Review Summary and Key Findings

The Tasmanian Economic Regulator engaged Utilities Regulation Advisory and Oakley Greenwood (the Review Team) to complete an assessment and provide advice and guidance to assist it with determining the efficiency of Aurora Energy's (Aurora) proposed cost to serve (CTS). The Review Team adopted a structured approached to the review that reflected the Base Step Trend (BST) forecasting method used by Aurora. The review involved the following steps:

- **Review of forecasting methodology** – A review of the proposed forecasting methodology and its ability to produce a forecast of efficient expenditure.
- **Review of the efficiency of the base year** – The Review Team assessed the efficiency of the base year by benchmarking Aurora's CTS against comparative cost outcomes reported in the Australian Competition and Consumer Commission's (ACCC) *Inquiry into the National Electricity Market – November 2021 report*. The ACCC report has broad coverage over 87 per cent of the residential customer base across Victoria, New South Wales, South Australia, south-east Queensland, Tasmania and the Australian Capital Territory, and categorises participating retailers as either Big 3 or Non-big 3 retail businesses.
- **Review of the efficiency of the base line forecasts** – A review of the proposed escalation factors used to generate Aurora's proposed baseline forecasts.

In relation to the forecasting method, Aurora has adopted different approaches to forecasting costs associated with its standing offer (excluding Aurora+ application costs) and costs associated with the Aurora+ application:

- For the **standing offer (excluding the Aurora+ application)**, Aurora adopted a forecasting approach that aligns with a BST method. The BST method is a well-established approach and has been implemented widely across Australian regulatory jurisdictions and sectors.
- For the **Aurora+ application**, Aurora adopted a range of methods aligned with the expenditure categories being forecast. Methods ranged from a BST (that is conceptually similar to the method used for the broader standing offer expenditure) through to extrapolations based on an identified cost driver. The Aurora+ application proposed expenditure is derived from allocations of the underlying cost base and have been separately accounted for in the base year used in the broader standing offer forecasts. The Review Team has not identified any instance of duplication or overallocation that would indicate that there is double counting of Aurora+ expenditure.

The Review Team found that the forecasting method adopted by Aurora was consistent with good practice and did not identify any methodology issues that would undermine the efficiency of the forecasts.

In relation to the benchmarking of base year expenditure, while the Review Team found that Aurora's proposed costs were higher than the costs reported for the Big 3 retailers, they align very closely with the costs reported for Non-big 3 retailers:

- For the Big 3 retailers identified in the ACCC report, the combined CTS and cost of customer acquisition and retention (CARC) was **$96** ($58 + $38) per customer;

- For the Non-big 3 retailers identified in the ACCC report, the combined CTS and CARC was **$170** ($109 + $61) per customer.

The Review Team's base year findings are:

- The ACCC information indicates that Aurora's proposed CTS (which also includes CARC) aligns closely with the costs reported by the ACCC for Non-big 3 retailers;

- Whilst Aurora is likely to benefit from some economies of scale relative to the average Non-big 3 retailer operating in the NEM, this may be counteracted by:
  - A lack of scope economies, and
  - More importantly, a requirement to serve a legacy customer base that leads to its debt collection/bad debts being materially higher than the costs that are incurred by most Non-big 3 retailers.

On balance, the Review Team's assessment indicates that Aurora's proposed base year retail CTS (including an allowance for CARC) is likely to be reflective of the efficient costs of providing retail services in Tasmania.

Findings that result in changes to Aurora's proposed CTS are:

- The Review Team does not consider Aurora's proposed zero efficiency rate to be appropriate and recommended an annual efficiency rate that reflects the annual rate of savings observable in the benchmark outcomes for the ACCC's Non-big 3 energy retailers (3.4%). However, for 2022-23, the Review Team has also recommended that the efficiency rate account for some labour cost savings identified by Aurora Energy.

- The exclusion of revenue protection labour and bad debt expenditure from the Aurora+ application cost forecasts, on the basis that it is proposed to be incorporated into Aurora's base service offering and not separately charged for.

CTS review outcomes ($2021)	2022-23
Review Team CTS (per Customer)	$164
Aurora proposed CTS (per Customer)	$173
Variance in CTS (per Customer)	-$10

Note The variance in CTS per customer has been rounded to the nearest dollar.