



# **Tasmanian Electricity Supply Industry**

## **2016 Standing Offer Pricing Investigation**

### **Draft Aurora Energy Standing Offer Price Strategy**

#### **Consultation Paper**

**March 2016**

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# 1 INVITATION FOR SUBMISSIONS

This consultation paper has been prepared to assist interested persons in making submissions and comments on Aurora Energy's Draft Standing Offer Price Strategy (the Draft Strategy).

It is the Economic Regulator's policy to publish all submissions on the Office of the Tasmanian Economic Regulator's (OTTER) website unless the author of the submission requests confidentiality in relation to the submission (or any part of the submission). Those parts of a submission that are requested to be confidential should be submitted as an attachment to that part suitable for publication.

The Economic Regulator will not publish submissions which contain material that the Economic Regulator believes is, or could be, derogatory or defamatory.

Submissions should be received by close of business on **1 April 2016**.

To facilitate the publication of submissions on OTTER's website, submissions by email are preferred. Submissions and enquiries may be made to:

office@economicregulator.tas.gov.au

or to

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A copy of the Draft Strategy is available on the Economic Regulator's website: [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au) under **Electricity – Electricity Consultations – Current Consultations – March 2016**.



## 2 CONTEXT, BACKGROUND AND PURPOSE

### 2.1 Context

The Economic Regulator periodically makes a standing offer price determination which outlines a formula for determining the maximum electricity standing offer prices that Aurora Energy, as a regulated offer retailer, may charge small electricity customers on mainland Tasmania (including Bruny Island) for services provided under standard retail contracts

The current standing offer determination expires on 30 June 2016. Before the existing determination expires and prior to making a new price determination the Economic Regulator is required by legislation to conduct a pricing investigation.

The purpose of the pricing investigation is to gather information to assist the Economic Regulator in making its determination. The new price determination, (the 2016 Standing Offer Determination), will run for the three year period from 1 July 2016 to 30 June 2019.

The Economic Regulator is currently consulting on its 2016 Standing Offer Draft Investigation Report, 2016 Standing Offer Draft Determination and Draft Standing Offer Price Approval Guideline. Copy of these draft documents are available on the Economic Regulator's website: [www.economicregulator.tas.gov.au](http://www.economicregulator.tas.gov.au) under **Electricity – Electricity Consultations – Current Consultations – February 2016**.

### 2.2 Background

The expiry of the 2013 Standing Offer Determination will also result in the lapse of the legislative requirements currently imposed on Aurora Energy to maintain the existing standing offer tariff structure and to introduce uniform price changes to maintain the relativities between the existing tariffs. The Economic Regulator has therefore required Aurora Energy to submit a Standing Offer Price Strategy for the 2016 – 2019 regulatory period.

The strategy is required to include Aurora Energy's proposed changes to the existing tariff structure and standing offer prices and provide details of the price transition mechanisms it intends applying during the regulatory period which will be used to assess proposed price changes as part of the annual standing offer price approval process.

As a precursor to submitting its Draft Standing Offer Price Strategy (Draft Strategy), Aurora Energy was required to submit, in September 2015, details of the high-level principles that would underpin its Standing Offer Price Strategy.

These principles emphasised Aurora Energy's desire to have flexibility in its standing offer prices in order to be able to compete with potential new entrant retailers. The three key principles are as follows:

1. Enhancing customer choice – the ability to reflect any new network tariff or emerging market trends in new or amended standing offer prices.
2. Progression to cost reflective standing offer tariffs – the ability to incrementally rebalance standing offer prices including relativities between fixed and variable, between residential and business, and between tariffs to take into account changes in input costs.
3. Transparent and simpler to understand – the ability to amend standing offer prices to ensure they are relevant, market compliant and reflect the terms of underlying network tariffs.

