Tasmanian Small Business Council
Uniting Small Business

TSBC Response to TasNetworks Directions and Priorities Consultation Paper

Transmission and Distribution Determination, 2019 to2024

September 2017

Acknowledgements & Disclaimers

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Contents

Introduction

The Tasmanian Small Business Council (TSBC) welcomes the opportunity to comment on TasNetworks' Directions and Priorities Consultation Paper, which sets out preliminary plans and poses eleven questions for consideration by interested stakeholders, prior to the submission of its first integrated transmission and distribution Revenue Proposal for the provision of regulated services from 1 July 2019 to 30 June 2024.

The TSBC notes the following:

- TasNetworks' development of its Revenue Proposal is at a very advanced and detailed stage;
- However, the Consultation Paper only provides a very brief description, at a high level, of the contents of its Revenue Proposal;
- The analysis which forms the basis of this submission is accordingly at a high level;
- The objective of this submission is to provide preliminary feedback and to highlight any concerns which may be evident, with the expectation that any such concerns will be addressed in TasNetworks' Revenue Proposal and given appropriate consideration and scrutiny by the AER; and
- The TSBC looks forward to the opportunity to undertake a detailed scrutiny of the Revenue Proposal following its release for comment by the AER in January 2018.

TSBC response – questions posed in the Consultation Paper

1. *Overwhelmingly, people have told us that they want about the same reliability for about the same price, is this consistent with what you think?*

This message from customers has not changed since electricity network companies started asking it, some 20 years ago, and is consistent with TSBC member views. In all jurisdictions however, network reliability performance has been improved over those 20 years in accordance with broad community expectations, which has often involved additional expenditure and thus price increases.

The TSBC notes that TasNetworks' overall distribution system reliability, adjusted for major disturbances, shows a marginally worsening trend[1] and also notes there remain areas of Tasmania where the reliability performance of the electricity network is significantly worse than other areas, largely reflecting the urban versus rural distinction.

The performance differential reflects the cost of supply, however the TSBC notes the increasing level of value adding small business, such as wineries, visitor experience centres, gourmet food production, intensive cropping and distilleries, located in rural areas and suggests that the acceptability of the performance gap by such small businesses can be expected to diminish, though their appetite for network price increases is unlikely to change.

The TSBC supports the approach to network (distribution) reliability which analyses the performance delivered to identified areas of economic activity (communities), and is much more narrowly focussed than the traditional feeder based approach. The latter better reflects small business experience of network reliability.

The TSBC suggests that TasNetworks' revenue proposal should provide details of community based network performance (reliability) and that incentive schemes should be based on that performance. We recognise that this may not be entirely consistent with the AER's regulatory approach but nevertheless encourage TasNetworks to provide such information as it can be useful to consumers as it provides additional information to them regarding reliability and where to address gaps in it.

[1] 2015-16 Energy in Tasmania Report

2. *Are there any other key issues or messages that you want us to know about as we finalise our service and expenditure proposals?*

The TSBC notes the reported improvement in TasNetworks' transmission productivity, as measured by the Multilateral total factor productivity index (p10, from the AER's 2016 Benchmarking Report), which is driven primarily by substantial reductions in operating costs from 2012/13 to 2014/15, with the cost of asset services roughly halving over that period, and further notes that the Capital partial productivity index declined over that period.

The TSBC wishes to understand more fully the drivers for the reduction in operating costs and the long term implications/benefits of the reduction in asset services expenditure.

3. *Do you share our 2025 vision for TasNetworks? If not, how should it be amended and why?*

The TSBC considers TasNetworks' 2025 vision provides an appropriate high level framework and views the adoption of the ENA's Energy Roadmap as the basis for its 2025 vision as commendable, but notes.

- The pace of change is very slow. The national Smart Grid Smart City project (funded by government and industry) delivered its final report and recommendations in July 2014, citing potential economic benefits of $28 billion over 20 years. The end of TasNetworks' next regulatory control period is 10 years after July 2014, halfway through the 20 year period from 2014.
- There is no evidence of where the $28 billion benefits proposed in the Smart Grid Smart City report or the ENA's forecast of avoided capex ($1.4 billion by 2024) is reflected in TasNetworks' forecasts.
- It is difficult to see from the Consultation Paper the detail of the changes and benefits customers will actually experience as a result of implementation of TasNetworks' 2025 vision. The TSBC looks forward to seeing that detail in TasNetworks' Revenue Proposal.
- In 2016, home energy management systems and a range of other customer enablers are available "off the shelf", but are in very limited use. At the level of detail in the Consultation Paper it is difficult to see how TasNetworks expects that to change by 2025. The TSBC looks forward to seeing that detail in TasNetworks' Revenue Proposal.
- The projected number of customers with access to distributed generation appears low (40,000 customers). Whilst we appreciate that accurate forecasting in this area poses some challenges, forecast errors can have significant impacts on TasNetworks future revenue and need for expenditure. The regulatory Proposal should, to the maximum extent possible, provide accurate and justifiable forecasts.

