



Statement of Reasons

on

2016 Standing Offer Pricing Investigation Final Report

and

Aurora Energy's Draft Standing Offer Price Strategy

May 2016

Printed May 2016
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ISBN 978-0-7246-5414-7

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1 INTRODUCTION

In accordance with the provisions of the *Electricity Supply Industry Act 1995* (the ESI Act) the Economic Regulator, in February 2016, released its 2016 Standing Offer Investigation Draft Report (the Draft Report), 2016 Standing Offer Draft Determination (the Draft Determination) and Draft Standing Offer Price Approval Guideline (the Draft Guideline), setting out its proposals for the regulatory period 1 July 2016 to 30 June 2019. The Regulator also released a Consultation Paper seeking comments on the proposals contained in the Draft Report, Draft Determination and Draft Guideline. The closing date for submissions was 15 March 2016.

On 9 March 2016 the Economic Regulator released Aurora Energy's Draft Standing Offer Price Strategy (Draft Strategy), along with a second Consultation Paper, for public comment. The closing date for submissions was 1 April 2016.

The following presents a summary of the Economic Regulator's amendments to the Draft Report, Draft Determination, Draft Guideline and Draft Strategy arising from comments made in the submissions. For brevity, comments supporting the proposals contained in the Economic Regulator's Draft Report or Aurora Energy's Draft Strategy have not been specifically mentioned in this Statement of Reasons.

The remainder of this Statement of Reasons sets out the Economic Regulator's decisions on the content of the Final Report, Determination, Standing Offer Price Approval Guideline and Aurora Energy's Standing Offer Price Strategy after considering comments raised in submissions.

2 DRAFT REPORT AND DRAFT DETERMINATION

This chapter outlines the issues raised in the submissions on the Economic Regulator's Consultation Paper on the Draft Report and Draft Determination, together with the Economic Regulator's response and decision on each issue.

2.1 Placement of the A_y component in the NMR formula

Maximum standing offer prices for small customers are to be set by reference to a Notional Maximum Revenue (NMR). The NMR is the notional amount of revenue, as determined by the Economic Regulator, for Aurora Energy to recover the efficient costs of supplying standard retail services to a Notional Tariff Base (NTB).

The Economic Regulator has decided that the NMR_y is to be calculated using the following formula (which is explained in more detail in Chapter 3 of the Final Report):

$$NMR_y = (R_y + WEC_y + NC_y + AEMO_y + M_y + RET_y + K_y) \times Margin_y + A_y + CF_y$$

In its preliminary submission Aurora Energy placed the NMR component A_y within the brackets in the NMR formula. As a result any adjustment approved by the Economic Regulator would receive the benefit of the retail margin reflected in the 2016 Standing Offer Draft Determination. In the Draft Report the Economic Regulator placed A_y outside the brackets, meaning that any adjustment made would not automatically include a retail margin.

Aurora Energy's submission

In its submission Aurora Energy sought confirmation as to whether the placement of A_y outside the brackets in the Draft Report and Draft Determination NMR formula was intentional.

Discussion and Regulator's Decision

Following discussions with Aurora Energy, the Economic Regulator has decided to retain A_y outside the brackets in the NMR formula. The Economic Regulator will amend the Draft Determination to clarify that Aurora Energy may include the applicable retail margin in the calculation of the adjustment value when seeking the Economic Regulator's approval for an adjustment to be included in the NMR calculation.

2.2 Retail Cost-To-Serve

The Economic Regulator sought feedback on its proposed approach to determining Aurora Energy's cost-to-serve allowance and the proposed indexation of the resultant figure for Periods 2 and 3, applying the prescribed inflationary factor methodology.

2.2.1 Churn rate assumptions

In calculating its proposed cost-to-serve allowance, Aurora Energy assumed churn rates that allow for other retailers entering the Tasmanian retail electricity market during the 2016-19 regulatory period. In its preliminary submission (which was submitted to the Regulator on 30 September 2015), Aurora Energy projected competitive churn rates for the regulatory period of 5 per cent per annum for residential customers and 10 per cent per annum for small business customers.

The Economic Regulator considered these churn assumptions to be too high, given the uncertainty as to when another retailer may move into the Tasmanian small customer electricity market during the upcoming regulatory period. The Draft Report therefore assumed an annual churn rate of 2.5 per cent for both residential and small business customers for Period 1 of the regulatory period, with Periods 2 and 3 being set based on actual customer numbers.