Aurora Energy subsequently submitted its Draft Strategy in November 2015. The Economic Regulator reviewed, and identified that that version of Aurora Energy's Draft Strategy was deficient in that it lacked detail about the proposed levels and structure of prices and the nature and timing of the proposed transition of customers from existing tariffs to the proposed new tariffs. The Economic Regulator subsequently required Aurora Energy to submit a revised Draft Strategy in February 2016 which addressed the identified issues.

Aurora Energy resubmitted its Draft Strategy to the Regulator on 12 February 2016.

The Draft Strategy resubmitted by Aurora Energy addresses the following points:

1. Aurora Energy's proposed approach to price changes, which involves two steps:
  - A. passing through price changes based on movements in specific underlying NMR cost components; and
  - B. incremental rebalancing for each component of each tariff to address disparities in tariffs created during previous regulatory periods (this incremental rebalancing would occur through a price constraint methodology which limits price increases due to rebalancing to a maximum of 1.5 per cent per year of the price calculated under step 1A);
2. a proposal to abolish obsolete tariffs, including Nursing Homes Light and Power (Tariff 34);
3. Aurora Energy's proposal to introduce opt-in Time-of-Use tariffs from 1 July 2016, and;
4. Aurora Energy's proposal to introduce opt-in demand based tariffs from 1 July 2017.



## **2.3 Purpose**

The purpose of this paper is to discuss issues associated with the Draft Strategy and seek feedback from stakeholders. It is intended that this paper be read in conjunction with the Draft Strategy, a copy of which is available on the Economic Regulator's website.



### 3 APPROACH TO PRICE CHANGES

TasNetworks submitted its Tariff Structure Statement (TSS) to the Australian Energy Regulator on 29 January 2016. The TSS sets out TasNetworks' proposed tariff structures and parameters, as well as the approach for setting each tariff annually.

The TSS notes that the present network pricing structure is geared towards charging for the amount of energy delivered rather than the main cost driver which is providing the sufficient network capacity to cater for peak periods. Recent changes to the National Electricity Rules require TasNetworks to apply a more cost reflective approach to determining network tariffs.

In section 6.2 of its Draft Strategy, Aurora Energy proposes an incremental transition to cost reflective tariffs, recognising the movement in input costs per year varies from tariff to tariff. Previously, all tariffs were subject to uniform price changes. Under the 2016 Standing Offer Determination Aurora Energy proposes passing through price changes based on movements in specific underlying NMR cost components. Additionally, Aurora Energy proposes an incremental rebalancing for each component of each tariff to address disparities in tariff prices created during previous regulatory periods.. This incremental rebalancing would occur through a price constraint methodology limiting price increases due to rebalancing to a maximum of 1.5 per cent per year of the price determined after allowing for the pass through of changes in NMR costs components.

The Economic Regulator notes Aurora Energy's proposal to apply a limit on tariff component price increases of 1.5 per cent per year refers only to changes due to tariff rebalancing and Aurora Energy has not proposed an overall constraint on annual price changes. This means that, depending on the movements in NMR cost components price increases could exceed 1.5 per cent per year.

The Economic Regulator seeks input on whether Aurora Energy's proposal protects consumers from significant price increases and whether it should maintain some measures to better manage those impacts. Options the Economic Regulator could consider include:

1. introducing a constraint on price increases, in addition to the 1.5 per cent rebalancing limit, which would see price increases limited to ten per cent per year. This is consistent with the approach the Economic Regulator took to protect customers from price shocks in transitioning water and sewerage pricing towards cost reflective tariffs, or;
2. the Economic Regulator could put in place an assessment process, in addition to the 1.5 per cent rebalancing limit, whereby as part of the annual price approval process, Aurora Energy submits its proposal price changes and the Economic Regulator assesses these against the following criteria:

- Do the price changes promote efficiency and competition in the electricity supply industry?
- Are the price changes in the interests of electricity customers?
- Do the price changes allow for Aurora Energy to recover the cost of providing the product and/or service to the customer?

More information on Aurora Energy's proposed approach to tariff changes can be found in section 6.2 of the Draft Strategy.

