period.

<sup>10</sup> [TasNetworks, Combined Regulatory Proposal, January 2023, Overview p. 4](#)

<sup>11</sup> [TasNetworks, Combined Regulatory Proposal, January 2023, Overview, p 7.](#)

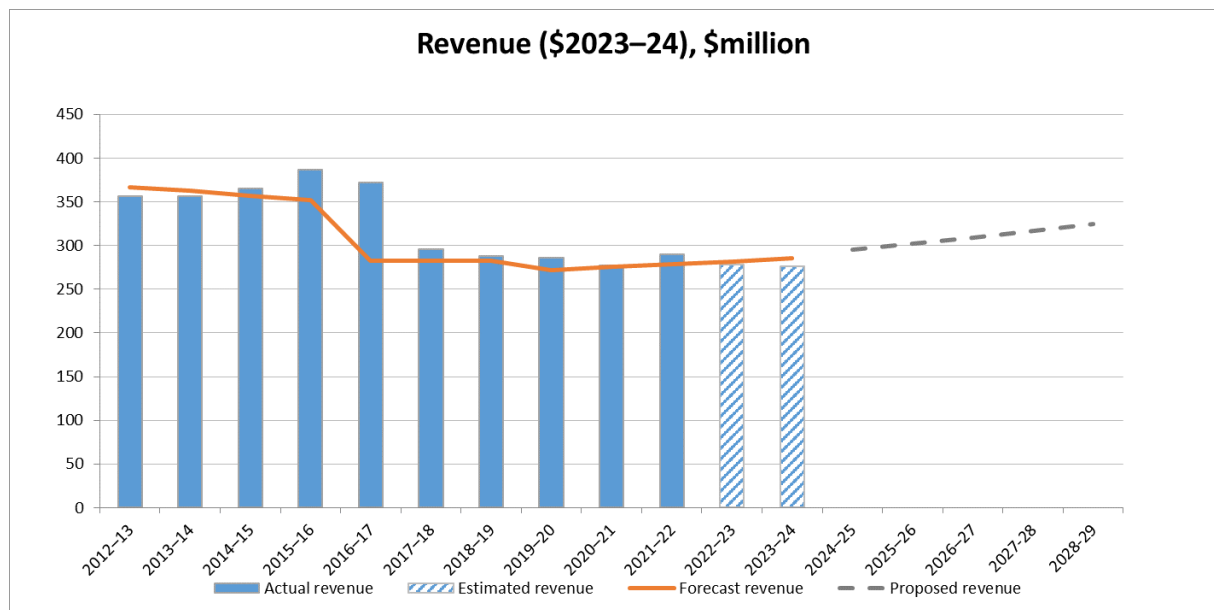
## 2.1 Drivers of revenue in the proposal

To compare revenue from one regulatory period to the next on a like-for-like basis, we make an adjustment for the impact of inflation. To do this, we use “real” values based on a common year (in this case, 2023–24) which have been adjusted to remove the impact of inflation.

In real terms, TasNetworks proposal, if accepted would allow it to recover \$1549 million (\$2023–24) from its distribution consumers over the 2024–29 period.

Although TasNetworks proposes higher nominal revenue over the 2024–29 period compared to what we approved for the 2019–24 period, Figure 1 shows a 11% increase in proposed real revenue for the 2024–29 period compared to the 2019–24 period. Higher real revenues over the 2024–29 period are largely driven by the forecast increases to the return on capital building block and revenue adjustment building block.

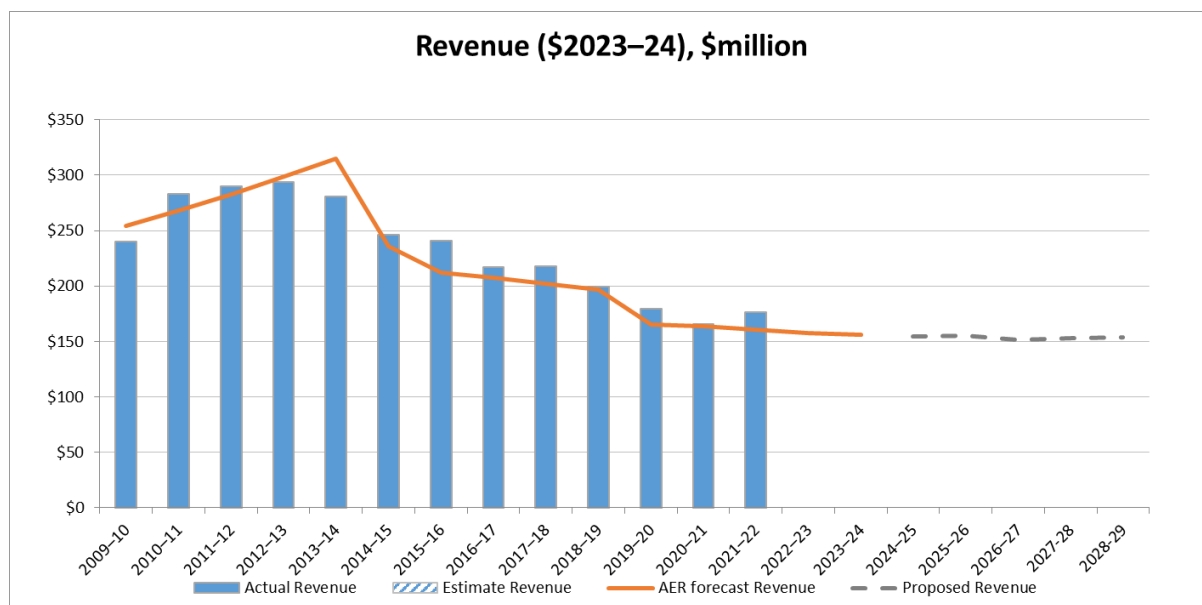
**Figure 1 changes in TasNetworks' distribution revenue over time (\$million, 2023–24)**



Source: AER analysis

In real terms, TasNetworks proposed transmission revenue is \$784 million (\$2023-24) which is a \$34.3 million reduction and a flatter annual profile for all annual revenue forecasts for the 2024–29 period. Although TasNetworks proposed higher nominal revenue over the 2024–29 period compared to what we approved for the 2019–24 period. Figure 2 shows a 4.3% decrease in proposed real revenue for the 2024–29 period compared to the 2019–24 period.

**Figure 2 changes in TasNetworks' transmission revenue over time (\$million, 2023–24)**



Source: AER analysis

Figure 3 (transmission) and Figure 4 (distribution) highlight the changes in TasNetworks proposal at the “building block” level to illustrate what is driving its proposed decrease in real revenue from 2019–24 to 2024–29.

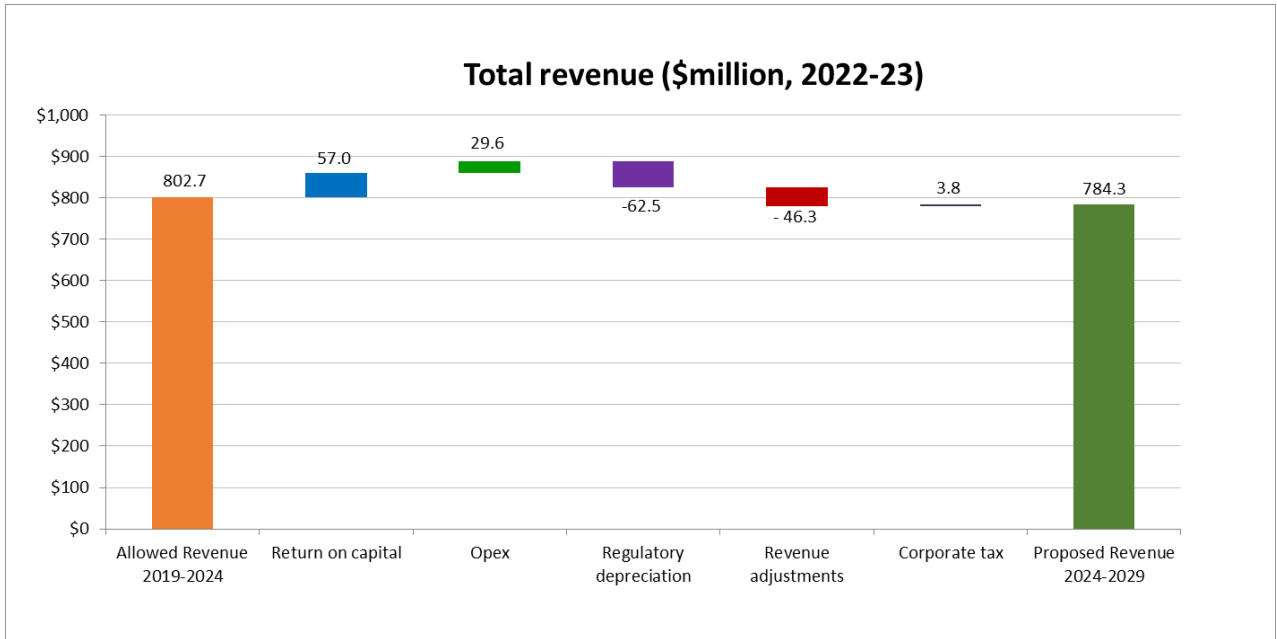
The overall trend in revenue is primarily driven by:<sup>12</sup>

- economic conditions driving increases in rate of return; the AER delayed its decision to update the Rate of Return instrument and instructed TasNetworks to prepare its proposal using the 2018 instrument. Based on government bond rates, an increase is forecast for the return on capital for 2024–29 compared to 2019–24 period.
- rising inflation (see Figure 7); TasNetworks has applied a placeholder estimate of 3.4 % however it is understood that the AER will update this at draft and final decisions.
- increasing cyber security and insurance costs; these costs are industry wide and are in response to global climactic and economic market conditions. TasNetworks have forecast increase opex costs due to compliance with Security of Critical infrastructure Act.
- network services to maintain safe, reliable and secure performance; investments to maintain achievement of service targets and levels of reliability. Some small areas of the network have not consistently met the AER’s and/or the Office of the Tasmanian Economic Regulator’s prescribed targets. Stakeholder consultation identified modest capex to bring within standards for 2024–29.

<sup>12</sup> [TasNetworks Combined Proposal Overview – January 2023](#) page 19-21



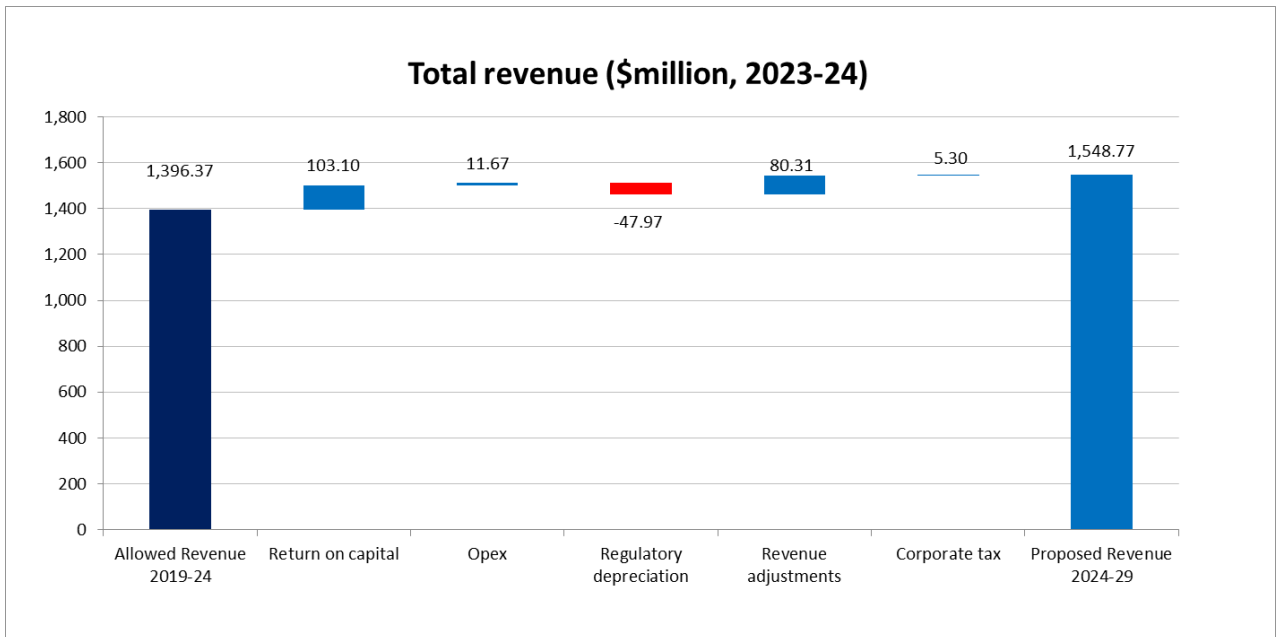
**Figure 3 comparison of TasNetworks' transmission proposed building block revenue for 2024–29 to the allowed revenue for 2019–24 (\$million, 2023–24).**



Source: AER analysis

Note: Allowed revenue and proposed revenue in the chart are unsmoothed total revenue for the regulatory period.

**Figure 4 comparison of TasNetworks' distribution proposed building block revenue for 2024–29 to the allowed revenue for 2019–24 (\$million, 2023–24).**



Source: AER analysis

Note: Allowed revenue and proposed revenue in the chart are unsmoothed total revenue for the regulatory period.

### 3 TasNetworks consumer engagement

TasNetworks is a natural monopoly supplying an essential service. Genuine, high quality consumer engagement by TasNetworks is essential to ensuring that its proposal is driven by consumer preferences, supports delivery of services that meet the needs of its consumers, and does so at a price that is affordable and efficient. We've seen through experience that a regulatory proposal developed through genuine engagement with consumers is more likely to be largely or wholly accepted in our decisions.

Our framework for considering consumer engagement in network revenue determinations is set out in the Handbook.<sup>13</sup> Used in conjunction with our technical analysis, the framework for our regulatory decision making allows us to place weight on the outcomes of the engagement activities undertaken by a business to assist in providing an overall assessment of a proposal.

TasNetworks' engagement program has been a concerted effort by the business to mature its engagement approach with its customers. Over its 18-month engagement plan TasNetworks has sought to identify and understand what is important to its customers and stakeholders to help shape the development of its combined proposal.<sup>14</sup> TasNetworks states its proposal has been guided by the Handbook and has identified its goal to endeavour to create a proposal that is capable of acceptance.<sup>15</sup>

In September 2021, TasNetworks' formed its Regulatory Advisory Committee (RAC), noting the key objective of the RAC was to support the '...development of a Combined Proposal that balances the needs of our customers, owners and the AER.'<sup>16</sup> The Consumer Challenge Panel, sub-panel 27 (CCP27) and AER staff have had the opportunity to observe much of TasNetworks' engagement, including meetings with its RAC. The RAC has separately submitted a report as part of the proposal submission providing an Engagement report that provides valuable insights from members on their experience and outcomes of the process.<sup>17</sup>

#### 3.1 Nature of engagement

The nature of engagement is about how networks engage with their consumers. Our expectations are that network businesses will sincerely partner with consumers and equip them to effectively engage in the development of their proposals.

