



## **Statement of Reasons**

# **Guideline on the Approval of standing offer prices in accordance with the 2013 Standing Offer Determination**

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## GLOSSARY

**“Absolute Minimum Capacity Offer Volume”** has the same meaning as in the **Wholesale Contract Regulatory Instrument**;

**“Aurora Energy Pty Ltd”** means Aurora Energy Pty Ltd ABN 85 082 464 622 and its successors;

**“Authorised Retailer”** has the same meaning as in the *Electricity Supply Industry Act 1995*;

**“draft Guideline”** means the draft Guideline, *Approval of standing offer prices in accordance with the 2013 Standing Offer Determination*;

**“Economic Regulator”** means the Tasmanian Economic Regulator established under the *Economic Regulator Act 2009*;

**“Guideline”** means the Guideline, *Approval of standing offer prices in accordance with the 2013 Standing Offer Determination*;

**“Hydro Tasmania”** means the Hydro Electric Corporation ABN 48 072 377 158;

**“Load Following Swap”** has the same meaning as in the **Wholesale Contract Regulatory Instrument**;

**“Period 2”** means the period from 1 July 2014 to 30 June 2015;

**“Period 3”** means the period from 1 July 2014 to 30 June 2015;

**“Regulatory Period”** means the period from 1 January 2014 to 30 June 2016;

**“Wholesale Contract Regulatory Instrument”** means the instrument that specifies the regulated contracts **Hydro Tasmania** must offer to **Authorised Retailers**. The instrument is:

- (i) the approval made by the Minister for Finance on 29 July 2013 (as amended from time to time), in accordance with sections 43G and 43O of the *Electricity Supply Industry Act 1995* and Regulation 20 of the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013*, having taken into account the principles set out in section 43H of the *Electricity Supply Industry Act 1995*; or
- (ii) the approval made by the **Economic Regulator** (as amended from time to time), in accordance with section 43G of the *Electricity Supply Industry Act 1995*, having taken into account the principles set out in section 43H of the *Electricity Supply Industry Act 1995*.

**“2013 Standing Offer Determination”** means the *Interim Price-regulated Retail Service Price Determination* issued on 29 July 2013 as amended by the

II APPROVAL OF STANDING OFFER PRICES IN ACCORDANCE WITH THE 2013 STANDING OFFER DETERMINATION – STATEMENT OF REASONS

**Economic Regulator** in accordance with the *Electricity Supply Industry (Pricing and Related Matters) Regulations 2013*.

# 1 INTRODUCTION

## 1.1 Purpose

This Statement of Reasons addresses the issues raised in submissions received on the draft Guideline, *Approval of Standing Offer Prices in accordance with the 2013 Standing Offer Determination*. This Statement of Reasons is intended to be read in conjunction with the draft Guideline which was released on 21 March 2014 and the accompanying Consultation Paper.

Chapter 2 outlines, in detail, each of the issues raised during the consultation process together with the Economic Regulator's response to, and decision on, each issue.

## 1.2 Background

Standing offer prices are the prices that a regulated offer retailer may charge small customers on mainland Tasmania (including Bruny Island) for services provided under standard retail contracts. Standing offer prices are effectively a fallback contract available for those customers choosing not to enter into a market retail contract.

Under section 41 of the *Electricity Supply Industry Act 1995*, standing offer prices are not to be fixed unless a draft of the standing offer price has been approved by the Economic Regulator.

It has been the Economic Regulator's past practice with respect to electricity determinations to prepare and release a guideline setting out the obligations imposed on the retailer charging regulated prices and the Economic Regulator's responsibilities with respect to the determination. To date, Aurora Energy has been the retailer responsible for supplying electricity to small customers under regulated tariffs including, from 1 January 2014, standing offer prices.

Additionally, under clause 5 of the *Interim Price-regulated electricity Retail Service Price Determination (2013 Standing Offer Determination)*:

Draft standing offer prices are to be submitted to the Regulator for approval in accordance with the *Electricity Supply Industry Act 1995* and the annual standing offer price approval process.