The Economic Regulator is seeking feedback on:

- whether Aurora Energy's proposal to limit 'rebalancing' increases for tariff prices to 1.5 per cent per year, but pass-through any other price changes for tariff components without limits, is appropriate; or
- whether one of the following options would be more suitable:
  - price increases being limited to ten per cent per year; or
  - price changes being assessed against a set of criteria.

## 4 TARIFF 34: NURSING HOMES LIGHT AND POWER

Section 6.1.3 of the Draft Strategy notes that the underlying network tariff for Nursing Homes Light and Power (Tariff 34) is an obsolete network tariff, meaning that new customers are unable to connect to this tariff. Aurora Energy has therefore proposed making Tariff 34 obsolete from 1 July 2016 (Period 1 under the 2016 Standing Offer Determination).

The Draft Strategy also states that Aurora Energy would not seek to abolish Tariff 34 until all existing customers have transitioned to an alternate electricity tariff.

The Economic Regulator understands the rationale behind Aurora Energy's proposal to make Tariff 34 obsolete. However the Economic Regulator notes that while the Draft Strategy mentions Tariff 34 customers transitioning away from this Tariff, the Economic Regulator understands that Tariff 34 customers will remain on the Tariff until they elect to move to a different tariff.

The Economic Regulator therefore seeks input on whether the Draft Strategy should be amended to make it clear that the Draft Strategy does not specify any transition path in respect of these customers.

The Economic Regulator is seeking feedback on:

- Aurora Energy's proposal to make Tariff 34 obsolete; and
- whether the Draft Strategy should clarify that customers on Tariff 34 will remain on this Tariff until they elect to move to an alternate tariff.



## 5 TIME-OF-USE TARIFFS

In section 6.3.1 of its Draft Strategy, Aurora Energy proposes introducing ‘opt-in’ Time-of-Use (ToU) Standing Offer tariffs to take effect from 1 July 2016.

Under current standing offer electricity tariffs the tariff prices are a ‘flat rate’ regardless of when electricity is used. Proposed ToU tariffs split electricity tariffs into three different time periods: peak, shoulder and off-peak, with a different price for each period. ToU tariffs are higher during the peak and shoulder periods and lower during the off-peak period. The Economic Regulator also notes that connecting via a ToU tariff will require the installation of an interval meter.

The Economic Regulator seeks input on whether there is a need for tariffs, other than basic standing offer tariffs, to be regulated by the Economic Regulator, with other types of electricity tariffs should be treated as unregulated, market offers.

The Economic Regulator notes that other NEM jurisdictions do have standing offer ToU tariffs available and that under certain circumstances a small number of customers could possibly be financially disadvantaged if ToU tariffs were only introduced as a market offer (ie if a customer moved into a residence that did not have a standard type 6 meter, but did not want to or could not take up a ToU market contract then that customer would either need to pay for a different meter to be installed or would have to pay for all their electricity usage under the general light and power tariff (Tariff 31).

Aurora Energy’s Draft Strategy states that a key driver for the introduction of a ToU tariff is that it will give customers an opportunity to reduce their electricity bills through greater control of their electricity consumption. However, the Economic Regulator has concerns that, combined with Aurora Energy’s plans to rebalance tariffs in favour of fixed charges at the expense of variable charges, the introduction of ToU tariffs may dilute incentives to reduce power usage.

The Economic Regulator seeks feedback on whether vulnerable customers may face a risk of higher energy prices if they switch to a ToU tariff but are unable to shift their electricity usage from peak to off-peak periods.

Aurora Energy is proposing that any ToU tariff introduced be on an opt-in basis. The Economic Regulator recognises that, regardless of the price of any proposed ToU tariffs, an opt-in basis mitigates against price risks to customers ie if Aurora Energy introduces a new tariff that is too highly priced customers will not take up the offer.