TasNetworks' engagement plan was a co-design process, broken into five phases of engagement. Figure 5, outlines TasNetworks phased approach.<sup>18</sup>

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<sup>13</sup> AER, *Better Resets Handbook*, December 2021.

<sup>14</sup> TasNetworks, *Combined proposal Overview – January 2023*, p.13.

<sup>15</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 2.

<sup>16</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 25.

<sup>17</sup> TasNetworks *Reset Advisory Committee Engagement Report*, January 2023.

<sup>18</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 12.

**Figure 5 TasNetworks engagement phases**

| Phase 1  | Phase 2   | Phase 3   | Phase 4   | Phase 5  |
|--|---|---|---|--|
| <b>Research + planning</b>   | <b>Context + capability building</b>  | <b>Deep dives</b>   | <b>Reporting back</b>   | <b>Closing the loop</b>  |
| Nov 2020–Sep 2021  | Oct–Dec 2021  | Jan–Jul 2022  | Jul–Oct 2022  | Nov 2022–Jan 2023  |
| 3 topics covered   | 10 topics covered   | 33 topics covered   | 13 topics covered   | 18 topics covered  |
| Dedicated to uncovering customer and stakeholder needs and interests through research, and using these to directly shape our Draft Customer and Stakeholder Engagement Strategy. | Centred around activities that build the knowledge and understanding of our engagement participants, identifying topics for the following phases of engagement, and seeking feedback on the Draft Customer and Stakeholder Engagement Strategy. | Focused on conducting deep-dives into the topics and issues that customers and stakeholders have highlighted, gathering detailed feedback to help shape our Draft Plan and Combined Proposal. | Involved with seeking feedback on our Draft Plan with engaged stakeholders and customers, and using these insights to refine our Combined Proposal. | Concentrated on reporting back to our customers and stakeholders regarding how their feedback has helped shape our Proposal. |

Source: TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 22

Of the listed objectives that TasNetworks was working to, it clearly identified it wanted to deepen customer and stakeholder trust in the process and outcomes of the proposal through genuine engagement.<sup>19</sup> TasNetworks also adopted an iterative approach of evaluating and reporting on its engagement from the beginning, to allow continual refinement of what they were hearing from participants, how it was going in terms of quality of engagement and whether it was meeting its objectives.<sup>20</sup> One method TasNetworks used for its own evaluation were specific metrics aimed to achieve a minimum satisfaction rating of 70% across its activities and phases. It largely met and exceeded these targets for all but one (ability to influence was clear) and the results demonstrated a consistent growth in improvement across phases 2-4.<sup>21</sup>

Key messages taken from the RAC's report indicate that over the course of its engagement TasNetworks staff became more open in to providing direct answers to questions posed and appreciated that TasNetworks encouraged the group to provide challenge.<sup>22</sup>

### 3.2 Breadth and depth of engagement

The breadth and depth of engagement is about the scope of engagement with consumers and the level of detail at which network businesses engage on issues. The breadth and depth of engagement also covers the range of avenues used to engage with consumers.

TasNetworks' customer engagement framework was based on the International Association of Public Participation Spectrum (IAP2) and provided an outline of the different levels of engagement available to engage with its customers.<sup>23</sup> In previous proposals, TasNetworks noted that its customer engagement tended towards engagement that focused on an inform or consult levels, where stakeholders have very little influence on the outcomes. It identified an intention to develop its maturity for the 2024–29 proposal and develop a program of activities

<sup>19</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 14.

<sup>20</sup> See Table 13 for a full list of metrics in TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 32.

<sup>21</sup> TasNetworks *Reset Advisory Committee Engagement Report*, January 2023, p31-32.

<sup>22</sup> TasNetworks *Reset Advisory Committee Engagement Report*, January 2023, p. 4.

<sup>23</sup> TasNetworks, *Customer Engagement Framework*, January 2022.

that spanned the spectrum of inform to empower.<sup>24</sup> Where empower ultimately places the decision making in the hands of its customers stakeholders.

TasNetworks' engaged in a suite of activities, stating it 'directly engaged with 567 individuals, in 61 activities, covering 64 topics.'<sup>25</sup> It placed the largest weight on more detailed feedback that it gathered from its deep and ongoing engagement with its RAC, Policy and Regulatory Working Group and Customer Council. TasNetworks acknowledging that:

Nonetheless, feedback from broader engagement methods, such as our annual customer survey, individual customer panels, discussion circles, focus groups and forums, has been used to confirm the direction provided by our more deliberative groups, to ensure their thinking is aligned with and representative of our broader customer base.<sup>26</sup>

TasNetworks' proposal has provided a detailed table of the topics discussed with its groups, and the level of influence that has been identified (from inform to empower).<sup>27</sup> Based on TasNetworks' own assessment, engagement on issues still leans towards the inform, consult or involve. Figure 6 highlights the four key themes that TasNetworks notes emerged clearly as priorities for its customers and stakeholders. Noting that the themes remained largely consistent following its last main feedback gathering session in Phase 3.

**Figure 6 TasNetworks' customers and stakeholders key themes**



Source: TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 22

On the theme of affordability, the RAC engagement report provided commentary that more focus could have been shown on this topic by TasNetworks. They saw the focus in its discussion as more weighted to technical and cost inputs associated with relevant expenditure activities, as opposed to focusing on customer benefits or bill impacts.<sup>28</sup>

The RAC also observed that over the course of the process it saw changes to the proposal as a result of response to its questions and comments but noted that it cannot determine whether it made a difference until it fully assesses the changes from the draft proposal to the proposal submitted.<sup>29</sup>

As TasNetworks maturity of engagement grows, we see a greater opportunity for customers and stakeholders to be empowered to partner with TasNetworks, to develop alternatives and identify preferred solutions or ultimately allow customers and stakeholders to make the final decision.

<sup>24</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 17.

<sup>25</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 3.

<sup>26</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 27.

<sup>27</sup> See Table 5, Topics and level of influence by audience: TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p. 18-19.

<sup>28</sup> TasNetworks *Reset Advisory Committee Engagement Report*, January 2023, p. 2.

<sup>29</sup> TasNetworks *Reset Advisory Committee Engagement Report*, January 2023, p. 4.

However, this does not detract from the significant progress that TasNetworks has demonstrated through its engagement strategy.

### 3.3 Clearly evidenced impact

TasNetworks submitted that its engagement approach on its 2024–29 proposal has helped inform the development of its combined proposal. Regard has been given to identifying and understanding what is important to its customers and stakeholders feedback, the IAP2 Spectrum best practice engagement, and guidance from the AER and CCP27. TasNetworks has also self-assessed against the consumer engagement principles outlined in the Handbook, which we applaud and encourage stakeholder views on.<sup>30</sup>

TasNetworks submitted that its 2024–29 combined proposal delivers on the consumer feedback it received on the key themes identified in section 3.2. For example, TasNetworks notes affordability for all is a priority, hence it has responded by constraining its capex, selecting 2020–21 as the most efficient base year for opex, aiming to achieve opex productivity, is developing initiatives that address cost of living pressures and continuing to develop cost-reflective network tariffs.<sup>31</sup>

We are particularly interested in stakeholders' view on how well TasNetworks has addressed consumers' key priorities as part of its proposal.

#### Questions

1. Do the key themes from TasNetworks' engagement resonate with your own preferences? Are there additional issues you would like to see influence its proposal and our assessment of the proposal?
2. Do you think TasNetworks has engaged meaningfully with consumers on all key elements of its 2024–29 proposal? Are there any key elements that require further engagement?
3. To what extent do you consider you were able to influence the topics engaged on by TasNetworks? Please give examples.

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<sup>30</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p.2.

<sup>31</sup> TasNetworks, *Combined proposal Attachment 1 Customer and stakeholder engagement summary*, January 2023, p.6.

## 4 Key elements of TasNetworks' revenue proposal

The regulatory framework governing electricity networks and our assessment of TasNetworks proposal is set out in the National Electricity Law and Rules (NEL and NER). Our work is guided by the National Electricity Objective (NEO) which promotes efficient investment in, and operation and use of, electricity services in the long-term interests of consumers.

The foundation of our regulatory approach is a benchmark incentive framework to setting maximum revenues: once regulated revenues are set for the five-year period, a network that keeps its actual costs below the regulatory forecast of costs retains part of the benefit. Service providers have an incentive to become more efficient over time, as they retain part of the financial benefit from improved efficiency. This delivers benefits to consumers as efficient costs are revealed over time and drive lower cost benchmarks in subsequent regulatory periods. By only allowing efficient costs in our approved revenues, we promote delivery of the NEO and ensure consumers pay no more than necessary for the safe and reliable delivery of electricity.

TasNetworks' proposed revenue reflects its forecast of the efficient cost of providing transmission and distribution network services over the 2024–29 period. Its 2024–29 proposal, and our assessment of it under the Law and Rules, are based on a “building block” approach which looks at five cost components:

- return on the regulated asset base (RAB) – or return on capital, to compensate investors for the opportunity cost of funds invested in this business
- depreciation of the RAB – or return of capital, to return the initial investment to investors over time
- forecast operating expenditure (opex) – the operating, maintenance and other noncapital expenses, incurred in the provision of network services
- revenue increments/decrements – resulting from the application of incentive schemes and allowances, such as for opex, capex and demand management innovation
- estimated cost of corporate income tax.<sup>32</sup>

Our assessment breaks these costs down further. For example:

- capex – this refers to capital costs and expenditure incurred in the provision of network services and mostly relates to assets with long lives, the costs of which are recovered over several regulatory periods. The forecast capex approved in our decisions directly affects the size of the capital base and, therefore, the revenue generated from the return on capital and depreciation building blocks. All else being equal, higher capex will lead to a higher RAB, return on capital and depreciation.
- RAB value – the RAB accounts for the value of regulated assets over time. To set revenue for a new regulatory period, we take the opening RAB value from the end of the last period, and roll it forward year-by-year by indexing it for inflation, adding new capex and subtracting depreciation and other possible factors (such as disposals or consumer contributions).<sup>29</sup> This gives us a closing RAB value at the end of each year of the regulatory period. The RAB value is used to determine the return on capital and depreciation building blocks.

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<sup>32</sup> See Figure 3.4 in AER, [State of the energy market](#), June 2022, p.65

## 4.1 Rate of return

The return each business is to receive on its capital base (“return on capital”) is a key driver of proposed revenues. We calculate the regulated return on capital by applying a rate of return to the RAB value.

We estimate the rate of return by combining the returns of two sources of funds for investment: equity and debt. The allowed rate of return provides the business with a return on capital to service the interest rate on its loans and give a return on equity to investors.

The approach that TasNetworks, and we, must take to estimate the rate of return, including the return on debt and the return on equity, as well as the value of imputation credits, is set out in our binding Rate of Return Instrument. We publish a new Rate of Return Instrument every 4 years. For the purpose of its proposal, TasNetworks has applied the 2018 Rate of Return Instrument (2018 Instrument). Our final decision on TasNetworks proposal, which will be made in April 2024, will apply the new 2022 Rate of Return Instrument which was published in February 2023.<sup>33</sup>

### 4.1.1 Inflation

In 2020, we concluded a review of our approach to estimating expected inflation. TasNetworks has applied the approach we established in that review, but once again, the estimates provided by TasNetworks should be considered indicative because estimates of inflation may change as we move through the process.

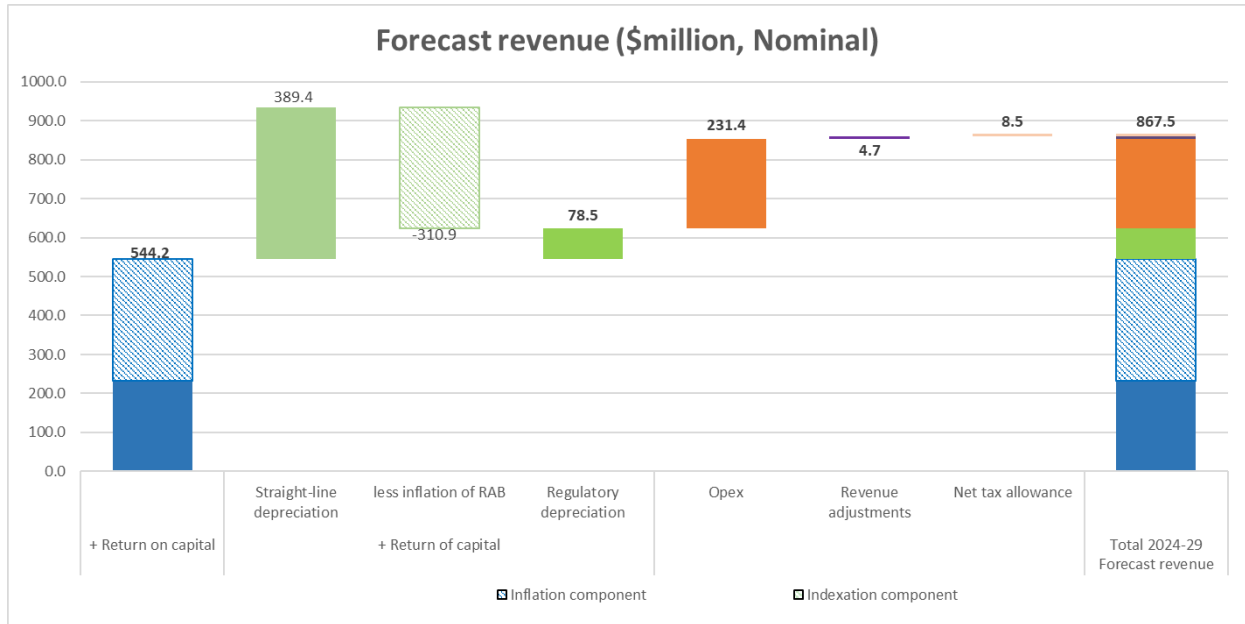
An allowance for expected inflation provides compensation for the risk to investors for the prospect of inflation eroding the investor’s purchasing power. Figure 7 and 8 show the interaction of expected inflation on TasNetworks’ distribution and transmission forecast building block revenues.

- The return on capital building block applies a nominal rate of return to the RAB. As the nominal rate of return includes expected inflation, part of that building block compensates for expected inflation. Higher expected inflation increases the return on capital mainly due to RAB and capex.
- The return of capital building block removes expected inflation indexation of the RAB from forecast depreciation. This avoids compensation arising from the effects of inflation being double counted by including it in the return on capital building block and also, as a capital gain (through the indexation of the RAB). Higher expected inflation therefore reduces the regulatory depreciation allowance.
- Other building blocks (such as opex, and revenue adjustments) include an inflation component, as the costs forecast in real dollar terms are escalated to nominal dollars using expected inflation in determining the required nominal revenues. Higher expected inflation will increase opex and revenue adjustments.