The Guideline sets out the annual process under which the Economic Regulator will adjust standing offer prices. The Guideline broadly follows the format of previous guidelines in terms of obligations, responsibilities, timeframes and the format of the annual pricing proposal (including certifications). However the Guideline has been modified to account for the different treatment of the various Notional Maximum Revenue (NMR) components under the 2013 Standing Offer Determination as compared to previous determinations. The components of the NMR include:

- the notional tariff base (NTB) which includes the number of customers and their load;
- electricity loss factors when electricity is transmitted and distributed across the electricity network;
- the operational cost to serve per customer (Cost to serve);
- the wholesale electricity price (WEP);
- network costs;
- Australian Energy Market Operator (AEMO) charges for market participation and ancillary services;
- renewable energy target (RET) costs; and
- over or under recoveries from a previous period covered by this Determination in relation to changes in network costs, RET costs and AEMO charges attributable to the notional tariff base as approved by the Economic Regulator; and
- retail margin.

Under previous electricity determinations, the only NMR components that were able to be varied during the Regulatory Period covered by the determination were RET costs, AEMO charges and Network costs (the latter two items being pass-throughs).

In contrast, under the 2013 Standing Offer Determination, all NMR components with the exception of the Cost to Serve and Retail Margin may be varied for each of Period 2 (2014-15) and Period 3 (2015-16). Whilst methodologies are already in place to vary the majority of the NMR components, the Economic Regulator has been required to develop new methodologies to estimate the revised WEP and the NTB.

In this regard, a draft Guideline and consultation paper were released for public consultation on 21 March 2014 with submissions closing on 11 April 2014.

The draft Guideline outlined the Economic Regulator's proposed process and methodology for updating standing offer prices each year, whilst the consultation paper requested comment on the proposed methodologies for updating the WEP and the NTB.

Hydro Tasmania lodged the only submission on the draft Guideline, which has been published on the Economic Regulator's website at: [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au).

### **1.3 Next Steps**

The Economic Regulator has finalised the Guideline after considering the issues raised in relation to the draft Guideline and has published it on its website.

## **2 PUBLIC SUBMISSIONS: ISSUES, RESPONSES AND DECISIONS**

This chapter outlines the issues raised in the sole submission on the draft Guideline followed by the Economic Regulator's response and decision on each issue. For ease of reference, the requests for comments in the Consultation Paper on specific aspects of the draft Guideline are included under the relevant sections.

### **2.1 Methodology for estimating the wholesale electricity price**

The Economic Regulator invited submissions on the proposed approach to estimating the wholesale electricity price (WEP) for each of Periods 2 and 3.

Hydro Tasmania's submission proposed an alternative approach to the estimation of the wholesale electricity price, being a time weighted average of weekly regulated Load Following Swap prices published by Hydro Tasmania for the last 51 weeks or back to 1 January 2014 where those prices were not available. Hydro Tasmania considers this to be a generalised form that will work for several years. Hydro Tasmania also considers that weighting prices by the Absolute Minimum Capacity Volume has no benefit since this value will rarely change and has no relevance to the issue.

#### ***Economic Regulator's conclusion***

The Economic Regulator disagrees with Hydro Tasmania's view on this issue. The Regulator notes that each week there is a different price offered for the four quarters in a period with different Absolute Minimum Capacity Volumes. The different Absolute Minimum Capacity Volumes reflect the typical load difference between quarters throughout the year. The cost to retailers in purchasing wholesale contracts will therefore reflect the volume they need to purchase each quarter and, in turn, the price on offer each week for that quarter. The Regulator considers that not taking into account the different volume offers per quarter would result in the cost to retailers of serving retail customers not being appropriately reflected at different times of the year.

