7 May 2021

Mr Joe Dimasi
Tasmanian Economic Regulator
Level 3, 21 Murray Street
HOBART TAS 7000

By Email: *office@economicregulator.tas.gov.au*

Dear Mr Dimasi

Submission to Draft Approach Paper for the Retail Electricity Standing Offer Price Methodology Review

Thank you for the opportunity to provide comment on the Draft Approach Paper for the Retail Electricity Standing Offer Price Methodology Review (Approach Paper).

Aurora Energy is supportive of the need to review the methodology as part of preparations for the 2022 price investigation process to ensure it continues to promote an efficient and competitive electricity market and protect the interests of Tasmanian customers.

Aurora Energy supports the majority of the proposals in the Approach Paper, including retention of the approach for determining the Notional Maximum Revenue calculation. It is Aurora Energy's view that the 2016 Price Determination has delivered appropriate outcomes for Tasmanian retailers and customers, and any material change in methodology must be supported by clear rationale and linkage to objectives contained in the *Electricity Supply Industry Act 1995*.

It is important to highlight that some proposed changes may negatively impact customers and the operations of Aurora Energy, in particular proposals to amend the methodology relating to Renewable Energy Target (RET) and Metering Costs.

Attachment A to this letter includes detailed submissions which address these concerns and also provide comment on the remaining methodology proposals.

Aurora Energy looks forward to discussing the points raised in this submission further at your earliest convenience.

Yours sincerely

Rebecca Kardos
Chief Executive Officer/Managing Director

Encl.

Attachment A:

Aurora Energy Submission to Standing Offer Price Methodology Review

1. Customer Numbers and Load

Aurora Energy supports the proposed change in approach to determine customer numbers on a combination of actual customer numbers at a point in time and a forecast basis. However, Aurora Energy proposes a mid-point between actual customers reported as at 31 March (as reported to the Australian Energy Regulator) prior to the commencement of the price period and 30 June (as opposed to 31 March) in the price period. Aurora Energy's annual price periods apply from 1 July – 30 June each year and therefore Aurora Energy considers it would be more appropriate to take a mid-point that covers the entire period.

Aurora Energy is also supportive of the Regulator's proposal that forecast billing days reconcile with forecast customer numbers and that forecast load is consistent with forecast customer numbers that apply for each period. However, Aurora Energy considers that it should be allowed to forecast internal customer churn (including associated load) between tariffs on the basis this remains consistent with the overall total forecast customers for the applicable period.

2. Wholesale Electricity Costs (WEC)

Aurora Energy is supportive of the Regulator's approach.

The Approach Paper states that *"The effect of section 40AB(3) of the ESI Act, as it applies over the next regulatory period, is that Aurora Energy's WEC are based on load following swaps."*

Aurora Energy seeks to clarify the effect of section 40AB(3) of the ESI Act, as it applies over the next regulatory period, only seeks to calculate the estimated wholesale energy costs it can recover from customers as the regulated offer retailer. This is distinct to the actual wholesale costs Aurora Energy incurs in managing its wholesale market exposure for regulated customers. Aurora Energy's actual wholesale contract arrangements and costs remain outside the scope of the regulated methodology review and Determination.

3. Wholesale Electricity Price (WEP)

Aurora Energy is supportive of the Regulator's approach.

4. Network Costs

Aurora Energy is supportive of the Regulator's approach.

5. Marginal Loss Factors (MLF) and Distribution Loss Factors (DLF)

Aurora Energy is supportive of the Regulator's approach.

6. Renewable Energy Target (RET) Costs

Aurora Energy does not support the proposed change.

Given the benefits to customers and retailers of the current methodology, as evidenced by its historical performance, it is Aurora Energy's position that there is no compelling reason to move to a different methodology for the last eight years of the RET scheme that closes in 2030.