Submissions

Aurora Energy

In its submission to the Draft Report and Draft Determination, Aurora Energy discussed the future development of effective competition within the Tasmanian electricity retail market and how there is strong evidence that consumers will benefit from competition. Aurora Energy also stated that with retailers seeking to acquire or retain customers, this is likely to promote efficiency in the market as retailers seek to reduce costs and provide more competitive prices. Products are also more likely to develop and evolve under these circumstances. Aurora Energy then observed that in other jurisdictions (ie Victoria, South Australia and New South Wales), it has taken seven to 12 years for competition to develop. Although Aurora Energy argued this point in the context of CARC-related expenses, the point is also relevant to churn rate considerations. Aurora Energy reiterated this argument in the Economic Regulator's Draft Standing Offer Price Strategy workshop which was held on 23 March 2016.

TasCOSS

In its submission, TasCOSS expressed its disappointment that an allowance for a 2.5 per cent churn rate be allowed in the continuing absence of competition. TasCOSS stated that a churn rate (as well as other competition-related allowances) should not be allowed until such time as retail competition actually exists in the Tasmanian residential electricity market.

Discussion

In the context of Aurora Energy's reference to the length of time it has taken for competition to develop in other jurisdictions, a 2.5 per cent churn rate for Period 1 of

the upcoming regulatory period would appear, in particular, to be too high for residential customers. The Economic Regulator also recognises the current supply situation may influence a new retailer deciding to enter the Tasmanian residential electricity market.

Regulator's Decision

Given the difficulty in forecasting churn rates and therefore customer numbers, the Economic Regulator has decided to use the same methodology to calculate customer numbers for Period 1 as it proposed in its Draft Report for Periods 2 and 3 ie customer numbers will be set in reference to actual customer numbers as reported by Aurora Energy to the Australian Energy Regulator, without adjustment for, and without reference to churn rate assumptions. The Economic Regulator will make the appropriate changes to the Draft Report and Draft Determination to reflect this change.

If, as a result of a new retailer entering the Tasmanian residential electricity market, Aurora Energy sustains a material change in costs or is materially adversely affected by the change in circumstances, the Pricing Regulations provide Aurora Energy with the ability to seek the Economic Regulator's approval to either adjust (see Section 7.6.2 of the Economic Regulator's Final Report), or amend (see Section 3.3 of the Final Report), the 2016 Standing Offer Determination.

2.2.2 Exclusion of Small Contract Customer Costs

After reviewing Aurora Energy's cost allocations, the Economic Regulator identified that Aurora Energy had included costs relating to small contract customers in its standing offer operating costs budgets. In the Draft Report, the Economic Regulator proposed that costs associated with small contract customers should not form part of operating costs required to service Standing Offer customers and excluded those costs from the cost-to-serve build-up.

Aurora Energy's Submission

In its submission on the Draft Report and Determination, Aurora Energy noted that small contract customer numbers had remained in total customer numbers, despite the associated costs being removed. Aurora Energy contended that the Economic Regulator had incorrectly removed these costs in assessing an appropriate cost-to-serve allowance, on the basis that:

- these costs relate to Standing Offer customers and therefore should be included as part of the costs associated with servicing the entire Standing Offer Customer base in Tasmania as the Regulated Offer Retailer;
- the costs relate to the provision of efficient standard retail services, and do not include any competition related costs; and
- the customer numbers associated with this customer segment have remained in the Economic Regulator's denominator to calculate the cost-to-serve allowance.

Discussion

Small contract customer costs were excluded from Aurora Energy's cost-to-serve allowance in the Draft Report based on the principle that standing offer customers should not pay for costs relating to non-standing offer customers. This approach was based on the Economic Regulator's understanding, at that time, of the nature of those costs ie it appeared that Aurora Energy was including costs relating to market contract customers as standing offer costs.

However, after considering Aurora Energy's submission and re-examining these costs, the Economic Regulator has decided that the small contract customer costs and associated customer numbers should be included in standing offer calculations on the basis that these costs and customers relate to current standing offer customers and actually represent the standing offer customers that Aurora Energy expects would transfer to market contracts during the 2016-19 regulatory period if a new retailer enters the market. This decision is consistent with the Economic Regulator's decision to exclude Aurora Pay-As-You-Go (APAYG) costs and customers from the cost-to-serve allowance calculation ie APAYG customers are on market contracts and are not, therefore, standing offer customers.