Accumulation metering and quarterly bills is a significant “dis enabler” for customer empowerment, but only 25 to 35 per cent of customers are projected to be using advanced meters by 2025. This seems extremely low, given TSBC’s understanding of previous regulatory approval to commence a roll-out of advanced meters around 2010. We look forward to understanding more about this projection from the Revenue Proposal.

4. *Do you agree with our direction and priorities for 2019-24? If not, how should they be amended and why?*

The TSBC considers the five goals identified as its directions and priorities (p16) as inarguable and necessary, and awaits provision of the detail to describe how those goals will be achieved in its Revenue Proposal.

The TSBC notes however that the Consultation Paper assumes a “steady state” scenario, where the delivery of electricity to customers, in particular small business, continues largely unchanged, and the electricity market remains stable, as do prices.

There are a number of foreseeable scenarios which could occur, including the loss of one or more major industrial customers or a rapid migration to embedded and off grid generation.

In the event that one such scenario were to become reality, there could be significant impacts on network prices and service outcomes.

The TSBC seeks to understand in more detail from the Revenue Proposal how TasNetworks is positioning itself to deal with a range of foreseeable future outcomes in order to avoid price shocks or service degradation in the event of a significant change to the existing “steady state” environment.

5. *Do you have any feedback on our preliminary forecast capital and operating expenditure for transmission and distribution?*

Capex- transmission:

Projected capital expenditure is relatively unremarkable, given past expenditure levels, subject to the comments at item 3 above.

The TSBC notes however the level of development expenditure from 2019/20 to 2021/22, including $15M for a new statcom at the George Town substation to help keep the electricity system secure and will be interested to see the detail of the rationale and benefits associated with that significant investment.

Capex – distribution:

The TSBC notes (at p21) the annual increase over 2018/2019 levels of around $10m in renewal capex over the three years 2019/2020 to 2021/2022. The explanation provided is – "with increased investment to manage safety risks". The TSBC considers this to be somewhat concerning, – implying a significant catch-up to address previous under expenditure, or perhaps additional expenditure to meet regulatory or other requirements, and looks forward to understanding the rationale for this expenditure in more detail.

The TSBC also notes that IT and communications spend has averaged over $12M pa for the period 2012 to 2019, or a total of over $100M. Despite that, IT and communications capex of a further $100M is projected over the 2019 to 2024 regulatory period. The TSBC considers that level of expenditure, following the significant expenditure over 2012 to 2019, appears to be very high given the scale of Tasmania's electricity distribution system.

The split tween IT and communications expenditure is not apparent from the Consultation Paper and the TSBC looks forward to seeing that detail.

It is the TSBC's understanding that a significant portion of IT expenditure relates to meeting the obligations imposed by a range of rule changes including, for example, NECF and NECL and the Power of Choice.

The TSBC wishes to understand the quantifiable financial benefits which will accrue from such expenditure, by way of reduced operating expenditure or reduced/deferred capital expenditure, or alternatively to understand where expenditure is required to meet compliance obligations which will not deliver quantifiable benefits and instead achieve more global objectives, such as consumer empowerment (including for small business).

The TSBC expects the AER to examine such expenditure with increased scrutiny in order to confirm that it is both necessary and efficient, and that TasNetworks' Revenue Proposal will provide the necessary detail.

Contingent capex:

The TSBC notes the number and scale of transmission contingent capital projects (p19) totalling $768M, and the trigger events which would need to occur before any of those projects moved from being contingent to part of the capital expenditure program.

The TSBC suggests the trigger of passing the AER's Regulated Investment Test should include an analysis of costs and quantifiable financial benefits which will accrue to each section of the Tasmanian electricity customer base, and that the project approval process should ensure that audited benefits exceed costs for any approved project.

Opex – transmission:

Projected opex is unremarkable, however the TSBC notes the inclusion of an annual allowance of around $2M per annum for as yet unspecified additional costs, to be absorbed and offset by efficiency gains, and is keen to see the detail of such costs and the areas where efficiency gains may be achieved.

Opex – distribution:

The TSBC notes the increase in projected costs from $75.5M per annum in 2018/19 to $85.2M in 2019/20, an increase of 13%, largely (it appears) due to an increase in NEM/electrical safety levies of around $2M per annum, and an increase in emergency management costs.

The TSBC looks forward to understanding the justification for those increases, noting that renewal and development capital expenditure could be expected to be progressively reducing the need for emergency management expenditure.

The TSBC also notes the identification of unspecified "additional forecast costs" of around $5M per annum, to be offset by efficiency gains in other expenditure areas.