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<sup>33</sup> AER, [Rate of Return Instrument 2022](#), February 2023.

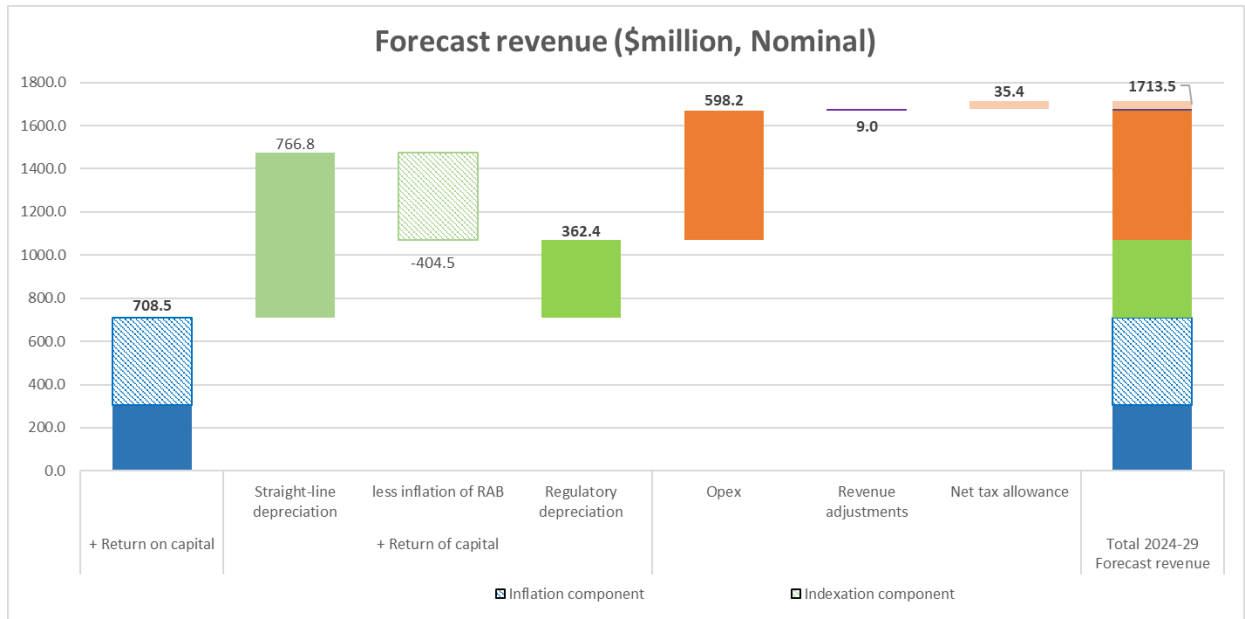
**Figure 7 Inflation components in TasNetworks' transmission proposal revenue building blocks (\$million, nominal)**



Source: AER analysis

Note: Proposed revenue in the chart is unsmoothed total revenue for the regulatory period.

**Figure 8 Inflation components in TasNetworks' distribution proposal revenue building blocks (\$million, nominal)**



Source: AER analysis

Note: Proposed revenue in the chart is unsmoothed total revenue for the regulatory period.

The RAB is the value of assets used by TasNetworks to provide network services. The value of the RAB substantially impacts TasNetworks revenue requirement, and the price consumers ultimately pay. Other things being equal, a higher RAB would increase both the return on capital and depreciation components of the revenue determination.

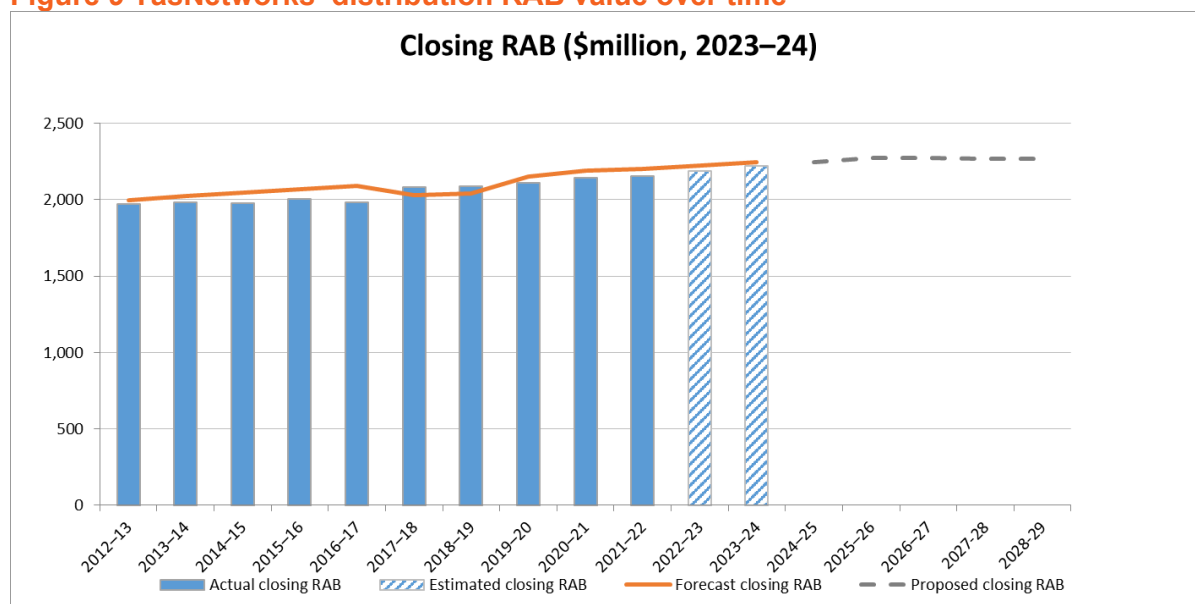
TasNetworks proposed a distribution RAB of \$2,674.0 million (\$ nominal) by the end of the 2024–29 period, which is \$450.9 million higher than the estimated RAB at the end of the 2019–24 period. This follows an increase of \$459.2 million (\$ nominal) in the estimated RAB over the 2019–24 period. The proposed nominal RAB increase (and in real terms) for the 2024–29



period is primarily driven by the proposed forecast capex. Figure 9 shows the value of TasNetworks' distribution RAB over time.

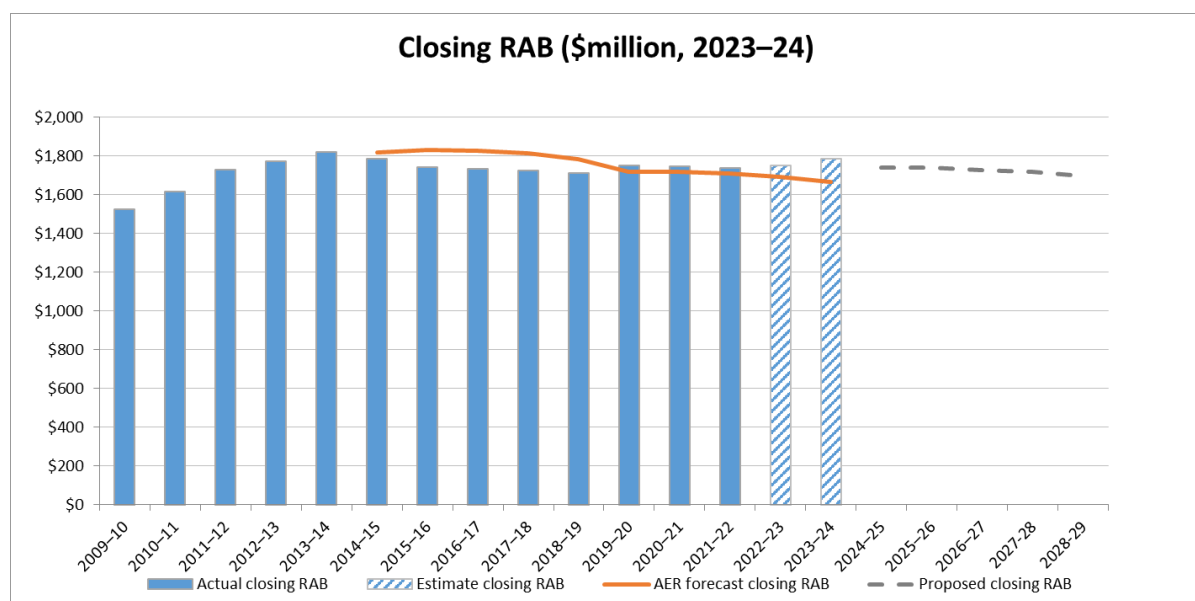
TasNetworks proposes a transmission RAB of \$2,001.7 million (\$ nominal) by the end of the 2024–29 period, which is \$242.9 million higher than the estimated RAB at the end of the 2019–24 period. This follows an increase of \$279.6 million (\$ nominal) in the estimated RAB over the 2019–24 period. The proposed nominal RAB increase for the 2024–29 period is primarily driven by the proposed forecast capex. However, in real terms (\$2023–24), TasNetworks' proposed RAB is forecast to be lower by the end of the 2024–29 period. Figure 10 shows the value of TasNetworks' transmission RAB over time.

**Figure 9 TasNetworks' distribution RAB value over time**



Source: AER analysis

**Figure 10 TasNetworks' transmission RAB value over time**



Source: AER analysis

Regulatory depreciation is provided so investors recover their investment over the economic life of the asset ("return of capital").

The Handbook sets our expectations for depreciation. In summary, we expect a network business:

- to use the AER's post-tax revenue model, roll forward model, and depreciation tracking module (where relevant) without amendments
- to apply the same asset classes from the last regulatory determination and the asset lives would also reflect those approved in previous decisions.

For TasNetworks' distribution network, it proposes regulatory depreciation of \$327.3 million (\$2023–24) for the 2024–29 period, which is \$53.5 million (14.0%) lower than for the 2019–24 period. The lower depreciation is due to lower proposed forecast capex for the 2024–29 period compared to the allowed capex for the 2019–24 period, and a higher forecast inflation indexation compared to the rate applied for the 2019–24 period.<sup>34</sup> Similarly, for TasNetworks' transmission network, it proposes regulatory depreciation of \$70.9 million (\$2023–24) for the 2024–29 period, which is \$64.4 million (47.6%) lower than for the 2019–24 period. The lower depreciation is due to lower proposed forecast capex for the 2024–29 period compared to the allowed capex for the 2019–24 period, and a higher forecast inflation indexation compared to the rate applied for the 2019–24 period.

TasNetworks' proposed to continue using the year-by-year tracking approach for implementing straight-line depreciation of existing assets for the 2024–29 period for both distribution and transmission networks. TasNetworks also proposed to maintain the same asset classes and standard asset lives as approved for the 2019–24 period.

Overall, based on our initial assessment, we consider TasNetworks has performed well against the depreciation expectations as set out in the Handbook.

### Question

4. Do you have views on TasNetworks' proposed depreciation approach for either transmission or distribution, as set out in its 2024–29 proposal?

## 4.2 Capital expenditure

Capex refers to the capital cost and expenditure incurred in the provision of TasNetworks distribution services. Capex is added to the RAB, and so forms part of the capital costs of the building blocks used to determine total revenue. Top-down testing is a starting point when assessing the overall reasonableness of a business' capex proposal. Where a business is responding to the incentives created by the capital efficiency sharing scheme, we consider current period spend is a good initial basis to test the reasonableness of capex required to maintain the network in the forecast period. This is particularly the case for recurrent types of expenditure such as replacement capex (repex) and recurrent ICT. Contingent projects will only be added to total revenue if the defined trigger events occur during the regulatory control period.

The Handbook sets our expectations for capex forecasts. In summary:

- The business should demonstrate that the proposed expenditure is not significantly above current period spending
- The components of capex should be well-justified, consistent with past spending for recurrent components, and, for repex, not materially above our repex model
- The business shows evidence of prudent and efficient decision-making on key projects/programs
- There should be evidence of genuine consumer engagement.

<sup>34</sup> The proposed forecast inflation used to calculate the RAB indexation for the 2024–29 period is 3.35%. This is higher than the forecast inflation rate of 2.42% used in the 2019–24 final decision.

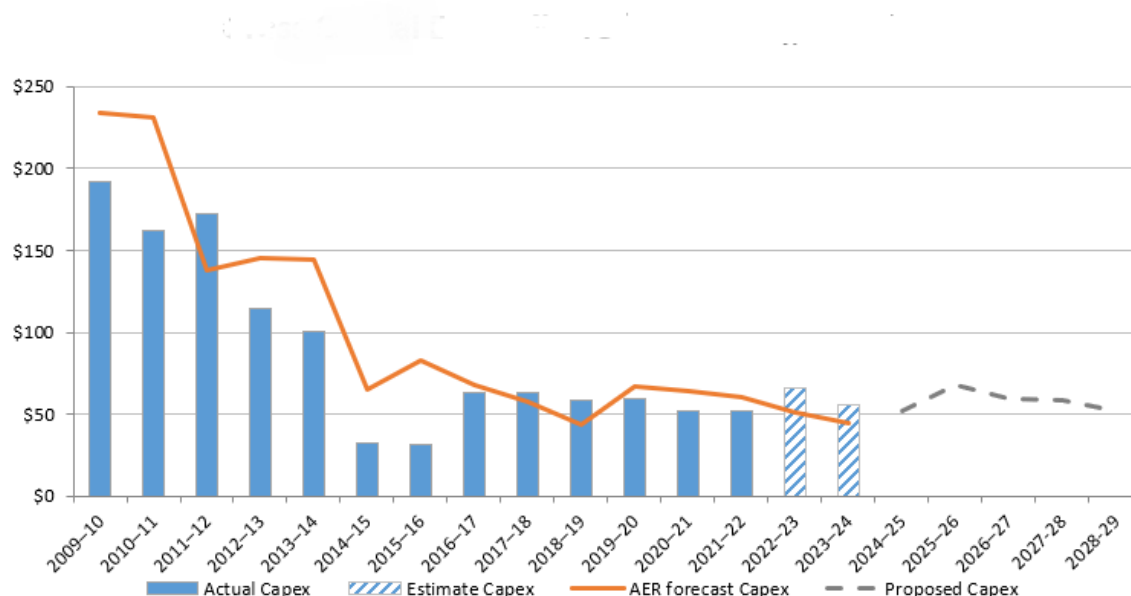
Our initial assessment against the Handbook expectations is included in the below sections.

## 4.2.1 TasNetworks' transmission capex proposal

### 4.2.1.1 Forecast transmission capex

We will assess TasNetworks' proposed transmission gross capex of \$288 million for the 2024–29 period which will form part of our draft decision. TasNetworks' proposed transmission net capex is 3% lower than its actual/estimated capex in the 2019–24 period. Figure 11 shows TasNetworks' actual and forecast capex over time.