Regulator's Decision

The Economic Regulator will reinsert the small contract customer costs into the cost-to-serve allowance build-up.

2.2.3 Treatment of bad debts

In its Draft Report, the Economic Regulator allowed Aurora Energy to recover the expenses associated with the recovery of bad debts to be included in the cost-to-serve allowance. However the Economic Regulator removed the bad debt expense on the basis that the risk of not recovering this revenue was accounted for in the Retail Margin, consistent with the approach taken, and agreed with by Aurora Energy, for the 2010 Determination.

Aurora Energy's Submission

In its submission on the Draft Report and Determination, Aurora Energy contended that costs relating to bad debts were recovered through the cost-to-serve in other jurisdictions and therefore, according to regulatory best practice and the Economic Regulator's benchmarking approach to determining Retail Margin, the Economic

Regulator should allow all costs associated with bad debts to be recovered through the cost-to-serve allowance.

Discussion

The Economic Regulator notes that there appears to have been some confusion in Aurora Energy's submission to the Consultation Paper that the Economic Regulator was proposing to disallow all expenses relating to bad debts as part of the cost-to-serve allowance build-up, which was not the case.

The Economic Regulator contacted the QCA, IPART and ICRC and confirmed that Aurora Energy's contention was correct ie each of these regulators had made at least some provision for bad debt expenses in their respective cost-to-serve allowances. Given that the Economic Regulator has adopted a benchmarking approach to determine appropriate retail margin and it is now clear that the other jurisdictions do not include the cost of bad debts in their retail margin, the Economic Regulator will include all relevant bad debt costs in the cost-to-serve allowance.

The Economic Regulator notes that the cost-to-serve model provided by Aurora Energy includes some non-Standing Offer bad debt costs. Only the Standing Offer-related component will be included in the cost-to-serve allowance (around 75 per cent of the total bad debt figure provided by Aurora Energy).

Regulator's Decision

The Economic Regulator will allow all costs relating to standing offer bad debts to be included in the cost-to-serve allowance.

2.2.4 Customer Acquisition and Retention Costs

In the Draft Report, the Economic Regulator proposed allowing Aurora Energy to recover a cost-to-serve allowance that included customer acquisition and retention costs (CARC). Like Aurora Energy's preliminary submission to the Draft Report, the Economic Regulator did not disaggregate CARC from the rest of the cost-to-serve allowance.

Submissions

Aurora Energy's submission

In its submission to the Draft Report Aurora Energy, referred to one of the figures (\$3.66) included in Table 6.4 of the Draft Report as representing the per customer CARC allowance that the Economic Regulator was proposing to allow Aurora Energy. This was not the case, the reference to \$3.66 per customer was included only to demonstrate the minimal impact on the cost-to-serve allowance of including CARC such as defensive campaigns and advertising (noting that the identified amounts related to Aurora Energy's internal costs only and did not include, for example, the costs of engaging external contractors to actually deliver those services).

The Economic Regulator notes from its review that there are a number of CARC items such as the costs of defensive campaigns and advertising costs embedded within

Aurora Energy's retail operating costs which the Economic Regulator could not separately identify and therefore were not accounted for in the Table.

Aurora Energy's submission on the Draft Report also sought approval to include an additional \$10 cost-to-serve allowance per customer to reflect Customer Acquisition and Retention Costs (CARC).

TasCOSS

In its submission TasCOSS stated that it was disappointed to see allowances granted to Aurora Energy in the 2013 Determination for CARC in the absence of retail competition, as it saw Tasmanian residential customers paying the costs of competition without receiving any of the benefits of competition and saw this as Aurora Energy receiving a 'windfall' of \$42 per customer by the final period of that Determination.

TasCOSS stated that it was further disappointed that there were CARC-type costs in the cost-to-serve allowance proposed in the Draft Report. TasCOSS proposed that these costs not be allowed in the 2016 Determination and not be allowed until such time as retail competition actually exists in the Tasmanian residential electricity market.

Discussion

The Economic Regulator does not consider that an increase in the CARC-related costs that Aurora Energy is allowed to recover through the cost-to-serve allowance is justified. The Economic Regulator notes that TasCOSS does not support the granting of CARC and that there was no support for an increase to the CARC allowance expressed in the community as part of the consultation process.

However, as required by legislation, the Economic Regulator will allow Aurora Energy to recover the efficient costs of operating in the current Tasmanian residential electricity market.