Furthermore, the Economic Regulator considers that Hydro Tasmania's methodology does not sufficiently take into account the fact that additional Absolute Minimum Capacity Volumes will be offered after the setting of the WEP. Under the Economic Regulator's proposal (as outlined in section 2.2 of the Consultation Paper) future regulated prices (that will be offered after the setting of the WEP) are estimated based on the point in time estimate of the regulated Load Following Swap offer price for each quarter at the point in time that the Regulator calculates the WEP. Additionally, these prices are weighted by the remaining residual minimum offers per quarter. Under this approach the most up to date information is used in estimating the future cost to retailers. If Hydro Tasmania's proposed approach was adopted and the simple average of the previous 51 weeks was used, no

consideration would be given to the fact that future sales will likely be made at a price closer to most recent prices and not prices dating back 51 weeks.

Given this, the Economic Regulator has decided not to amend the Guideline to reflect Hydro Tasmania's suggested changes.

## **2.2 Methodology for revising the Notional Tariff Base**

The Economic Regulator also invited submissions on the proposed approach to revising the notional tariff base (NTB) for each of Periods 2 and 3.

Stakeholders did not make any comment on the approach proposed in this section of the Guideline.

The Economic Regulator identified that several minor changes were required to this section of the Guideline to reflect the NTB revision process for Period 2 as described below:

- (i) Aurora Energy is to provide the Economic Regulator with its forecast NTB for Period 2;
- (ii) the Economic Regulator will revise downwards by 3.75 per cent the forecast NTB provided by Aurora Energy under (i); and
- (iii) Aurora Energy's submitted pricing proposal is required to reflect the revised NTB calculated under (ii).

### ***Economic Regulator's conclusion***

The Economic Regulator has made several minor changes to the wording in this section of the Guideline to reflect the final nature of the Guideline and to accurately reflect the process to be followed in revising the NTB for Period 2.

## **2.3 Other matters**

Hydro Tasmania made two other comments with respect to the Guideline.

Firstly, Hydro Tasmania considered that the timeframe for the application of the Guideline should be open ended and not restricted to the 2013 Standing Offer Determination. Hydro Tasmania considered that this would provide more certainty for future determinations, would provide more flexibility to deal with determinations made part way through a year and would lead to less regulatory work for future determinations.

Secondly, Hydro Tasmania considered that "Aurora Energy" should be replaced with "regulated retailer" or "standing offer retailer" to allow for the possibility of there being more than one regulated offer retailer in the future.

### ***Economic Regulator's conclusion***

With respect to Hydro Tasmania's first point the Economic Regulator notes that its normal practice has been to develop a new guideline at the commencement of the

regulatory period covered by each determination. Each guideline has therefore been tailored to reflect the specific circumstances of the regulatory period. For the draft Guideline the Regulator has adopted the same approach by tailoring it to the specific requirements and circumstances surrounding the 2013 Standing Offer Determination. This includes specific requirements for Periods 2 and 3 in relation to the calculation of the WEP and the NTB. The Economic Regulator does not consider it practical to adjust the draft Guideline in a manner which gives it general application without removing the specific requirements applying to Periods 2 and 3.

In light of the changes that are to occur during the regulatory period covered by the 2013 Standing Offer Determination including the commencement of full retail contestability and the likelihood of customers transferring to new retailers on competitive market contracts, the Regulator considers it more appropriate to issue a specific Guideline relating to this period.

The Regulator will prepare a new Guideline for the next regulatory period and consult on the contents and format of that Guideline. The Regulator is of the view that the question of whether a more general guideline would be warranted for future determinations should be considered as part of that process.

With respect to Hydro Tasmania's second point the Economic Regulator notes that the purpose of the Guideline is to outline the annual standing offer price approval process and sets out Aurora Energy's obligations, and the Economic Regulator's responsibilities, with respect to the 2013 Standing Offer Determination. Given the Economic Regulator's preference to make the Guideline specific to the 2013 Standing Offer Determination the Economic Regulator does not consider it appropriate to remove references to Aurora Energy.

Given this, the Economic Regulator has decided not to amend the Guideline to reflect Hydro Tasmania's proposed other amendments.