The TSBC contends that $5M is a material expense, representing some 17% of the largest expenditure category (maintenance and vegetation management) and is therefore very interested to understand the nature of the additional costs, the expenditure they will replace and the impact on service levels in the short and long term.

Opex – combined:

The value of unspecified "other" and "additional" costs across transmission distribution businesses amounts to around $10M per annum, which the TSBC expects to be clarified in TasNetworks' Revenue Proposal, along with details of the implications of any offsetting expenditure reductions on a risk assessed basis.

The TSBC notes that there does not appear to be a reduction in future operating costs which might be attributed to the substantial additional investment in IT and communications over the current regulatory control period. Alternatively, the TSBC would expect to see a measurable improvement in service levels or some other consumer benefit which consumers can readily assess and develop a position on.

6. *What information would you like to better understand in our preliminary forecast capital and operating expenditure for transmission and distribution?*

As per comments at item 5.

7. *Do you support aligning the timing of our service incentive schemes across transmission and distribution services?*

The TSBC would like to see more detail about how that would occur before commenting further, noting that the benefits accruing to consumers arising from any proposed change would need to be clearly articulated.

The capability to compare past performance over an extended period should not be lost in any change.

8. *Our transmission outage performance has improved over time. Do you support us changing the measures for big and small transmission outages to provide clearer incentives to maintain or improve performance?*

The Consultation Paper indicates at p23 – *"our transmission service performance has improved a lot over the last ten years……….".*

In the 2016 Tasmanian Electricity Network Reliability Review (p23) the Tasmanian Economic Regulator indicated:

"the annual trend for system minutes off supply for Tasmania's transmission network has fluctuated from one year to the next, and has generally been higher than for other Australian transmission networks".

The TSBC wishes to better understand the claim at p23 of the Consultations Paper, and the ramifications for ongoing investment in the transmission network, along with the expectations of future network performance.

Also it is indicated at p23 of the Consultations Paper – *"We are considering asking the regulator to change what is considered a 'big' and 'small' outage under the service scheme, so that we have clearer incentives to maintain or improve our transmission service performance".*

The TSBC is of the understanding that due to the size of the load consumed by major industrial customers compared to total customer load, which is high compared to other Australian transmission service providers, the application of one system minute as the measure of performance results in a binary outcome.

Any outage will exceed the one system minute limit and incur the applicable full performance penalty, whilst no outages will result in the application of the full performance reward.

The TSBC endorses the development of a more appropriate performance measure upon which to base the service incentive scheme, provided it recognizes transmission network performance to date and which provides appropriate encouragement for TasNetworks to maintain operating and capital expenditure at a level which, in the first instance, maintains existing performance levels, or improves performance without increasing the cost to consumers.

9. *Do you have any feedback on our preliminary revenue requirements and indicative pricing outcomes?*

The TSBC notes that the gap between the prices paid by small business compared to domestic customers, and the inherent residual cross subsidy, appears to be maintained over the next six years, or is even widening. The TSBC does not support this.

The reticence of both TasNetworks and the major shareholder to hasten the convergence of the residential tariff and the residential tariff to appropriately reflect the AER requirement for cost reflective pricing appears to be in direct contravention of the rule and its intent.

The TSBC acknowledges that any changes may provide a potential impost on residential pricing, where a significant number of customers are considered in hardship, however, the ongoing practice of penalising a sector which, in itself, is exceptionally cost conscious and price sensitive is unsustainable.

TasNetworks should provide clear and measurable directions in its forthcoming proposal.

10. *What information would you like to better understand in our tariff reform plan?*

The TSBC wishes to understand what information will be provided to small businesses and how the information will be provided, in order to understand the difference between what they are currently being charged, what they will be charged in future as a result of changes which they cannot influence, and what they will be charged if they switch tariffs or change their consumption behaviour.

The "how" includes expectations of the technologies which will be available and how the costs of deploying that technology will be shared.

Small businesses are typically time poor and can be expected to have little engagement in the tariff reform process without such information and clear incentives for them to change.

Importantly, small businesses should not be expected to modify their electricity consumption behaviour unless the rewards for doing so are sufficiently large and measurable.

11. *Do you support our approach to tariff reform?*

Through the Pricing Reform Working Group process, the TSBC has maintained its broad support for TasNetworks' approach to tariff reform, noting the following points:

- Moving to cost reflective network tariffs and eliminating existing cross subsidies, which do not favour small business, is supported;
- The proposed transition time to wind out existing subsidies is too long;
- The move to demand based tariffs is supported, noting that small business customers need quality information about the basis on which they are being charged and how they can reduce their charges;
- In order to result in changes to consumption, the impact of price signals must be sufficiently large to change consumption behaviour; and
- Any increase in fixed charges is contrary to the objective of using pricing signals to bring about changes in consumption.

TSBC response – additional comments

Pricing reform

The TSBC notes (p26) TasNetworks' intention to continue the process of pricing reform based on demand-based price signals.