The Economic Regulator acknowledges that Table 6.4 of the Draft Report could be misinterpreted and that the Economic Regulator's approach towards CARC could have been more clearly explained in the Draft Report.

Regulator's Decision

The Economic Regulator has decided that there is no basis for approving the inclusion of additional CARC of \$10 per customer in the cost-to-serve allowance as Aurora Energy has requested.

Table 6.4 will be deleted from the Final Report and the Final Report will be amended to more clearly explain the Economic Regulator's approach.

3 DRAFT GUIDELINE

The Economic Regulator did not receive any comments or feedback specifically relating to the Draft Guideline as part of the consultation process.

However, the Economic Regulator reviewed the Draft Guideline and identified several changes that were required to ensure that the Draft Guideline:

- clearly outlines Aurora Energy's obligations;
- reflects current practice; and
- aligns with the Regulator's decisions as outlined in the Final Report and in the Determination.

The Economic Regulator also discussed its proposed changes with Aurora Energy to ensure that they did not raise any practical issues or place unreasonable demands on Aurora Energy in terms of it complying with the requirements of the Draft Guideline.

The major changes relate to:

- including the criteria to be applied by the Economic Regulator when considering whether to approve the proposed introduction of new standing offer tariffs (time-of-use tariffs, Demand-based tariffs and any as yet unknown future tariffs);
- including the criteria to be applied by the Economic Regulator when assessing the impact of uniform and non-uniform price changes for both existing and new standing offer tariffs;
- aligning the description of the methodology for estimating the Wholesale Electricity Price with the actual methodology;
- revising the methodology for estimating Notional Tariff Base for Periods 1, 2 and 3 of the regulatory period in accordance with the recommended approach to estimating Aurora Energy's Cost-To-Serve allowance; and
- refining the description of the Economic Regulator's methodology for determining "adjustments" (Ay) as required under Regulations 12 and 16 of the Pricing Regulations.

In addition to the above changes the Economic Regulator made a number of minor changes to correct errors and improve clarity.

4 DRAFT STRATEGY

This chapter outlines the issues raised in the submissions on the Economic Regulator's Consultation Paper on Aurora Energy's Draft Price Strategy (Draft Strategy), together with the Economic Regulator's response and decision on each issue.

4.1 Approach to Price Changes

The Economic Regulator sought 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.

Submissions

Aurora Energy

Aurora Energy did not support imposing limits on price increases for individual tariffs or tariff components on the basis that limiting price increases will:

1. necessitate the use of the retail margin to compensate any reduction in tariff revenue, thereby reducing its profitability and consequently its financial sustainability; and
2. perpetuate the current cross-subsidies between tariffs and not provide price signals to customers as to Aurora Energy's actual cost of supplying electricity at a given tariff.

Aurora Energy expressed a preference for a set of criteria to be adopted that allows the Economic Regulator to examine the overall price impacts on customers ie as the total change to a customer's electricity bill.

Aurora Energy also considered that tariff approval criteria should promote prices that reflect the actual cost of offering a particular tariff.

TasCOSS

TasCOSS did not favour limiting price increases to ten per cent per year, stating that it was concerned this may ultimately result in higher price spikes if the cap is subsequently lifted. In addition TasCOSS is concerned that any limit of price increases may become a target rather than a limit, resulting in higher price increases than would have otherwise occurred.

TasCOSS stated a preference for a criterion-based assessment combined with Aurora Energy's proposed 1.5 per cent rebalancing limit.

TasNetworks

TasNetworks did not support either of the Economic Regulator's proposals in its submission, as neither of the approaches specifically addressed the issue of tariff prices changing to reflect underlying costs. However, TasNetworks did acknowledge that customer impacts need to be considered when changing tariff component prices in order to avoid price shocks.

Tasmanian Renewable Energy Alliance

TREA stated that changes in pricing should be implemented over a period of time and that it supports any regulatory option that avoids rapid changes in existing tariffs.

Tasmanian Government

In its submission the Tasmanian Government expressed support for the transitional approach outline by Aurora Energy, in its Draft Strategy, ie. to improve the cost reflectivity of standing offer tariffs, and noted that the approach is consistent with the Tasmanian Government's Energy Strategy objectives. The Tasmanian Government also stated that the transition should align with the process for distribution network price changes (commencing from July 2017) and that it is important that consumers do not face price shocks.