**Figure 11 TasNetworks' transmission gross capital expenditure (\$million, 2023-24)**



Source: AER analysis.<sup>35</sup>

Based on our initial assessment against the Handbook expectations set out above, we have identified the following focus areas for our assessment as the proposal departs from our standard assessment methodology set out in our Expenditure Forecast Assessment Guideline or reflect new types of capex:

- Repex: TasNetworks' proposes repex of \$155m which is \$10m or 7% higher than its estimated current period spend. Repex makes up 53% of the total net capex in the 2024–29 proposal. This category of capex covers the replacement of network assets that have reached the end of their service life or become obsolete. It includes the replacement of transformers, transmission line support structures and foundations, extra high voltage (EHV) switchgear and other ageing assets. We will review TasNetworks' proposed strategy to see that it is prudent and efficient taking into consideration industry practice and applying benchmarks.
- Information and communication technology ICT capex: TasNetworks' proposal includes \$27 million on both recurrent and non-recurrent ICT expenditure. The expenditure is consistent with the previous period. We will review the expenditure focusing on cybersecurity and in accordance with the non-network ICT capex assessment approach.<sup>36</sup>

<sup>35</sup> AER's graph is based on data from the following: AER, AER - Final decision TasNetworks transmission determination - RFM - April 2015, April 2015; AER, AER - Final decision TasNetworks transmission determination - PTRM - April 2015, April 2015; AER, AER - TasNetworks 2019-24 - Transmission - Final decision - Roll Forward Model - April 2019, April 2019; AER, AER - TasNetworks 2019-24 - Transmission - Final decision - Post-tax Revenue Model - April 2019, April 2019; AER, AER - Tribunal varied - Transend 2009-14 - post tax revenue model, October 2009; TasNetworks, TasNetworks - Post Tax Revenue Model - Prescribed - December 2022, December 2022; TasNetworks, TasNetworks - Roll Forward Model - Prescribed - December 2022, December 2022

<sup>36</sup> AER Guidance note, Non-network ICT capex assessment approach, November 2019.

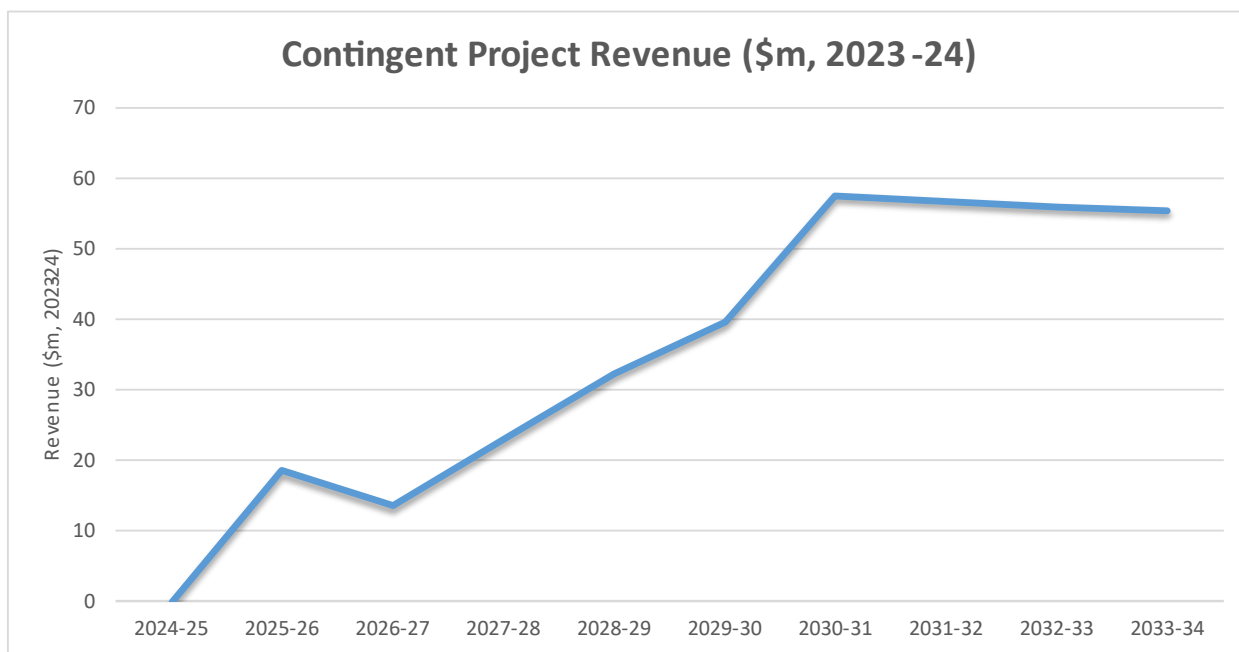
- Augmentation capex (augex): TasNetworks proposes \$21 million for augmentation projects, this category of capex includes the purchase of assets that expand the capacity of the network, often to accommodate changes in demand. TasNetworks' proposal is made up of one reliability driven and one efficiency driven transmission substation augmentation project, and several land acquisitions to support development needs beyond 2029. We will assess these projects to confirm that identified needs, a range of options and appropriate business cases have been presented.

#### 4.2.1.2 Contingent Projects

TasNetworks has identified seven contingent projects in its proposal. TasNetworks submits these projects may be required to connect additional renewable generation to deliver the legislated Tasmanian Renewable Energy Target and to connect load associated with the production of green hydrogen envisioned in the State Government's Tasmanian Renewable Hydrogen Action Plan.<sup>37</sup> TasNetworks has outlined the seven projects and the associated triggers in Attachment 7 of its combined proposal.<sup>38</sup>

We will assess these projects to ensure they meet the requirements of a contingent project under the NER.<sup>39</sup> Consumers will only pay for a contingent project if a defined trigger event takes place in the period. We note that capex associated with contingent projects is \$905 million, or three times TasNetworks' standard forecast capex. Consequently, these projects, if triggered, would significantly change the nature of TasNetworks' revenue requirement going forward (Figure 12)

**Figure 12 TasNetworks' contingent projects additional revenue impact (\$million, 2023-24)**



Source: TasNetworks, *Response to information request IR004*, Received 01 March 2023.

#### 4.2.1.2.1 Bill impacts

Table 2 shows the indicative bill impact if all contingent projects included in TasNetworks transmission capex forecast were to proceed, excluding the actionable ISP project for Marinus Link. The indicative bill impact for contingent projects, if they are triggered, is separate from any bill impact of the 2024–29 TasNetworks determination. In the table below, proposed capex of \$1,195 million (including base capex) is the amount that TasNetworks includes in its proposed revenue. Based on this amount, TasNetworks has estimated annual bill impacts for a five and

<sup>37</sup> TasNetworks *Combined Proposal 2024–29 – Attachment 7 Contingent Projects*, January 2023, p 3.

<sup>38</sup> [TasNetworks Combined Proposal 2024–29 – Attachment 7 Contingent Projects](#), January 2023.

<sup>39</sup> NER, cl. 6A.8.1.

ten-year time horizon. TasNetworks estimates an additional bill impact for 2028–29 of around \$16.7 (1.9% increase) for the typical residential consumer and an around \$41.8 (2.0% increase) for the typical small business consumer. TasNetworks estimates an additional bill impact in ten years (2033–34) of around \$16.6 (1.9% increase) for the typical residential consumer and an around \$41.6 (1.9%) increase for the typical small business consumer.<sup>40</sup>

**Table 2 TasNetworks' contingent projects' indicative bill impact (\$, 2023-24)**

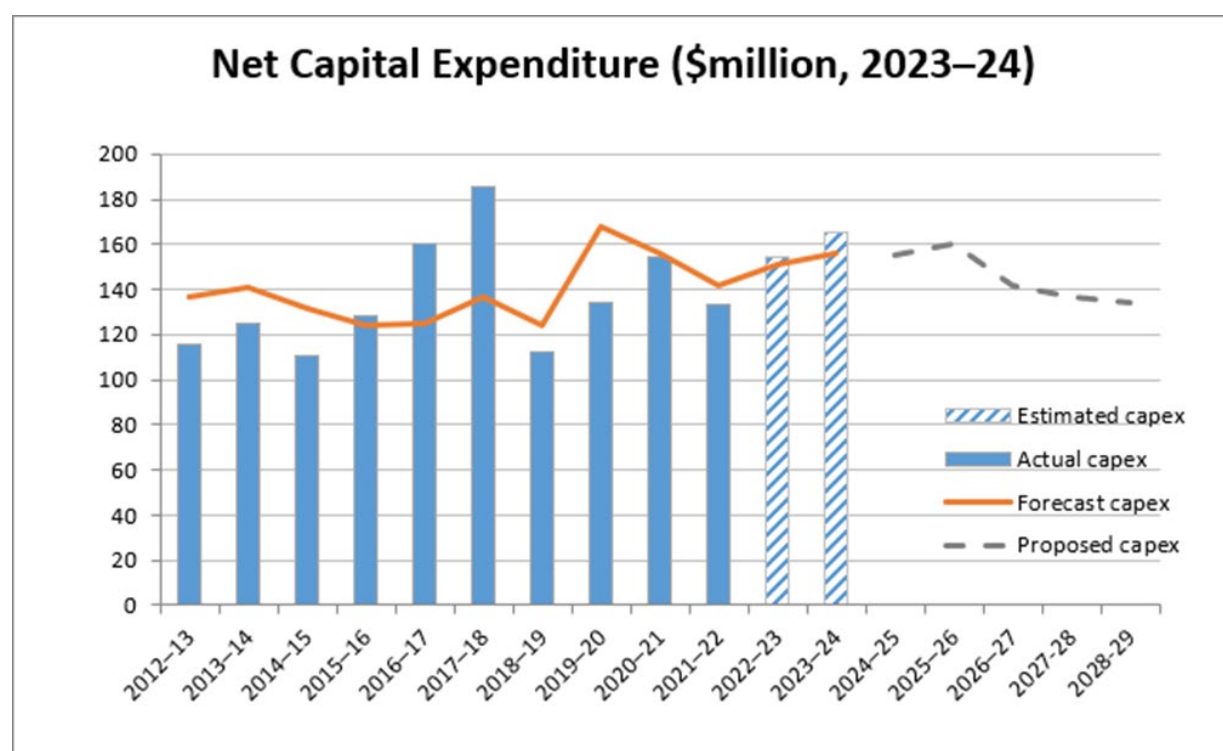
| Indicative bill impact                         | 2028-29\$    | 2033-34\$    |
|--|--------------|--------------|
| Distribution – typical residential customer    | 16.68 (1.9%) | 16.60 (1.9%) |
| Distribution – typical small business customer | 41.81 (2.0%) | 41.62 (1.9%) |

Source: TasNetworks, *Response to information request IR004*, Received 01 March 2023

#### 4.2.2 TasNetworks' distribution capex proposal

TasNetworks identified affordability, reliability and managing safety and risks as its key considerations in developing its capex forecast.<sup>41</sup> TasNetworks forecast net distribution capex of \$729.4 million for the 2024–29 period.<sup>42</sup> This is 4% lower than its actual/estimated net distribution capex in the 2019–24 period. TasNetworks noted that it has constrained its forecast capex to not exceed its 2019–24 period. Figure 13 below illustrates TasNetworks net distribution capex from 2012.

**Figure 13 Comparison of TasNetworks' past and forecast net distribution capex**



Source: AER analysis

##### 4.2.2.1 Proposed Distribution Capex

We will assess proposed distribution net capex of \$729 million for the 2024–29 period, which will form part of our draft decision. TasNetworks' proposed distribution net capex is 4% lower than its actual and estimated 2019–24 period capex of \$764 million. Based on our initial assessment against the Handbook expectations set out above, we have identified the following focus areas for our assessment as the proposal departs from our standard assessment

<sup>40</sup> TasNetworks, *Response to information request IR004*, Received 01 March 2023.

<sup>41</sup> TasNetworks, *Combined Proposal 2024-2029 – Attachment 6 – capital expenditure*, January 2023, p 2.

<sup>42</sup> Comparing the Roll-forward Model and Post-tax Revenue Model.

methodology set out in our Expenditure Forecast Assessment Guideline or reflect new types of capex:

- Repex: TasNetworks' repex of \$282m is \$19 million or 7% higher than its estimated current period spend. Repex makes up 38% of the total net capex in the 2024–29 proposal. While TasNetworks has not used the AER's Repex Model which provides a top-down comparison of a network's forecast modelled repex against all other networks, our preliminary review indicates that TasNetworks' repex forecast performs well against the repex model. TasNetworks has also included \$10 million for network resilience to reflect customer preferences.<sup>43</sup> We will review this new type of capex having regard to our guidance note on network resilience.<sup>44</sup>
- Augex: TasNetworks' augex of \$50 million is \$12 million or 32% higher than its estimated current period spend. This includes major augmentation projects such as 'high and low voltage network reinforcements' (\$16 million) and customer energy resources (CER) enablement (\$10 million). We will review TasNetworks CER expenditure having regard to our DER Integration Expenditure Guidance note and Customer export curtailment value methodology.<sup>45</sup>
- Non-network capex: TasNetworks forecast \$137 million for non-network distribution capex. This category includes major ICT projects, fleet and facility upgrades. TasNetworks' combined its transmission and distribution proposal. In addition to our assessment of the prudence of the projects, we will also assess the allocation of these costs between the two networks.

### Questions

5. Do you consider TasNetworks capex proposal addresses the concerns of electricity consumers as identified in the course of its engagement on the proposal?
6. Has TasNetworks engaged constructively with its stakeholders on its capex proposal? Please provide reasons for your response.
7. Are there particular areas of TasNetworks capex proposal that you would expect further engagement on?
8. Has TasNetworks clearly identified the need for its proposed contingent projects, and are the triggers well defined?

## 4.3 Operating expenditure

Opex refers to the operating, maintenance and other non-capital expenditure incurred in the provision of network services. It includes labour costs and other non-capital costs that a prudent service provider is likely to require for the efficient operation of its network.

The Handbook sets our expectations for opex forecasts. In summary:

- the business will use our base-trend-step approach, including our standard assumptions
- step changes will be small in number and well-justified
- category specific costs will be small in number and well-justified
- there should be evidence of genuine consumer engagement.

<sup>43</sup> TasNetworks, *Combined Proposal 2024-2029 Attachment 6 capital expenditure*, January 2023, p 10.

<sup>44</sup> AER, *Network resilience – a note on key issues*, April 2022.

<sup>45</sup> AER, *DER integration expenditure guidance note*, June 2022; and AER, *Customer export curtailment value methodology*, June 2022.

Based on our initial assessment, TasNetworks' transmission and distribution opex proposals adopt our base-trend-step approach and its approach to trend productivity growth in 2024–25, of 3%, is higher than our standard forecasts. It has also proposed a relatively small number of step changes, comprising 10.6% and 4.3% of total forecast opex for transmission and distribution respectively. For distribution it has proposed three category specific forecast beyond debt raising costs, consistent with the approach in previous determinations.