The current approach to determining RET costs has been in operation since the start of the RET and has delivered efficient price outcomes for customers, whilst allowing retailers to recover their compliance costs and manage associated risks. It is not clear how the move away from this established methodology after such a long period incentivises positive changes in industry practice or promotes the objectives in the *Electricity Supply Industry Act 1995* (Act). Rather, the proposed change is likely to present risks to both Aurora Energy as the regulated offer retailer and Tasmanian customers.

(a) Recognising value and contribution of longer term Power Purchase Agreements (PPAs)

Aurora Energy considers that the proposed approach to rely solely on forward market prices at a point in time fails to consider the value (and cost) of a range of contracting arrangements that a prudent retailer may have in place. The forward and spot market price of LGCs only reflects the marginal cost of LGCs and does not reflect the fact that the majority of LGCs are contracted under longer term PPAs.

The LGC market is volatile and to manage the risks associated with supply issues, price volatility and politically uncertainty evident over the life of the RET, prudent retailers, in part, source LGCs through longer term PPAs. It has been these longer terms agreements that have contributed to the achievement of the RET and, in turn, the lowering of forward contract LGC prices now currently evident in the market. As such, the inherent value, and cost, of relevant long term contracts needs to be recognised in any approach adopted by the Regulator.

Aurora Energy has over time entered into two longer term PPAs to manage LGC supply and hedge against spot and forward market price volatility. These contracts are with Studland Bay and Cattle Hill. The Studland Bay contract expired on 20 December 2020.

The latest LGC contract with Cattle Hill was executed in June 2017 following a robust and competitive 'Request for Tender' process, conducted in line with Aurora Energy's Procurement Policy, whereby a number of different renewable projects and purchasing options where thoroughly evaluated. At the time of entering into this long term arrangement, the regulatory framework provided for the cost recovery of Aurora Energy's actual costs.

In addition, whilst market prices currently sit below Aurora Energy's forecast LGC purchase costs, this only reflects a point in time assessment of the LGC market. Based on historical evidence, the recognition of longer term PPAs has been no less efficient than the Regulator's proposed approach, whilst also reducing customer's exposure to volatility inherent in short term forward and spot markets.

This can be demonstrated by considering the application of the proposed market based approach with the current actual costs approach over the past 12 years. When comparing Aurora Energy's actual costs (that includes both Studland Bay and Cattle Hill PPAs and market purchases to meet its remaining RET liability) compared to the 12 month average spot price for the relevant period, LGC costs were just 1.6% higher under the actual costs approach compared to the spot market average.

Importantly, whilst being only nominally higher than the market average approach, the actual costs approach also benefited from price certainty and as a result did not expose regulated customers to the significant volatility in market price outcomes as would have been the case under a under forward market approach. During the height of extended market prices, the price smoothing effects of the long term PPA resulted in actual LGC costs reflected in Standing Offer tariffs (STOF) in the four years from 2015 to 2018 being 19% below market prices. This contributed to reducing significant year on year movements in retail regulated tariffs and highlights the risk to customers of moving to a solely forward market based approach which, by the nature of markets, will continue to exhibit volatility.

(b) Impacts on Aurora Energy as regulated offer retailer

As evidenced above, the inherent volatility in shorter term forward market prices means that, whilst comparably efficient over time, there are periods where there is inconsistency between forward market prices and fixed prices in longer term PPAs. As the proposed methodology will apply, at most, for only the remaining eight years of the scheme, long term PPA prices may not be comparably efficient to market prices during this relatively short period.

Assuming current forward contract market prices are solely used to determine STOF LGC costs (as per the proposed methodology), a shift away from the current actual cost approach will have a material adverse financial impact on Aurora Energy of not recognising the costs of the Cattle Hill contract proportionally attributable to regulated customers for the periods of the 2022 Determination.

Aurora Energy considers that any approach that disregards the financial impact on the regulated offer retailer of contracts already in place and executed under the current regulatory framework would be punitive in nature and ultimately inconsistent with the principle set out in 40AB (1) of the ESI ACT that the regulated offer retailer be able to make reasonable return on its investment in respect of the provision of standard retail services.