As indicated in answer to Question 11, the TSBC supports tariff reform but contends that the value of such reform will be eroded unless the retail pricing signals which consumers receive reflect network pricing signals.

The TSBC acknowledges that retail pricing is not within the domain of the AER or TasNetworks, but encourages both parties to engage with Aurora Energy, the TER and other necessary stakeholders to achieve the best possible outcome in the shortest possible time. We note that Aurora has indicated the likelihood of introducing demand based retail tariffs in its next annual pricing proposal and it should be encouraged to do so.

IT and communication costs

The ever increasing costs associated with IT systems is a concern to the TSBC. From discussions with TasNetworks we understand that the cost of upgrading/replacing one component of their IT systems (with a new version of the same system) involves a fourfold increase in the capital cost.

Section 5 of this submission refers to this issue, however the expenditure involved is sufficiently large and the demonstrable benefits delivered sufficiently unclear to warrant further mention.

The TSBC is of the view that the level of scrutiny applied by the AER to such expenditure needs to be enhanced given the increasing importance of IT costs. We are concerned that unless this happens it risks approaching a "black box" assumption, whereby everything within the black box is assumed to be appropriate and/or too complex to scrutinize. We suggest that TasNetworks take a proactive approach to this by including such information in its regulatory Proposal so that consumers can better understand the need and justification of TasNetworks' proposed IT expenditure.

The annual cost to Tasmanian electricity customers by way of return on and return of capital of TasNetworks' IT expenditure over the current and forthcoming regulatory periods, assuming a 10 year asset life (which appears to be longer than is actually occurring) amounts to around $15M per year, which is reflected in electricity prices.

The TSBC acknowledges that the issue is not unique to TasNetworks and applies to all other network service providers, but that does not lessen the significance of the issue.

The TSBC encourages the AER to apply the same level of rigour in its scrutiny of IT costs, including the underlying drivers, as it does with all other expenditure categories.

The TSBC notes that communications costs at a scale which can be expected to be incurred as TasNetworks implements its 2025 Vision and follows the ENA's Transformation Roadmap are not yet evident in expenditure forecasts, adding further weight to the need to scrutinize IT expenditure, along with any associated communications costs.

Weighted Average Cost of Capital (WACC)

The TSBC welcomes the reductions in WACC that have been evident in TasNetworks' recent Regulatory Proposals and in the AER's associated Determinations for both transmission and distribution. This has helped to lower network prices for small business. We note that the main drivers have been the low interest rate environment that has prevailed (a windfall impact that is subject to upside risk in future), along with TasNetworks' acceptance of the AER's Rate of Return Guideline. We expect that these influences will also be evident in TasNetworks' forthcoming regulatory Proposal.

However, we maintain an underlying concern that TasNetworks' rate of return continues to be inflated by the AER's acceptance of inappropriate values for parameters such a cost of debt that does not reflect TasNetworks' low risk status as a State Government owned entity, an excessive equity beta and an excessive market risk premium. This continues to disadvantage Tasmanian electricity consumers. We further note that TasNetworks professes a desire to keep its prices as low as possible and recognises that its “success is anchored to the prosperity of our customers”. Small business electricity prices in Tasmania, although capped for 2017/18, are under pressure particularly from wholesale costs, retail charges and renewable energy charges. In this regard, it is worth pointing out that TasNetworks is not required to accept the AER’s parameter values in its Proposal but can adjust them to better reflect the above if it so chooses.

Consumer Engagement

We welcome and support the consumer engagement activities that TasNetworks has undertaken to date in developing both its regulatory Proposal and its Directions and Priorities, including its involvement with the TSBC. The TSBC also notes that TasNetworks has continued to evolve and improve its consumer engagement. As part of our input to TasNetworks’ last distribution determination, we suggested a need to engage more with rural and regional small businesses in Tasmania in order to better understand their needs. We understand that TasNetworks has moved further in this direction as part of developing its 2019 to 2024 Revenue Proposal and we encourage a continuation of this, including a focus on small businesses with critical electricity supply issues.

Network Prices

As mentioned above, small business electricity prices in Tasmania, although capped for 2017/18, are under pressure particularly from wholesale costs, retail charges and renewable energy charges. We expect that the price outcomes for small business from TasNetworks’ regulatory Proposal will fully reflect its expressed desire to keep its charges as low as possible and recognise that its “success is anchored to the prosperity of our customers”. This clearly reflects back first and foremost to its expenditure proposals and rate of return, as well as its tariff reforms. Our initial comments on these matters in this submission are of importance to that issue.

The TSBC is seeking a Revenue Proposal from TasNetworks that reflects the desire of small business to keep network charges as low as possible whilst being provided with a reliable supply of electricity. That includes the timely removal of cross-subsidies that burden small business.