The Economic Regulator notes that in the absence of effective competition in the Tasmanian small customer electricity market, ensuring that customers have access to a variety of standing offer products may be a more effective way of allowing customers to purchase electricity products that reflect their own circumstances and consumption patterns.

The Economic Regulator also notes that there may be metering costs involved in moving between different electricity tariffs and that these costs would be met by customers. The Economic Regulator notes that this is broadly in line with the current arrangements in relation to Aurora Energy's Pay As You Go product which, after a three month trial period, requires customers to pay for the cost of changing meters. In this regard the Economic Regulator notes that for 2015-16 these charges, as approved by the AER, are outlined in Section 6 of TasNetworks' *Fee Based Services, Application and Price Guide, 2015-16* available at: <https://www.tasnetworks.com.au/TasNetworks/media/pdf/our-network/2015-16-Fee-Based-Services-Application-and-Price-Guide.pdf>.

The Economic Regulator notes that the constraints on price movements in Section 3 of this Paper, ie the 1.5 per cent limit on incremental rebalancing and any other price change constraints adopted, apply to both existing tariffs and any new tariffs that are introduced. The Economic Regulator seeks feedback on whether the Draft Strategy needs to clearly reflect this.

Acknowledging that customers face transaction costs in changing tariffs, the Economic Regulator seeks feedback on a proposal to assess any price changes associated with ToU tariffs against the same criteria as proposed above in Section 3 of this Paper.

The Economic Regulator is seeking feedback on:

- Aurora Energy's proposed introduction of a ToU product;
- whether Aurora Energy's proposed ToU product should be a regulated standing offer tariff or as an unregulated market offering;
- whether the Draft Strategy should be amended to make it clear that constraints on price changes apply to any new tariffs in addition to existing tariffs; and
- in the event that it is decided to approve Aurora Energy proposal to include ToU tariffs as standing offer tariffs, whether price changes should be assessed against a set of criteria (see Section 3 of this Paper).



## 6 DEMAND-BASED TARIFFS

In its TSS (discussed in Section 3 of this Paper), TasNetworks considers that time-of-use demand-based network tariffs will provide a clear and effective price signal to their customers that encourage them to manage their peak demand and the impact that their use of electricity has on the cost of delivering that energy<sup>1</sup>. Demand-based network tariffs consist of a daily service charge plus one demand charge for demand in peak periods and a second demand charge for demand in off-peak periods where demand is measured as an average over 30 minute intervals<sup>2</sup>.

Aurora Energy's Draft Strategy indicates that Aurora Energy proposes introducing 'opt-in' demand-based Standing Offer tariffs commencing in Period 2 (2017-18) of the upcoming regulatory period in response to TasNetworks' anticipated introduction of demand-based network tariffs from 1 July 2017.

The Economic Regulator understands that Aurora Energy intends mirroring the network tariff structure in its proposed demand-based standing offer tariff ie the existing daily charge and consumption charge structure would be replaced by a daily service charge and peak and off-peak demand-based charges.

The Economic Regulator notes that while Aurora Energy proposes introducing demand-based tariffs on an opt-in basis, it is unclear whether in the long term Aurora Energy intends replacing existing tariffs with demand-based tariffs. As with ToU tariffs, the Economic Regulator questions whether demand-based tariffs should be treated as market offers rather than standing offer products.

The Draft Strategy does not provide details of the criteria against which any proposed demand-based retail tariffs would be assessed and approved by the Economic Regulator as part of the annual stand offer price approval processes. However the Economic Regulator understands that the demand-based tariffs would be based on network tariffs that are approved by the AER.

If the Economic Regulator is to approve demand-based products as standing offer products, then feedback is sought as to whether AER approval of the underlying network tariff is sufficient for the Economic Regulator to approve demand-based tariffs. Otherwise an alternative method of assessment will need to be developed.

The Economic Regulator notes that the constraints on price changes outlined in Section 3, ie the 1.5 per cent limit on incremental rebalancing and any other price change constraints that are ultimately adopted, apply to both existing tariffs as well as

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<sup>1</sup> TasNetworks, *Distribution Tariff Structure Statement Overview (Customer Overview) 1 July 2017 to 30 June 2019*, page 10.