Aurora Energy proposes that any forward market approach must include and have regard to longer term PPAs that the regulated offer retailer already had in place under the existing regulatory framework. Furthermore, for the balance of purchases where a forward market based price methodology is to be applied, Aurora Energy considers an approach that reflects a progressive buying methodology will reduce price risks to retailers and customers associated with the point in time view of the forward market as proposed. For example, it could reflect the average forward market prices for the relevant periods for the 12 months preceding 30 April each year.

Finally, as any form of market based approach represents a departure from the current methodology, a transition period that provides for the final adjustments of load and price for periods 5 and 6 of the 2016 Determination is considered necessary.

In summary, this approach would:

- Ensure that any regulatory change is not punitive in nature and limits the adverse financial impact on the regulated offer retailer.
- Recognise a prudent approach adopted by large retailers that is proven to be efficient and results in lower volatility in Large Generation Certificate (LGC) costs being passed through to customers.
- Provide a hedge to the risks of price volatility in short term forward contract prices resulting in more price certainty for customers.
- Be in line with the Tasmanian Government's renewable policy and not undermine the achievement of the TRET.

(c) Forecast RET Liable Load & Adjustments

Aurora Energy supports maintaining the current approach to calculate the liable MWh by splitting the forecast load for the first and second half of each Financial Year. This support is contingent on allowance being made for prior period adjustments for variances in actual load and the final binding Renewable Power Percentage (RPP) and Small-scale Technology Percentage (STP) as set out in Section 11.4 of the Approach Paper.

Aurora Energy considers that maintaining an adjustment mechanism for the final binding RPP and STP are necessary to reduce the risks to retailers associated with the variation to the non-binding estimates. This risk is illustrated in Table 1 that highlights the significant variations between the non-binding STP estimates and the binding STP.

Table 1: Binding vs Non-Binding STP

Year	Small Scale Technology Percentage	Non-binding STP (published previous year)
2022	-	22.40%
2021	28.80%	19.40%
2020	24.40%	14.56%
2019	21.73%	12.13%
2018	17.08%	8.06%

7. Metering Costs

Aurora Energy does not support the proposed change under consideration by the Regulator as it will result in a range of adverse customer and broader sector impacts. The proposal will:

- Lead to inequalities in charges applied across the standing offer customer base as well as subsequent customer confusion.
- Conflict with both State and Federal Government policy and regulatory drivers for progressing the roll out of advanced meters.
- Create barriers to customer empowerment tools and services uptake and, consequentially, limit the capacity for customers to address affordability issues.
- Create inefficiency within Aurora Energy's operational systems and lead to cost to serve impacts.

Additional points supporting the above views are as follows:

(a) Inequality of customer charges and customer confusion

Under the proposal outlined by the Regulator in Section 7.4 of the Approach Paper, a customer would pay for the extra cost of an advanced meter in all circumstances, whether this be a new installation, a property where an advanced meter is already installed, in cases of fault or where an advanced meter is required due to a customer driven request. The latter customer driven request scenario may cover many multiple reasons, such as a change in tariff, the installation of a solar system, a need to address an access related issue or for a product such as aurora+.

While this is theoretically the most consistent and simplistic approach to applying a new metering charge, it presents a range of operational challenges and creates a material level of inequality with customers yet to receive an advanced meter. This is particularly so for customers whose meters are required to be replaced due to fault or being a new installation.

It is also important to recognise that the benefits of advanced meters may not be accessed consistently across the customer base. The value and need for advanced meter tools such as remote reading or enhanced meter data will be treated differently by customers based on their unique circumstances. Applying a flat rate charge for receiving an advanced meter assumes the customer choices align with customer selected benefits. Further, there is no guarantee that customers who receive an advance meter, under any circumstance, will choose to access potential benefits.

In the event that the considered proposal was realised, it would likely cause significant confusion with customers. Customers will have a charge levied on their bills not previously applied to them. This will create a two-tiered customer bill outcome. Even if charges were only applied on a 'going forward' basis, there would still be the creation of a two-tiered customer outcome.