TasNetworks outlined how its transmission and distribution opex proposals were shaped by consumer feedback related to one of its key themes - affordability for all. Specifically, the use of 2021–22 as the base year for the opex forecast, as it considered this had been deemed as efficient by the AER's economic benchmarking standards, and TasNetworks aim to achieve opex productivity improvements of 3% in 2024–25 and 0.5% for the remaining years.<sup>46</sup>

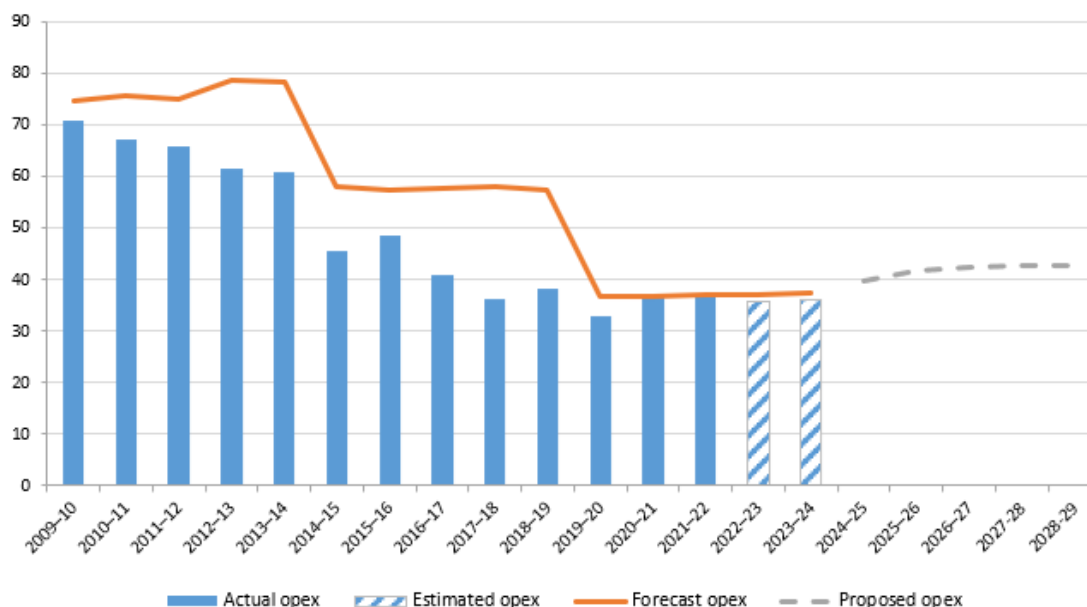
### 4.3.1 TasNetworks opex proposal

TasNetworks proposed total transmission opex of \$209.2 million (\$2023–24) for the 2024–29 period<sup>47</sup> or:

- \$31.1 million (17.5%) more than TasNetworks actual/estimated transmission opex for the 2019–24 period
- \$24.8 million (13.4%) more than the opex forecast we approved for the 2019–24 period.

Figure 14 shows the trend in TasNetworks' transmission opex over time. TasNetworks' actual transmission opex has been steadily reducing since 2009–10 (and been less than the AER's forecast), but some plateauing has been observed in the current period where actual/forecast opex is broadly in line with the forecast.

**Figure 14 TasNetworks' transmission opex trend over time (\$million, \$2023-24)**



Source: TasNetworks (T), Economic benchmarking – regulatory information notice response 2009-21: AER, final decision PTRM 2009-14, AER, final decision PTRM 2014-19, AER, final decision PTRM 2019-24 and Opex model: TasNetworks, 2024–29 Revenue proposal: AER analysis.

TasNetworks proposed total distribution opex of \$541.0 million (\$2023–24) for the 2024–29 period<sup>48</sup>, or:

- \$34.4 million (6.8%) more than TasNetworks actual/estimated opex for the 2019–24 period

<sup>46</sup> TasNetworks, 2024–29 Combined Regulatory Proposal, Attachment 1. 31 January 2023, p. 6.

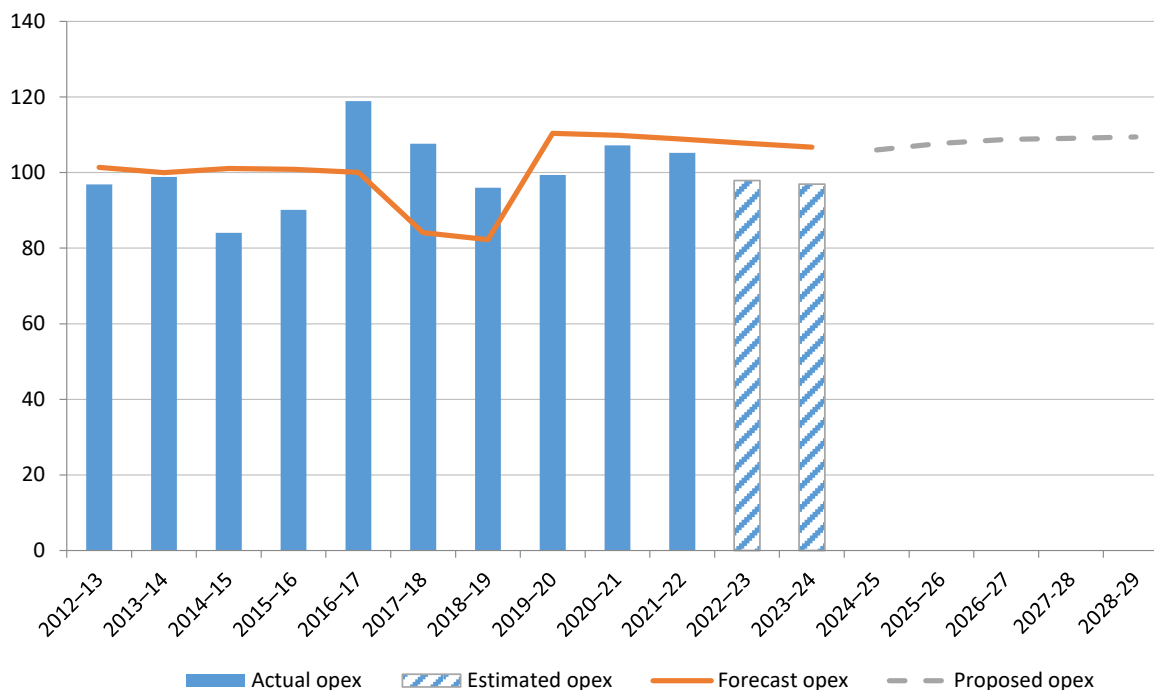
<sup>47</sup> TasNetworks, 2024–29 Combined Regulatory Proposal, 31 January 2023, p. 9. Includes debt raising costs.

<sup>48</sup> TasNetworks, 2024–29 Combined Regulatory Proposal, 31 January 2023, p. 9. Includes debt raising costs.

- \$2.6 million (-0.5%) lower than the opex forecast we approved for the 2019–24 period.

Figure 15 shows the trend in TasNetworks' distribution opex over time. TasNetworks' actual distribution opex has been increasing on an average annual basis since 2012, but in the current period there have been some actual / forecast reductions in opex costs.

**Figure 15 TasNetworks' distribution opex trend over time (\$million, \$2023-24)**



Source: TasNetworks (D), Economic benchmarking – regulatory information notice response 2009-21: AER, final decision PTRM 2009-14, AER, final decision PTRM 2014-19, AER, final decision PTRM 2019-24 and Opex model: TasNetworks, 2024–29 Revenue proposal: AER analysis.

### 4.3.2 Key drivers of the opex proposal

TasNetworks used a base-step-trend approach to forecast transmission and distribution opex for the 2024–29 period. This is broadly consistent with our approach to assessing opex, as outlined in our Expenditure Forecast Assessment Guideline.<sup>49</sup>

TasNetworks used actual transmission and distribution opex in 2021–22 as the base to forecast opex (\$36.6 and \$104.3 million (\$2023–24) respectively). It considered this provides a good estimate of the efficient costs required to operate safe and reliable transmission and distribution networks and meet relevant regulatory obligations.<sup>50</sup>

For transmission, TasNetworks:

- added \$1.9 million (\$2023-24) to reflect the forecast change in transmission opex between the base year (2021–22) and final year (2023–24), using the approach outlined in the Expenditure Forecast Assessment Guideline.
- applied a rate of change for output, price and productivity growth. These contribute the following to TasNetworks' total opex forecast:<sup>51</sup>

<sup>49</sup> AER, *Expenditure Forecast Assessment Guideline*, November 2013.

<sup>50</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, p. 6.

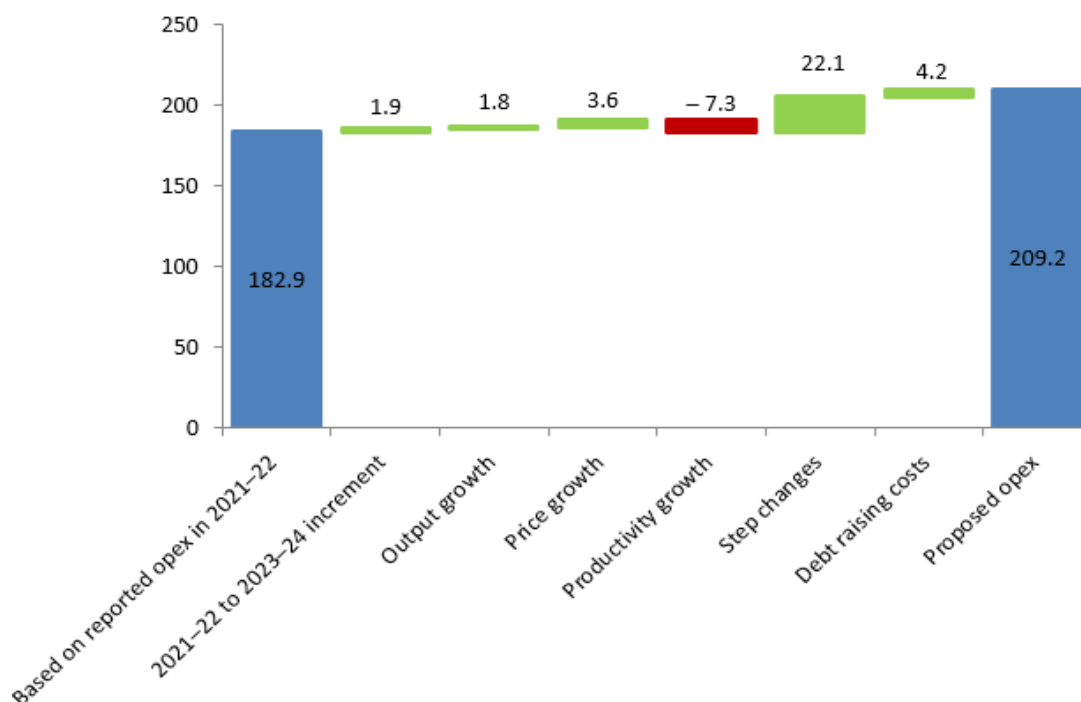
<sup>51</sup> In its proposal TasNetworks stated that the rate of change contributes \$2.0 million (\$2023–24) to its total opex forecast. This is different to our calculation of the total impact of the rate of change of \$1.9 million (\$2023–24). These values at the total level are not significantly different, but are for the individual trend components and reflect different ways of presenting the contribution of the rate of change to forecast opex, not a different approach to forecasting total opex itself. The impacts using our approach are set out in the dot points in the following text and in Figure 3 and the impacts using TasNetworks' approach are: output growth \$0.1 million (\$2023-24); price growth \$0.6 million (\$2023-24); productivity growth -\$2.7 million (\$2023-24).



- output growth – \$1.8 million (\$2023–24) based on using the output measures and weights from our opex benchmarking models, consistent with our standard approach for forecasting output growth.<sup>52</sup>
- real price growth –\$3.6 million (\$2023–24) based on the weighted average of forecast labour price growth (from BIS Oxford Economics plus superannuation guarantee increases) and zero non-labour price growth.<sup>53</sup> The labour price growth forecasts do not use our standard approach of using an average of forecasts from our consultant and the businesses' forecasts.
- productivity growth – 3% in 2024–25 and 0.5% per annum for the remainder of the regulatory period, reducing its transmission opex forecast by \$7.3 million (\$2023–24).<sup>54</sup> TasNetworks submitted the 3% productivity growth in 2024–25 represents forecast opex reductions from its transformation program being implemented in 2022–23 and 2023–24. Further, that the average annual productivity of 1% over the five years is higher than the transmission industry average over the long term of 0.6%.
- added two transmission step changes totalling \$22.1 million (\$2023–24) (or 10.6% of total forecast opex) for:
  - insurance premiums –\$6.7 million (\$2023–24) to account for forecast increases, particularly those associated with continued extreme fire and flooding events and cyber security threats.
  - cyber security / security of critical infrastructure –\$15.4 million (\$2023–24) for additional opex it expects to incur to achieve Security Profile 3 (SP3) maturity including to meet cyber security obligations to comply with new critical infrastructure legislation.
- added \$4.2 million (\$2023–24) for debt raising costs.

Figure 16 shows how each of these components contributes to TasNetworks total transmission opex forecast.

**Figure 16 Breakdown of TasNetworks' transmission opex forecast (\$million, \$2023–24)**



Source: TasNetworks, *Operating Expenditure Model - Prescribed*, December 2023: AER analysis.

<sup>52</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 11.

<sup>53</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 12.

<sup>54</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 12.

For distribution, TasNetworks used its actual opex in the proposed base year 2021–22 and then:

- removed costs<sup>55</sup> which it forecast on a category specific basis for:
  - Guaranteed Service Level (GSL) payments
  - The Electrical Safety Inspection (ESI) levy
  - The National Electricity Market (NEM) levy
- removed \$10.5 million (\$2023–24) reflecting the forecast final year increment change in opex, using the approach outlined in the Expenditure Forecast Assessment Guideline.
- applied a rate of change for output, price and productivity growth. For transmission, these contribute the following to TasNetworks' total opex forecast<sup>56</sup>:
  - output growth – \$7.6 million (\$2023–24) based on using the output measures and weights from our opex benchmarking modes, consistent with our standard approach for forecasting.<sup>57</sup>
  - real price growth – \$7.7 million (\$2023–24 based on the weighted average of forecast labour price growth (from BIS Oxford Economics plus superannuation guarantee increases) and zero non-labour price growth.<sup>58</sup> The labour price growth forecasts do not use our standard approach of using an average of forecasts from our consultant and the businesses' forecasts
  - productivity growth – 3% in 2024–25 and 0.5% from 2025–26 to 2028–29, reducing its distribution opex by \$18.4 million (2023–24).<sup>59</sup> As for transmission, TasNetworks noted the 3% productivity growth in 2024–25 represents reductions from the transformation program currently being implemented.
- Added two step changes totalling \$23.0 million (\$2023–24) (or 4.3% of total forecast opex) for:
  - insurance premiums – \$19.1 million (\$2023–24), to account for forecast increases particularly those due to increased extreme fire and flooding events and cyber security threats, leading to increased volatility in insurance markets and a contraction in available insurance cover capacity.
  - cybersecurity – \$3.9 million (\$2023–24) for additional opex it expects to incur to achieve SP3 maturity, including to meet cyber security obligations to comply with new critical infrastructure legislation.
- Added category specific forecast for GSL payments, ESI and NEM levy equal to \$51.9 million (\$2023–24).
- Added \$5.5 million (\$2023–24) for debt raising costs.