<sup>2</sup> *Ibid*, page 13.

any new tariffs that may be introduced. The Economic Regulator seeks feedback on whether further details are needed in the Draft Strategy to clarify this.

More information on Aurora Energy's proposed approach to the introduction of demand-based Standing Offer tariffs can be found in section 6 of the Draft Strategy.

The Economic Regulator is seeking feedback on:

- Aurora Energy's proposed inclusion of demand-based products as standing offer products;
- Aurora Energy's proposed approach to the introduction of demand-based Standing Offer tariffs in the upcoming regulatory period; and
- whether only demand-based tariffs based on network tariffs approved by the AER should be considered for approval as standing offer products.

## 7 FUTURE TARIFFS

Section 6.3.2 of Aurora Energy's Draft Strategy notes that it does not foresee the introduction of new Standing Offer tariffs other than the ToU and demand-based tariffs (see Sections 5 and 6 above). However, the Draft Strategy refers to the emergence of new technologies such as electric vehicles and battery storage and their likely impact either during the 2016-19 regulatory period or in subsequent regulatory periods. The Draft Strategy also states that Aurora Energy intends seeking the Economic Regulator's approval to be able to propose new standing offer tariffs in response to these emerging trends as part of the annual standing offer price approval process during the 2016-19 regulatory period.

The Draft Strategy does not provide details of the criteria against which future retail tariffs would be assessed and approved by the Economic Regulator as part of the annual standing offer price approval process.

The Economic Regulator seeks feedback on whether or not future tariffs should be introduced as unregulated market products.

If the approval of future tariffs as standing offer products were to be considered, the Economic Regulator seeks feedback on whether it should assess the suitability of a potential tariff against the following criteria:

- the tariff is offered on an opt-in basis;
- the tariff is subject to the same constraints on price movements as existing tariffs;
- the tariff is solely related to the provision of retail electricity services;
- the tariff promotes efficiency and competition in the electricity supply industry;
- the introduction of the new tariff is in the interests of electricity customers;
- the tariff allows for Aurora Energy to recover the cost of providing the product to the customer;
- the tariff is transparent and clear in the way that it functions; and
- Aurora Energy has consulted with its customers prior to proposing the introduction of the tariff.

The Economic Regulator notes that Aurora Energy is currently able to offer a wide variety of energy products as unregulated market offers. The Economic Regulator is therefore seeking feedback on whether different tariff types should be regulated as standing offer tariffs.

More information on Aurora Energy's proposed approach to the introduction of demand-based Standing Offer tariffs can be found in section 6.3.2 of the Draft Strategy.

The Economic Regulator is seeking feedback on:

- whether the Economic Regulator should consider the approval of unknown future tariffs as standing offer products during the next regulatory period;
- its proposed criteria against which future tariffs would be assessed in the event that the Economic Regulator was to consider the approval of future tariffs as standing offer products.

## 8 NEXT STEPS

The Economic Regulator is seeking submissions and comments from interested parties on the Draft Strategy. Submissions will be considered prior to the Economic Regulator approving Aurora Energy's final Standing Offer Price Strategy in April 2016 and releasing the Final Report and Final Determination in that month.

After approving Aurora Energy's Standing Offer Price Strategy, the Economic Regulator will make a determination that under section 40AA of the ESI Act in respect to the maximum prices that Aurora Energy, as regulated offer retailer, may charge small customers on mainland Tasmania (including Bruny Island) under standard retail (standing offer) contracts.

Aurora Energy will then be required to submit its proposed standing offer prices for Period 1 of the regulatory period (ie 1 July 2016 to 30 June 2017) for the Economic Regulator's consideration and approval.

Submissions should be received by close of business on **1 April 2016**.

For further information on how to make a submission or comment please refer to Section 1 of this Paper.