Under a more complex delivery model, additional charges could theoretically solely apply to meters installed due to customer driven requests. For customers who receive an advanced meter for any other reason than customer requested, it will be confusing as to whether they can access products at a later stage and not incur a cost (given they already have an advanced meter installed.)

Practically, any version of the proposal to apply an advanced meter charge will be very complex in its delivery and may create customer confusion, complaints and inequity. This approach will also be time-limited with the remaining advanced meters expected to be installed across Tasmania in the next five years. The Approach Paper proposal will create a short term environment of anxiety and complaint regarding an additional charge that ultimately all customers will have to bear. In practice, all Tasmanian electricity customers will ultimately pay an advanced meter cost once all meters are replaced. This is effectively a smeared cost model approach, which mirrors the current approach to applying metering costs.

(b) Conflict with State and Federal Government policy and regulatory positions

Advanced meters are now firmly embedded across the national framework as a valid, benefit providing instrument to improve customer access to information and affordability. The Council of Australian Governments (COAG) Energy Council instigated the Power of Choice reforms so that customers could make more informed decisions about how they participate in the electricity market as well as gain access to improved information, product and services.

There are also broader sectoral benefits that drove the COAG decision such as reduced metering reading costs and better grid management.[1] These benefits are not assignable to any one particular customer, rather, they are applied on a community case basis and are the 'expected outcomes'[2] from the Power of Choice rule changes. Under the Approach Paper proposal, the broader community benefits that arise from advanced meter installation will only be paid for by those who have a meter installed. The smeared approach to costs is one that is consistent with current practice in Tasmania as well as other jurisdictions such as the Australian Capital Territory.

The presence and drive towards advanced metering is reflected in a number of recent market reviews, rule changes and decisions impacting market participants. The AEMC has also been reviewing the regulatory requirements for future markets as it relates to reflecting the ongoing digitalisation of retailing[3] and the AER is conducting a review of the format and presentation of bill information in recognition of the differing ways that customers are now being provided their energy data. There is also the drive towards cost reflective tariffs from the AER with TasNetworks nomination of Tariff 93 as their default cost reflective tariff and the use of advanced meter data as the source of information to base a conversation with a customer about the optimal tariff arrangements for their premises.

[1] https://www.aemc.gov.au/sites/default/files/content/ed88c96e-da1f-42c7-9f2a-51a411e83574/Final-rule-determination-for-publication.pdf Page 1

[2] https://www.aemc.gov.au/sites/default/files/content/ed88c96e-da1f-42c7-9f2a-51a411e83574/Final-rule-determination-for-publication.pdf Page xii

[3] AEMC, Issues Paper 2, Consumer Protections In An Evolving Market: Traditional Sale Of Energy - 2020 Retail Energy Competition Review, Pages 4-5

(c) Customer affordability impacts

Advanced metering and pricing decisions by the Regulator will impact key customer issues in the Tasmanian market such as affordability. Whilst Tasmanians have some of the lowest electricity prices in Australia they experience some of the highest bills.[4] High winter usage and a lack of natural gas penetration are key factors in these high bills, yet, affordability remains an ongoing issue for Tasmanian customers. The Tasmanian Government is seeking to address the issue of affordability through empowering customers to better manage their energy costs.

The Tasmanian Renewable Energy Action Plan, released in December 2020, highlights commitments in Actions 2.4 and 2.7 to utilise customer empowerment by developing an "Energy Customer Empowerment Blueprint" to ensure Tasmanian customers are empowered to manage their energy needs and take advantage of new technology and market offerings.[5]

As per Action 2.4, "a critical element of customer empowerment is the use of advanced meters." By placing an additional charge on advanced meters, targeted approaches to tackling affordability such as customer empowerment, will be inhibited.

(d) System and process impacts

The changes required to address how the proposal may be implemented will be administratively complex. Both in system and process costs with changes required to customer bills, customer information, call centre operator training as well as customer advocacy costs rising due to expected customer complaints.