Figure 17 shows how each of these components contributes to TasNetworks total distribution opex forecast.

<sup>55</sup> TasNetworks stated it removed \$53.5M (\$2023–24) in category specific forecasts. This is different to our calculation of the category specific forecasts removed of \$47.3 million (\$2023–24). As for the trend issue below, this reflects a different way of presenting the costs removed, not a different approach to forecasting total opex.

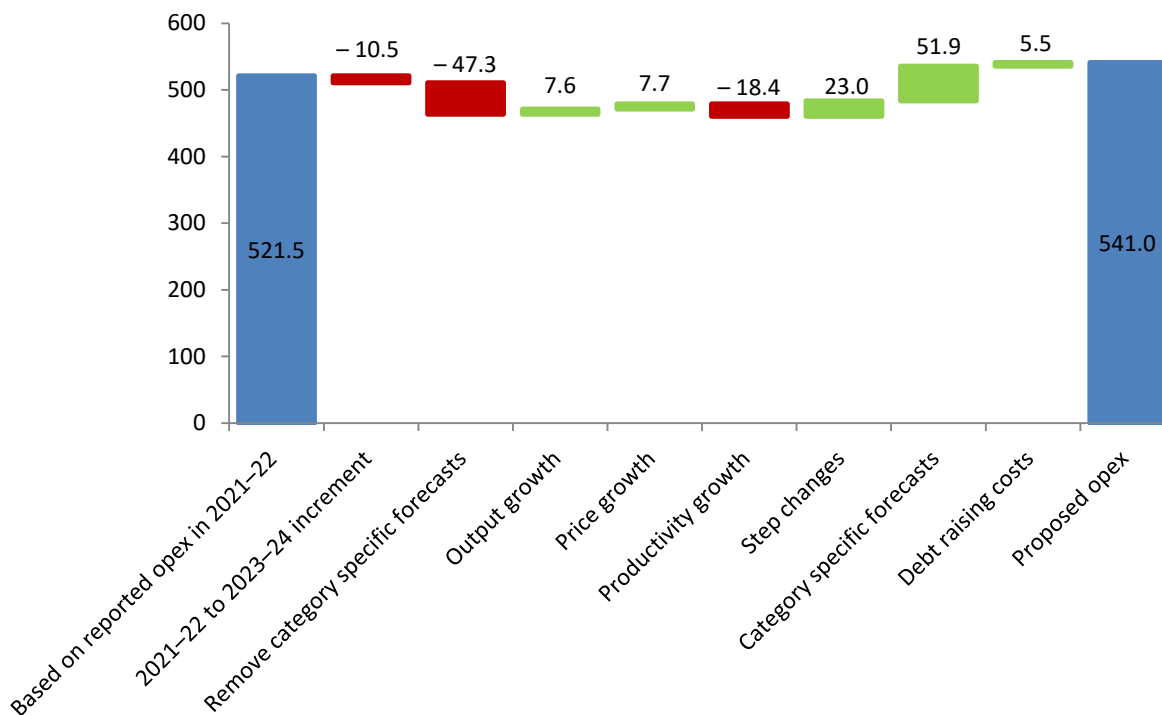
<sup>56</sup> In its proposal TasNetworks stated that the rate of change contributes \$2.9 million (\$2023–24) to its total opex forecast. This is different to our calculation of the total impact of the rate of change of –\$3.1 million (\$2023–24). There are also differences in calculation of the impact of each trend item (set out in the following dot points). These values reflect different ways of presenting the contribution of the rate of change to forecast opex, not a different approach to forecasting total opex. The impacts using our approach are set out in the dot points in the following text and in Figure 4 and the impacts using TasNetworks' approach are: output growth \$3.7 million (\$2023–24); price growth \$3.2 million (\$2023–24); productivity growth - \$4.0 million (\$2023–24)

<sup>57</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 11.

<sup>58</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 12.

<sup>59</sup> TasNetworks, *2024–29 Combined Regulatory Proposal, Attachment 8*, 31 January 2023, pp. 3, 12.

**Figure 17 Breakdown of TasNetworks' distribution opex forecast (\$million, \$2023–24)**



Source: TasNetworks, *Operating Expenditure Model - Standard Control*, December 2023: AER analysis.

#### Questions

9. Do you consider TasNetworks' transmission and distribution opex forecasts for the 2024–29 period reasonably reflect the efficient costs of a prudent operator?
10. Do you consider TasNetworks' transmission and distribution opex proposals were sufficiently considered as a part of the stakeholder engagement processes and adequately address the themes and issues raised by stakeholders?

## 4.4 Corporate income tax

The building block approach to calculating the annual revenue includes an amount for the estimated cost of corporate income tax payable by the business. We forecast tax in accordance with the requirements of the Rules.<sup>60</sup>

Using the approach set out in the post-tax revenue model, TasNetworks proposed a forecast corporate income tax amount of \$32.2 million (\$2023–24) for its distribution network, and \$7.7 million (\$2023–24) for its transmission network for the 2024–29 period. We note that TasNetworks has:

- forecast zero immediate expensing of capex for the 2024–29 period using an approach consistent with its current tax policy
- adopted the diminishing value method for tax depreciation to all future capex.<sup>61</sup>

#### Questions

11. Do you have views on the approach to calculating to corporate income tax in TasNetworks' 2024–29 proposal?

<sup>60</sup> NER, cl. 6.5.3 and 6A.6.4.

<sup>61</sup> TasNetworks did not propose any forecast capex for the types of assets which must be depreciated using the straight-line depreciation method under the tax law.

## 5 Incentive schemes and allowances

Incentive schemes are a component of incentive-based regulation and complement our approach to assessing efficient costs. They provide important balancing incentives under network determinations, encouraging businesses to pursue expenditures efficiencies while maintaining the reliability and overall performance of its network. Our final Framework and Approach (F&A) for TasNetworks noted our intention to apply the five incentive schemes and allowances in the 2024–29 period that are set out below.<sup>62</sup> TasNetworks agreed with this approach in its 2024–29 proposal.

- **Efficiency benefit sharing scheme (EBSS):** provides TasNetworks with a continuous incentive to pursue efficiency improvements in opex and provide for a fair sharing of these between TasNetworks and network users. Consumers benefit from improved efficiencies through lower opex in regulated revenues for future periods.

The EBSS applies to both TasNetworks transmission and distribution for the 2019–24 period. TasNetworks proposed EBSS carryover amounts resulting in a reward of \$0.2 million (\$2023–24) for transmission and a penalty of \$2.9 million (\$2023–24) for distribution, based on its estimate of the opex it will incur in 2021–22.<sup>63</sup>

While TasNetworks supported the continued application of the EBSS during the 2024–29 period, it proposed two new exclusions, opex arising from actionable ISP projects and REZ developments, in addition to the exclusions it applied to the current regulatory period.<sup>64</sup> TasNetworks considered that given the uncertainty and possible magnitude of these expenditures they should be excluded from the EBSS as they could result in a penalty that is unrelated to its efficiency. Further that inclusion would create a perverse incentive to proceed with projects which may only be of marginal economic viability in order to avoid a penalty.

- **Capital expenditure sharing scheme (CESS):** this incentivises TasNetworks to undertake efficient capex throughout the period by rewarding efficiency gains and penalising efficiency losses, each measured by reference to the difference between forecast and actual capex.

The CESS applies to TasNetworks for the 2019–24 period. TasNetworks forecasts a capex underspend of \$5.2 million for the 2019–24 period for its transmissions network. This results in proposed CESS carryover amounts totalling \$3.2 million for the 2024–29 period. For TasNetworks' distributions network, it forecasts a capex underspend of \$36.7 million for the 2019–24 period. This results in proposed CESS carryover amounts totalling \$10.5 million for the 2024–29 period.<sup>65</sup>

If a provider defers capex from the current regulatory period to the next, the CESS outcome may be adjusted. TasNetworks argues that the CESS outcome for its transmission network should not be adjusted. This is because its capex underspend is not material, a necessary condition for adjustment. For its distribution network, TasNetworks acknowledges that it is deferring its Market Data Management System (MDMS) capex project from the current regulatory period to the next. It argues that this does not justify adjusting the CESS outcome, as a further necessary condition is the materiality of deferred capex. It states that

<sup>62</sup> AER, *Final Framework and Approach for TasNetworks for the 2024-29 regulatory control period*, July 2022.

<sup>63</sup> TasNetworks, *Workbook 3 EBSS for Transmission and Distribution*, January 2023. These values are slightly different to those in TasNetworks written proposal, possibly reflecting an update to inflation included in Attachment 10.

<sup>64</sup> TasNetworks, *2024-29 Combined Regulatory Proposal, Attachment 10*. January 2023. pp 2, 5.

<sup>65</sup> TasNetworks, *Combined proposal 2024-29 – Attachment 11 – Capital expenditure sharing scheme*, January 2023, pp. 3-5.

deferring the MDMS project does not materially increase the next period's proposed capex.<sup>66</sup>

- **Service target performance sharing scheme (STPIS):** TasNetworks distribution STPIS is intended to ensure that distributors' service levels do not deteriorate due to distributors' effort to achieve efficiency gains under our expenditure schemes, which are typically associated with a reduction in expenditure. The STPIS provides incentives to distributors to improve existing service levels where electricity consumers are willing to pay for these improvements.<sup>67</sup>
- Transmission also has financial incentives for maintaining and improving service performance and there are three main components applicable to TasNetworks:
  - a service component, which incentivises TasNetworks to reduce the frequency of unplanned outages and the time taken to return the network to service
  - a market impact component, which incentivises TasNetworks to minimise the financial impact of outages on the dispatch of generation
  - a network capability component, which incentivises businesses to identify transmission network limits and increase capability by undertaking projects with a capital cost of less than \$7 million and which are likely to result in a material benefit.
- **Customer service incentive scheme (CSIS):** creates an incentive for distributors to maintain and improve customer services not covered by the STPIS, or other mechanisms.<sup>68</sup> To apply the CSIS, TasNetworks must demonstrate to us that its customer engagement has been genuine and that its customers support the proposed customer service parameters and incentives. This differs from a prescriptive scheme (like the STPIS) that specifies precisely what is incentivised as well as how penalties and rewards are calculated.<sup>69</sup> TasNetworks should note that robust data oversight is a vital component of the CSIS.
- **Demand management innovation allowance Mechanism (DMIS)/ Demand management innovation scheme (DMIAM);** funds TasNetworks for research and development in demand management projects that have the potential to reduce long-term network costs. Projects to be funded under the DMIAM and DMIS must meet the approval criteria in both schemes<sup>70</sup>.

## Questions

12. Do you consider TasNetworks proposed EBSS carryover amounts provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–24 period?
13. Do you consider applying the EBSS to TasNetworks in the 2024–29 period would provide it with a continuous incentive to reduce its opex and do you consider that the proposed exclusions from the scheme are appropriate?
14. Do you consider TasNetworks proposed CESS carryover amounts provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–24 period?
15. Do you have views on TasNetworks CSIS? Does it meet the customer priorities identified through its customer engagement program? Please provide examples.

<sup>66</sup> TasNetworks, *Combined proposal 2024-29 – Attachment 11 – Capital expenditure sharing scheme*, January 2023, pp. 3-5

<sup>67</sup> Using the value of customer reliability values.

<sup>68</sup> AER, *Explanatory Statement Customer Service Incentive Scheme*, July 2020, p. 4.

<sup>69</sup> AER, *Explanatory Statement Customer Service Incentive Scheme*, July 2020, pp. 5–9.

<sup>70</sup> AER, *Demand Management Incentive Scheme for Electricity distribution network service providers*, December 2017, clause 2. AER, *Demand Management Innovation Allowance Mechanism Electricity distribution network service providers*, December 2017, clause 2.

## 6 Network pricing

In the F&A paper we published last year, we set out our intended classification of the distribution services TasNetworks provides its customers:<sup>71</sup>

Standard control services are those that can only be provided by TasNetworks, and are common to most, if not all, of TasNetworks' customers. The costs of providing these services are captured in the building block revenue determination we've discussed in the previous sections of this paper and shared between all customers.

Alternative control services, which are either:

- services that can only be provided by TasNetworks, but will only be required by some of its customers, some of the time; or
- services that can be purchased from TasNetworks, but which can also—or have the potential to be—purchased from a competing provider.

The cost of providing alternative control services is recovered from users of those services only. TasNetworks proposed changes to its tariffs in its new tariff structure statement (TSS), which sets out the tariff structures through which TasNetworks will recover its regulated revenue for standard control services. It has also proposed a number of changes to prices for alternative control services. We discuss the key features of these elements of TasNetworks' proposal below.

We don't determine the classification of TasNetworks' transmission services. The classification of these services is set under the NER. However, like in distribution, we do determine the revenue path for these services, which affects the price path.

### 6.1 Control mechanisms

A distribution determination must impose controls over the prices and/or revenues of direct control services (standard and alternative control services). The form and formulae of the control mechanisms in our distribution determination are set out in the relevant F&A. There are only limited circumstances in which the AER can depart from this. TasNetworks accepted the form and formulae of the control mechanisms as set out in the F&A.

In our distribution determinations, we provide further definition for elements of these control mechanisms. We also define other mechanisms that are not required to be incorporated in the F&A, such as the side constraint and unders/overs mechanisms. In November 2022, we published our final decision on the side constraint mechanism that will be applied in our draft decisions, following stakeholder engagement.<sup>72</sup> We are interested in stakeholder's feedback in relation to the aspects detailed below.

#### 6.1.1 Quoted services price cap control formula

As set out in section 6.3.1, quoted services prices are determined at the time of a customer's enquiry and reflect each customer's individual requirements. They are subject to a price cap form of control based on a build-up of inputs such as labour, contactor costs, materials.

In our F&A paper, we identified the quoted services price cap control formulae was inconsistently applied across jurisdictions. As such, we proposed the inclusion of margin and tax components to reflect the desirability of consistency between regulatory arrangements for

<sup>71</sup> AER, *Final Framework and approach for TasNetworks for the 2024-29 Regulatory control period*, July 2022.

<sup>72</sup> See <https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/annual-pricing-process-review>.

similar services, as well as cost reflectivity. However, we did not define the margin and tax components. This will be done in our distribution determinations.

Some distributors proposed the margin to be the nominal weighted average cost of capital (WACC) either for a particular year or an average of the forecast nominal WACC over the 2024–29 period (at present, these values are around 6%). Others have proposed a fixed value margin set close to the forecast nominal WACC, such as 6%.

For the tax component, a pragmatic approach would be to set the rate at the corporate tax rate of 30%. However, some distributors have proposed the tax rate could be set at a rate that better reflects the actual tax payable, which may differ from the corporate tax rate. We are interested in stakeholder views on the appropriate definitions for these components.

### 6.1.2 Metering form of control

The Australian Energy Market Commission (AEMC) is currently undertaking a review of the regulatory framework for metering services which includes an indicative timeline to retire legacy meters by 2030. The AEMC's final report is due prior to our draft decision on TasNetworks' 2024–29 determination.

We consider that if the AEMC's metering review constitutes a material change in circumstances, it may allow us to depart from the form of control set in the F&A. An alternative form of control might be warranted if it provides better consumer outcomes. We address metering issues further in section 6.3.2 of this paper.

#### Questions

16. What do you consider to be an appropriate rate for a margin recovered on quoted services? Should this be set at the average nominal WACC for the period, or some fixed value (e.g., 6%)?
17. Do you consider the tax component of the quoted services price control formulae should be set at the corporate tax rate of 30%, or an alternative rate?
18. Do you consider the AER should review the current price cap form of control for legacy metering services following the AEMC's decision?
19. More generally, do you have any comments on TasNetworks' proposed control mechanisms?

## 6.2 Tariff structure statement

As part of their regulatory proposal, distributors are required to submit to us a tariff structure statement (TSS).<sup>73</sup> The TSS will apply for the 5-year regulatory control period. A TSS must set out a distributor's:

- proposed network tariffs
- network tariff structures
- charging parameters
- policies and procedures the distributor will use to assign customers to network tariffs or reassign customers from one network tariff to another.

<sup>73</sup> This requirement came out of the AEMC 2014 rule change for distribution pricing.

The tariff structures provide the charging framework through which distributors collect their annual allowed revenue. Once approved, a TSS becomes a compliance document against which the AER assesses the distributor's annual pricing proposals.

TSSs are also how distributors progressively reform their network tariffs for standard control services to better signal to customers the cost of providing network services. As customers ultimately pay for upgrades to network services, tariff reform that encourages more efficient use of the network will lead to lower network costs for all customers.

We note that network tariffs are targeted at retailers who package them with other costs, such as the cost of wholesale energy, in their service offerings to electricity customers. As such, the retail electricity tariff may not directly reflect the network tariff.

This is the third regulatory period for which TasNetworks has submitted a TSS and it continues the process of incremental tariff reform.

### 6.2.1 Progress on tariff reform

TasNetworks proposed some positive changes to progress tariff reform, but they support only a very modest pace of reform. The key reforms include:

- closing its flat, single rate tariffs to new customers
- aligning small business time of use (TOU) charging windows with network usage
- revising its consumer energy resources tariff structure - it would be primarily TOU instead of demand, with a demand charge applying only if peak demand is above 8.5 kW
- introducing 6 embedded network tariffs (4 for the low voltage network, 2 for the high voltage network).

Based on our high-level assessment we consider TasNetworks has provided a TSS that demonstrates incremental progress on tariff reform. However, we acknowledge this responds to its customer feedback and to state-specific socio-economic circumstances. While we would prefer to see more rapid tariff reform, we consider TasNetworks' approach can be accepted in light of its responsiveness to its customers and state specific circumstances. We are looking for feedback on whether the approach by TasNetworks is reasonable in view of its customer feedback and circumstances.

#### Question

20. Do you consider TasNetworks has demonstrated reasonable progress on tariff reform considering its customer feedback and circumstances?

### 6.2.2 Expectations for tariff structure statements

The Handbook sets out our expectations for TSSs:

- Demonstrate progression of tariff reform consistent with the network pricing objective and pricing principles set out in the Rules
  - TasNetworks' proposed to close its single flat rate tariffs to new customers and to continue reducing cross subsidies between network tariffs.
- Demonstrate incorporation of its tariff strategy in its overall business plan
  - TasNetworks included a section in its tariff structure explanatory statement which discusses how its tariff strategy helps reduce long term network expenditure and includes analysis on forecast penetration of renewable customer energy resources.
- Demonstrate significant stakeholder engagement and broad stakeholder support



- TasNetworks undertook significant stakeholder engagement and its proposed pace of tariff reform responds directly to its engagement feedback.
- Demonstrate insight into and management of any adverse customer impacts
  - TasNetworks modelled customer bill impacts and found, on average, most customers across all groups benefitted from switching to a cost reflective tariff with lower network charges.

TasNetworks proposed to manage adverse impacts through its assignment policy under which all small customers, if their meter was recently replaced, would have a 12-month lag on reassignment to the cost reflective tariff and also have the option, for 12 months, to opt-out back to the flat tariff.

We think TasNetworks has met these expectations, noting its progress towards cost reflective tariffs was balanced against customer impact considerations. Further relevant elements of the TSS are discussed briefly below.

### 6.2.3 Electric vehicles

The uptake of electric vehicles poses opportunities but also challenges for electricity networks. TasNetworks did not propose a specific electric vehicle tariff, but its new consumer energy resources TOU tariff has a 'super off-peak' period to encourage customers to charge electric vehicles between midnight and 4am. TasNetworks introduced the super off-peak charge in response to its Distributed Energy Resources Customer Survey, through which both electric vehicle owners and non- electric vehicle owners (anticipating future charging needs) indicated they would charge their electric vehicles predominantly at home.<sup>74</sup> Additionally, TasNetworks stated that where they can be identified, residential or small business customers with an electric vehicle fast charger would be assigned to its new consumer energy resources TOU tariff.

### 6.2.4 Two-way pricing

Under the AEMC's access, pricing and incentive arrangements for distributed energy resources rule change, distributors can now introduce two-way pricing (providing rewards and charges for customers who export electricity to the grid).<sup>75</sup> TasNetworks did not propose to introduce two-way pricing in the 2024–29 period.

However, all distributors are required to submit an export tariff transition strategy as part of their TSSs, regardless of whether they propose to introduce two-way pricing. Our Export Tariff Guidelines set out what distributors should include in their export tariff transition strategy.<sup>76</sup>

TasNetworks included an export tariff transition strategy as part of its tariff structure statement. TasNetworks submitted that solar PV exports are currently not driving network expenditure, but it will consider undertaking two-way tariff trials over the 2024–29 regulatory period if its export hosting capacity nears exhaustion.

## 6.3 Alternative control services

Alternative control services are requested, and paid for, only by customers using those services. There are three broad categories of alternative control services in these proposals.

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<sup>74</sup> TasNetworks - *Combined Proposal Attachment 22 - Tariff structure Explanatory Statement* - January 2023, p. 61.

<sup>75</sup> On 12 August 2021 the AEMC made a new rule change, Access, pricing and incentive arrangements for distributed energy resources, to integrate distributed energy resources such as small-scale solar and batteries more efficiently into the electricity grid and to allow two-way pricing.

<sup>76</sup> AER, *Export tariff guidelines*, May 2022, p. 6. For distributors not proposing two-way pricing our Guidelines set out the export tariff transition strategy should explain their medium to longer-term strategy for introducing two-way pricing, should it prove necessary, including any planned export tariff trials and describe their present or intended future stakeholder engagement related to two-way pricing.

### 6.3.1 Ancillary network services

These are non-routine services provided to individual customers on request. These services are either charged on a fee or quotation basis. Fee-based services tend to be homogeneous in nature and can be costed in advance of supply with reasonable certainty. Quoted service prices are determined at the time of a customer's enquiry and reflect each customer's individual requirements. In March 2022, we published a standardised model for use by electricity distributors to develop their prices. This streamlines our assessment, increases consistency, and provides stakeholders greater scope to engage in our distribution determinations.

Labour costs make up a large proportion of ancillary network service costs. Another significant cost element is the time taken to perform the service, including travel time. Our assessment includes review of these elements for the most frequently requested ancillary network services. We also benchmark proposed labour rates and prices for fee-based services across distribution networks as well as with prices from the current regulatory period.

Ancillary network services are regulated by price cap. Our distribution determination sets first year price caps for fee-based services, labour escalators used to escalate prices for the remaining years of the regulatory period, and capped labour rates used in quoted services.

#### 6.3.1.1 Distributors' engagement and service offering

TasNetworks' stakeholder engagement involved its individual and business customers, energy supply chain representatives and other stakeholders as part of its Policy and Regulatory Working Group (PRWG)<sup>77</sup>. Customers were given an opportunity to shape TasNetworks' ancillary network services.

TasNetworks is proposing to introduce a traffic control fee-based service so that individual customers who are paying for a fee-based service also pay for TasNetworks' safety costs where it applies<sup>78</sup>. It also simplified its labour categories from 16 to 8 in response to stakeholder and PRWG feedback.

TasNetworks also proposed to remove the accumulated depreciation rebate associated with asset relocation quoted services to increase cost reflectivity. This was supported by the PRWG and local governments, even though these local governments would face increased costs to relocate older assets. Stakeholders noted that TasNetworks did not stand to receive more income because of this change.<sup>79</sup>

#### 6.3.1.2 Benchmarking labour rates

Labour rates are a key cost input for ancillary network service prices. The distributors proposed labour rates are assessed against benchmark efficient maximum labour rates developed using a bottom-up cost build up across six categories (administration, field worker, technical specialist, engineer, senior engineer, and engineering manager).<sup>80</sup>

The benchmark rates include increases to the superannuation allowance and the vehicle allowance because of the changes in the superannuation guarantee and inflation. The 'transmission line design engineer' has been removed from the engineer benchmark category as this occupation is not an appropriate benchmark for distributors' engineers.

TasNetworks' proposed labour rates are higher than our preliminary maximum efficient benchmark rates (these are based on inputs which will be updated for our draft decision). These

<sup>77</sup> TasNetworks, *Combined Proposal Attachment 18 – Alternative Control Services*, January 23, p. 6.

<sup>78</sup> TasNetworks, *Combined Proposal Attachment 18 – Alternative Control Services*, January 23, p. 4.

<sup>79</sup> TasNetworks, *Combined Proposal Attachment 18 – Alternative Control Services*, January 23, p. 6.

<sup>80</sup> Marsden Jacob Associates, *Review of ancillary network services: Advice to the Australian Energy Regulator*, September 2018.

labour rates are also higher than TasNetworks' current approved rates (we escalate the current rates to compare them on a like-for-like basis). Our draft decision on TasNetworks' labour rates will be dependent on the updated maximum efficient benchmark rates we determine after applying the most recent inputs.

### 6.3.1.3 Benchmarking fee-based services prices

Proposed fee-based services are also benchmarked against prices from the current regulatory control period as well as similar services supplied by other distributors. Cost inputs may also be benchmarked. TasNetworks proposed to modify the standardised model's formulae to reduce the allocation of overheads for after-hours services as this change halved the rate of overhead recovery applied to after-hours work.

TasNetworks proposed significant increases to most of its prices for fee-based services. In response to our information request, TasNetworks stated the price changes were driven by a detailed review of its inputs which revealed the actual timings and costs for its services. TasNetworks stated that it has understated service timings and material costs in the current regulatory period.<sup>81</sup>

#### Questions

21. Do you consider that sufficient justification has been provided in the provision of new services?
22. Do you consider the proposed labour rates and fee-based prices to be reasonable?

## 6.3.2 Metering

Metering services are currently provided by electricity distributors, retailers and other third parties. Since the AEMC's Power of Choice reform, retailers and/or other third parties have been responsible for the installation and replacement of legacy meters with smart meters now being the meters installed. TasNetworks is responsible for providing services, including operation and maintenance, for the accumulation meters it historically installed (legacy meters).

The AEMC is currently undertaking a review of the regulatory framework for metering services which includes an indicative timeline to retire legacy meters by 2030. The AEMC's final report is due prior to our draft decision on TasNetworks' 2024–29 determination.

Due to the retirement of legacy meters, we are interested in stakeholder's feedback in relation to the aspects detailed below. Our consideration of these aspects will also be influenced by the AEMC's final report. TasNetworks' regulatory proposal also reflects the Tasmanian Government's election promise to accelerate the rollout of smart meters.

### 6.3.2.1 Cost recovery

The current framework for the cost recovery of legacy meters involves a separation of metering charges into capital and non-capital charges. These are charged to individual customers (user pays) and are regulated under a price cap.

Capital charges relate to the recovery of costs associated with installation and management of the legacy metering asset base. All customers who had a legacy meter prior to 30 June 2015 incur capital charges, regardless of whether they still have a legacy meter or not. Non-capital charges relate to the recovery of costs associated with the operation of the remaining legacy

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<sup>81</sup> TasNetworks, *Response to information request IR003*, Received 23 February 2023

meters and are charged to customers who still have TasNetworks-owned legacy meters installed at their premises.

As legacy meters are replaced by smart meters, the per unit cost of operating and maintaining legacy meters increases. Greater distances are required to be travelled to do manual meter reads, testing or maintenance of legacy meters. As more legacy meters are retired, customers with legacy meters could face material increases in their charges. These increasing costs are accentuated by the advanced rollout of smart meters driven by the Tasmanian Government and Aurora Energy.

We are interested in stakeholder views on whether the current cost recovery framework (user-pays approach) is appropriate. An alternative approach could include the socialisation of operating expenditure (spread across all customers) to ensure customers who are last to transition to smart meters do not incur substantive prices for these services, particularly if they are vulnerable customers. The socialisation of these costs may occur through removing the capital/non-capital split for cost recovery, or by reconsidering the service classification for legacy metering services and shifting them to standard control services.

Our initial view is that we see merit in moving legacy meter charges into standard control services by revising the service classification. This would allow costs to be spread across the entire customer base. We consider that the expected accelerated rollout of smart meters from the AEMC metering review will constitute a material change in circumstances required to depart from the F&A. We propose to make this change in our draft decision and would like stakeholder views before we lock-in the change.

We are aware that retailers generally socialise both network metering charges (for legacy meters) and their own metering charges (for smart meters) across their customer base. We note this approach is not mandated for retailers and therefore socialisation of these costs may be better suited at the network level which would create a universal and more equitable approach.

### **6.3.2.2 Accelerated depreciation**

The ongoing cost recovery of the historical legacy metering asset base is expected to continue for some networks until the 2034–39 period. Some distributors have engaged with stakeholders on the accelerated depreciation of these remaining asset bases

We are interested in stakeholder views on whether accelerated depreciation of these asset bases is appropriate. The benefits of this include the avoided regulatory and administrative burden of the recovery of those asset bases in future regulatory control periods. We note that accelerated depreciation will increase costs in the short term. Increases may be accentuated by other expected short-term cost increases resulting from the increasing per-unit cost of operating expenditure, and any accelerated retirement of legacy meters.