8. Cost-to-Serve

Aurora Energy supports the proposed approach to maintain the current methodology (a combination of a bottom-up build approach and benchmarking approach) in determining Aurora Energy's Cost-to-Serve allowance.

Aurora Energy is eager to ensure the methodology for any annual adjustment mechanism that is applied to the Cost-to-Serve allowance is reasonable in the context of the bottom-up build and benchmarking approach.

9. Retail Margin

Aurora Energy supports the proposed approach to maintain a benchmarking approach to setting the retail margin, taking account of the risks Aurora Energy faces in delivering retail services under standard retail contracts.

Conceptually, Aurora Energy has no objection to a change in the methodology for calculating retail margin from a percentage of total forecast Notional Maximum Revenue to a $/customer basis. Aurora Energy supports an approach that provides stability in the retail margin Aurora Energy receives from its regulated standing offer customer base. Notwithstanding this, Aurora Energy will seek to ensure that any change in methodology continues to reflect an appropriate level of total retail margin that compensates Aurora Energy for ongoing investment and enables it to continue to manage the risks it faces in providing standard retail services in Tasmania.

[4] Annual Retail Markets Report 2019-20, Australian Energy Regulator, Page 39

[5] Tasmanian Renewable Energy Action Plan, Page 38

Aurora Energy notes the statement in Section 9.4 of the Approach Paper, "This will take into account the energy price risks that Aurora Energy may face in Tasmania compared with retailers operating in interstate markets". Aurora Energy notes that its wholesale risks are consistent with that faced in other jurisdictions, with exposure to the same volatility in spot price as other participants in the National Electricity Market (NEM). To overcome the monopoly position of Hydro Tasmania, the Tasmanian Government introduced the Wholesale Contract Regulated Instrument (WCRI). It is important to note that the WCRI was designed to ensure risks in Tasmania were consistent with, and not lower than, other NEM jurisdictions that have a more liquid and transparent forward contract market for retailers to manage their wholesale risk.

Consistent with its Cost to Serve allowance, Aurora Energy requests any $/customer base value be indexed by movements in the Australia Consumer Price Index (CPI) to ensure the value of retail margin allowance is retained over time.

10. AEMO Costs

Aurora Energy is supportive of the Regulator's approach.

11. Adjustments for Under and Over Recoveries

Aurora Energy is largely supportive of the Regulator's approach outlined in Section 11.4 of the paper.

However, Aurora Energy considers that adjustments for under and over recoveries should be calculated using the actual Notional Tariff Base for relevant year (therefore adjusting for changes in customer numbers and load). This is on the basis that this approach would more accurately reflect the actual over or under recovery of costs for a given year. In particular, Aurora Energy notes that given its current market share, there is a higher likelihood that its customer numbers and load will decrease over time. Under the Regulator's proposed approach, this would likely lead to the overstatement of under or over recoveries each year.

This approach would also be more in line with the Regulator's statement in the first paragraph of Section 11.4 of the Approach Paper, to "allow the difference between forecast per unit costs and actual per unit costs.

12. Adjustments for Tax Events and Material Changes in Aurora Energy's Costs

Aurora Energy is supportive of the Regulator's approach.

13. Standing Offer Tariff Strategy

Aurora Energy will submit a Standing Offer Tariff Strategy (SOTS) in line with the Regulator's request and acknowledges the proposed approach not to require high level principles to be set out separately. The SOTS will address the future pathway for development of Aurora Energy tariffs, including price and non-price components across the length of the Determination.

14. Length of the Determination

Aurora Energy proposes a four-year Determination. This is a different time period compared to the 2013 and 2016 Determinations that were both set to run for three years, although, it is noted that the 2016 Determination will ultimately run for a period of six years.

A Price Investigation is a complex and protracted process with costs and impacts for not only Aurora Energy but the Office of the Tasmanian Economic Regulator. It will also impact the community advocacy sector in requiring their engagement throughout the investigation. Aurora Energy contends that given the extended period of the 2016 Determination and the resource impacts of a price investigation process, there is merit in adopting a four year Determination period.