We see merit in accelerating depreciation because it means that customer will not continue to pay for assets that are no longer in service. If we were to accelerate the depreciation of these meters, the impact would be to increase network charges for all customers by an estimated \$1.80 per year.

### **6.3.2.3 Legacy metering retirement plan**

TasNetworks has proposed retirement of legacy meters that is in line with retailer Aurora Energy working towards an election promise made by the Tasmanian Government to roll out smart meters by the end of 2026.

As a result of this, and the increasing operating cost per unit mentioned above, this will lead to significant increases in the per unit charge. TasNetworks' proposal relies on the retailer-led

rollout of smart meters and the socialisation of costs at the retail level. As TasNetworks legacy metering cost recovery operates under a price cap, this presents a significant risk of TasNetworks over-recovering amounts related to legacy meters where Aurora Energy (or other retailers) fall behind the target of rolling out smart meters by the end of 2026.

TasNetworks has incorporated a replacement failure rate to reflect sites that may have restricted access or require remediation. We are interested in stakeholder views on whether the risks of not meeting these targets are real, and whether there should be further consideration around the volume risk that may result in over-recoveries related to legacy meter costs.

### Questions

23. Do you consider legacy metering cost recovery should be socialised at the network level, or be left to retailers?
24. Do you consider accelerated depreciation of the legacy metering asset bases to be preferable to phase out legacy metering charges?
25. Do you consider there are risks that may materially impact the 2026 target for rolling out smart meters, and if so, do you consider the current control mechanism (price cap) appropriate when such a volume risk applies?
26. More generally, do you have any comments on TasNetworks' proposed cost recovery for legacy metering services?

## 6.4 Public lighting

Public lighting services include the provision, construction and maintenance of public lighting assets. Customers of public lighting services primarily are local government councils and jurisdictional main roads departments.

TasNetworks operates and maintains public lighting infrastructure on behalf of councils and government road authorities. Around 75 % of public lighting is supported on distribution network poles and TasNetworks owns most of the luminaires. The remaining public lighting is mounted on dedicated poles, which in most cases are privately owned by local governments, State Government agencies and business enterprises, as well as contract clients.

TasNetworks therefore offer two streams for public lighting prices that reflect this arrangement: public lighting prices and private contract lighting prices.<sup>82</sup> The prices for these streams comprise of capital and operating expenditure (opex) prices.

TasNetworks has applied a building block approach to determine the efficient costs of providing public lighting services under the price cap control mechanism. For opex prices, important drivers include asset failures rates, spot and bulk maintenance cycles, labour rates and traffic controller assumptions. Corporate overheads are also a material driver of public lighting prices.

We understand stakeholders support TasNetworks' public lighting proposal. On this basis and based on our initial review, we consider TasNetworks' public lighting proposal is capable of acceptance.<sup>83</sup>

<sup>82</sup> In this issues paper, the term "public lighting" refers to these two streams unless otherwise indicated.

<sup>83</sup> We may also make adjustments to TasNetworks' modelling as a consequence of our general analysis. For example, we may adjust the labour inputs into the public lighting model as a consequence of our analysis of labour inputs into TasNetworks' proposal for ancillary network services.

### TasNetworks pre-lodgement engagement

TasNetworks submits it consulted on its public lighting proposal with stakeholders, notably representatives of 29 local governments. These stakeholders jointly represent the largest component of the customer base for TasNetworks public lighting services.

TasNetworks noted that stakeholders queried the technical attributes of LED lighting (such as the availability of LED replacements for large wattage lights, and expected service lives of LED light fittings). Nevertheless, over 90% of local governments attending agreed with TasNetworks proposed strategy to replace all legacy streetlights with LED fittings.

### TasNetworks' service and price offerings

In response to its pre-lodgement engagement, TasNetworks proposed to continue the transition to LED technology in the 2024–29 period by:

- using LED fittings for all new public and private contract light installations
- in response to legislative requirements, ending the like-for-like replacement of mercury and sodium vapour globes by installing LED fittings instead.

The transition to LED fittings will enable TasNetworks to realise savings in the maintenance of public lights. LED fittings do not require a replacement 'globe' over their twenty-year life, allowing TasNetworks to maintain light fittings on a ten year instead of a four yearly cycle. The associated reduction in opex has resulted in proposed public light rates approximately 15% lower for the 2024–29 period.<sup>84</sup>

The public lighting pricing model and indicative pricing schedule contain TasNetworks' proposed suite of public lighting services and prices for the 2024–29 period.<sup>85</sup>

### Questions

27. Do you consider TasNetworks public lighting proposal generally incorporates stakeholder inputs from this pre-lodgement engagement? If not, did TasNetworks communicate these potential departure points to stakeholders and provide adequate explanation during pre-lodgement engagement?
28. Do you support TasNetworks proposed suite of public lighting services and prices?
29. Do you have any other comments on TasNetworks public lighting proposal and pre-lodgement engagement?

## 6.5 Transmission pricing methodology

Our transmission determination for TasNetworks must specify a pricing methodology for its prescribed transmission services.<sup>86</sup> Its role is to answer the question “who should pay how much” in order for a transmission business to recover its costs.<sup>87</sup>

TasNetworks' proposed pricing methodology for the 2024–29 period is largely identical to the 2019–24 period's pricing methodology, except for the following changes:

- Updated to include the requirements of the NER change relating to efficient management of system strength on the power system (system strength final rule), such as TasNetworks'

<sup>84</sup> TasNetworks, *Combined Proposal 2024–2029 - Attachment 18 - Alternative control services*, January 2023, p. 16.

<sup>85</sup> TasNetworks, *Combined Proposal 2024–2029 - Public Lighting Annuity Model-Dec 22*. A detailed listing of the public lighting services that TasNetworks proposes to offer during the 2024–29 regulatory control period, including indicative prices, can also be found in the Tariff Structure Statement (Attachment 21) that accompanies the Proposal.

<sup>86</sup> NER, cl. 6A.2.2(4)

<sup>87</sup> AEMC, *Rule determination: National Electricity Amendment (Pricing of Prescribed Transmission Services)*, December 2006.

method to calculate system strength unit prices and the principles to forecast system strength revenues.<sup>88,89,90</sup>

- Inclusion of National Transmission Planner Costs established under a NER rule change to compensate the AEMO for its planning role in the NEM.<sup>91,92</sup>
- A clearer description of the arrangements should TasNetworks be appointed as a Co-ordinating network service provider.<sup>93</sup>
- Updated to include the NER rule change regarding integrating energy storage systems into the NEM.<sup>94,95</sup>
- Updated to include the NER rule change allowing Transmission Network Service Providers (TNSPs) to recover the cost of AEMO's participant fees.<sup>96,97</sup>

On this basis, we consider this proposed pricing methodology is capable of acceptance.

### Questions

30. Do you consider TasNetwork's proposed changes to its transmission pricing methodology for the 2024–29 period appropriate and that they give effect to the pricing principles for prescribed transmission services and the pricing methodology guidelines?<sup>98,99</sup>
31. More generally, do you have any comments on TasNetwork's proposed transmission pricing methodology for the 2024–29 period?

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<sup>88</sup> AEMC, *Rule determination: Efficient management of system strength*, 21 October 2021.

<sup>89</sup> TasNetworks, *Transmission Pricing Methodology*, Dec 2022, pp. 7-8, 10, 16-18, 29-33, 36, 39, 45, 67-68 and 70-74.

<sup>90</sup> On 30 November 2022, TasNetworks submitted proposed system strength amendments to its 2019–24 pricing methodology as required by the system strength final rule. On 31 January 2023, the AER published its final decision accepting these amendments. The system strength components of TasNetworks' proposed pricing methodology for the 2024–29 regulatory control period is largely identical to those we approved in January 2023.

<sup>91</sup> AEMC, *Rule determination: Reallocation of national transmission planner costs*, 29 October 2020.

<sup>92</sup> TasNetworks, *Transmission Pricing Methodology*, Dec 2022, Public, pp. 7-8.

<sup>93</sup> TasNetworks, *Transmission Pricing Methodology*, Dec 2022, Public, pp. 7-8, 11-13, 16, 23, 36, 37 and 65-67.

<sup>94</sup> AEMC, *Rule determination: Integrating energy storage systems into the NEM*, 2 December 2021.

<sup>95</sup> TasNetworks, *Transmission Pricing Methodology*, Dec 2022, Public, pp. 7-9 and 16.

<sup>96</sup> AEMC, *Rule determination: Recovering the cost of AEMO's participant fees*, 20 October 2022.

<sup>97</sup> TasNetworks, *Transmission Pricing Methodology*, Dec 2022, Public, pp. 7, 9, 16 & 24.

<sup>98</sup> NER, cl. 6A.23.

<sup>99</sup> AER, *Pricing methodology guidelines 2022 – System strength pricing*, 25 August 2022.

## Summary of questions

### Consumer engagement

1. Do the key themes from TasNetworks' engagement resonate with your own preferences? Are there additional issues you would like to see influence its proposal and our assessment of the proposal?
2. Do you think TasNetworks has engaged meaningfully with consumers on all key elements of its 2024–29 proposal? Are there any key elements that require further engagement?
3. To what extent do you consider you were able to influence the topics engaged on by TasNetworks? Please give examples.

### Regulatory asset base

4. Do you have views on TasNetworks' proposed depreciation approach for either transmission or distribution, as set out in its 2024–29 proposal?

### Capital expenditure

5. Do you consider TasNetworks capex proposal addresses the concerns of electricity consumers as identified in the course of its engagement on the proposal?
6. Has TasNetworks engaged constructively with its stakeholders on its capex proposal? Please provide reasons for your response.
7. Are there particular areas of TasNetworks capex proposal that you would expect further engagement on?
8. Has TasNetworks clearly identified the need for its proposed contingent projects, and are the triggers well defined?

### Operating expenditure

9. Do you consider TasNetworks' transmission and distribution opex forecasts for the 2024–29 period reasonably reflect the efficient costs of a prudent operator?
10. Do you consider TasNetworks' transmission and distribution opex proposals were sufficiently considered as a part of the stakeholder engagement processes and adequately address the themes and issues raised by stakeholders?

### Taxable income

11. Do you have views on the approach to corporate income tax in TasNetworks' 2024–29 proposal?

### Incentive schemes and allowances

12. Do you consider TasNetworks proposed EBSS carryover amounts provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–2024 period?
13. Do you consider applying the EBSS to TasNetworks in the 2024–29 period would provide it a continuous incentive to reduce its opex and do you consider that the proposed exclusions from the scheme are appropriate?
14. Do you consider TasNetworks proposed CESS carryover amounts provide for a fair sharing of the efficiency gains and losses it has achieved in the 2019–24 period?
15. Do you have views on TasNetworks' CSIS? Does it meet the customer priorities identified through its customer engagement program? Please provide examples.



## **Network Pricing**

### ***Control Mechanisms***

16. What do you consider to be an appropriate rate for a margin recovered on quoted services? Should this be set at the average nominal WACC for the period, or some fixed value (e.g., 6%)?
17. Do you consider the tax component of the quoted services price control formulae should be set at the corporate tax rate of 30%, or an alternative rate?
18. Do you consider the AER should review the current price cap form of control for legacy metering services following the AEMC's decision?
19. More generally, do you have any comments on TasNetworks' proposed control mechanisms?

### ***Tariff structure statement***

20. Do you consider TasNetworks has demonstrated reasonable progress on tariff reform considering its customer feedback and circumstances?

### ***Ancillary network services***

21. Do you consider that sufficient justification has been provided in the provision of new services?
22. Do you consider the proposed labour rates and fee-based prices to be reasonable?

### ***Metering***

23. Do you consider legacy metering cost recovery should be socialised at the network level, or be left to retailers?
24. Do you consider accelerated depreciation of the legacy metering asset bases to be preferable to phase out legacy metering charges?
25. Do you consider there are risks that may materially impact the 2026 target for rolling out smart meters, and if so, do you consider the current control mechanism (price cap) appropriate when such a volume risk applies?
26. More generally, do you have any comments on TasNetworks' proposed cost recovery for legacy metering services?

### ***Public lighting***

27. Do you consider TasNetworks public lighting proposal generally incorporates stakeholder inputs from this pre-lodgement engagement? If not, did TasNetworks communicate these potential departure points to stakeholders and provide adequate explanation during pre-lodgement engagement?
28. Do you support TasNetworks proposed suite of public lighting services and prices?
29. Do you have any other comments on TasNetworks public lighting proposal and pre-lodgement engagement?

### ***Transmission Pricing Methodology***

30. Do you consider TasNetwork's proposed changes to its transmission pricing methodology for the 2024–29 period appropriate and that they give effect to the pricing principles for prescribed transmission services and the pricing methodology guidelines?
31. More generally, do you have any comments on TasNetwork's proposed transmission pricing methodology for the 2024–29 period?

## Shortened forms

| Terms                            | Definition   |
|----------------------------------|--|
| ACS                              | alternative control services                                   |
| AEMC                             | Australian Energy Market Commission                            |
| AEMO                             | Australian Energy Market Operator                              |
| AER                              | Australian Energy Regulatory                                   |
| ASP                              | Accredited Service Provider                                    |
| capex                            | capital expenditure  |
| CCP26                            | Consumer Challenge Panel, sub-panel 26                         |
| CESS                             | capital expenditure sharing scheme                             |
| CSIS                             | customer service incentive scheme                              |
| DER                              | Distributed Energy Resources                                   |
| DMIAM                            | demand management innovation allowance mechanism               |
| DMIS                             | demand management incentive scheme                             |
| DNSP or distributor              | Distribution Network Service Provider                          |
| DUoS                             | Distribution Use of System Charges                             |
| EBSS                             | efficiency benefit sharing scheme                              |
| ECA                              | Energy Consumers Australia                                     |
| EHV                              | extra high voltage   |
| ENA                              | Energy Networks Australia                                      |
| ESB                              | Energy Security Board  |
| F&A                              | framework and approach   |
| GSL                              | guaranteed service level                                       |
| ICT                              | information and communication technologies                     |
| MDMS                             | Market Data Management System                                  |
| NEL                              | National Electricity Laws                                      |
| NEM                              | National Electricity Market                                    |
| NEO                              | National Electricity Objectives                                |
| NER                              | National Electricity Rules                                     |
| opex                             | operating expenditure  |
| PIAC                             | Public Interest Advocacy Centre                                |
| RAB                              | regulated asset base   |
| repex                            | replacement expenditure  |
| SAIDI                            | system average interruption duration index                     |
| SAIFI                            | system average interruption frequency index                    |
| SAPS                             | stand-alone power systems                                      |
| SCS                              | standard control service                                       |
| Service classification guideline | Electricity distribution service classification guideline 2018 |
| TNSP                             | Transmission Network Service Providers                         |
| STPIS                            | service target performance incentive scheme                    |
| VCR                              | value of customer reliability                                  |
| WACC                             | Weighted average cost of capital                               |