Discussion

The Economic Regulator considers that assessing price changes against a set of criteria provides the Economic Regulator with flexibility to respond to circumstances surrounding a proposed price change.

The Economic Regulator acknowledges that due to the subjective nature of the assessment criteria, there is a risk that it may be more difficult for the Economic Regulator to reject significant price increases compared to limiting price changes. However, noting the submissions on this issue, the Economic Regulator considers assessment criteria to be preferable to a price cap.

The Economic Regulator acknowledges Aurora Energy's comment that a set of criteria adopted should allow the Economic Regulator to examine the overall price impacts for customers. The Economic Regulator will therefore include assessment criteria in the Draft Guideline which requires the assessment of the overall price impact on customers to consider both the total change to a customer's bill and any changes to tariff components.

Regulator's Decision

The Draft Guideline will be amended to include criteria and require Aurora Energy to provide sufficient information that will enable the Economic Regulator to assess price impacts for customers and the respective advantages and disadvantages of the

proposed price change. These criteria and requirements will be grouped into the following three categories:

- uniform price changes to standing offer prices;
- non-uniform price changes to standing offer prices (reflecting that the underlying costs for different standing offer prices may change at different rates); and
- introduction of new tariffs (time-of-use (ToU), demand-based and as yet unknown future tariffs).

The criteria for existing tariffs to be assessed against as part of the annual price approval process are listed below (the criteria for new tariffs are discussed in Section 4.3 of this Statement).

For proposed uniform price changes, the Standing Offer Pricing Proposal must:

1. set out and describe the tariffs and charges that will apply for the relevant period, including the terms and conditions that will apply to each tariff and charge;
2. set out for each tariff the draft standing offer prices that are proposed to apply for the relevant period;
3. detail and justify any proposed changes to the tariffs and charges including any changes to definitions, terms and conditions that are to apply, and;
4. demonstrate the impact on a typical customer's electricity bill including any changes to tariff components.

For proposed non-uniform price changes, the Standing Offer Pricing Proposal must:

1. demonstrate how the proposed price changes meet the following price impact assessment criteria:
 - (a) the price changes promote efficiency and competition in the electricity supply industry;
 - (b) the price changes are in the long-term interests of electricity customers;
 - (c) the price changes enable Aurora Energy to recover the cost of providing the product and/or service to the customer, and;
2. demonstrate the impact on a typical customer's electricity bill including any changes to tariff components.

4.2 Tariff 34: Nursing Homes Light and Power

The Economic Regulator sought feedback on Aurora Energy's proposal to make Tariff 34 obsolete and whether the Price Strategy should clarify that customers on Tariff 34 will remain on this Tariff until they elect to move to an alternative tariff.

Submissions

Aurora Energy

In its submission Aurora Energy agreed with the Economic Regulator's proposal to change the Draft Strategy to clarify that no new customers will be supplied under Tariff 34 and existing customers will remain on Tariff 34 until they elect to move to an alternative tariff. Aurora Energy stated that it will ensure that this commitment is clear in its Final Price Strategy.

TasCOSS

TasCOSS requested that the Price Strategy state clearly that customers currently on Tariff 34 will remain on the tariff until they elect to move to an alternative tariff.

TasNetworks

TasNetworks supported the plan to make Tariff 34 obsolete and to ultimately abolish the tariff as this would be consistent with its network tariff strategy and the network pricing principle that customers with similar connection and usage profiles should be treated on a consistent basis.

Regulator's Decision

The Economic Regulator will require Aurora Energy to amend the Draft Strategy to clarify that customers on Tariff 34 will remain on this Tariff until they elect to move to an alternative tariff. The Economic Regulator also approves Aurora Energy's proposal to make Tariff 34 obsolete given the abolition of the underlying network tariff.

Additionally, as there are existing customers on this tariff Aurora Energy's annual standing offer price schedule will need to continue to present fixed and variable charges for this tariff.

4.3 New Standing Offer Products

In its Draft Price Strategy Aurora Energy proposed that ToU and demand-based tariffs be offered as standing offer products rather than market contracts.

The Economic Regulator sought feedback on Aurora Energy's proposed introduction of ToU, Demand-based tariffs and as yet unknown future tariffs as standing offer products.

Aurora Energy

In its submission Aurora Energy supported applying a consistent approach to the approval of tariffs and suggested that the approval of a new Standing Offer ToU tariff and also Demand-based tariffs be undertaken on the same basis as the review and approval of the current schedule of tariffs.

Aurora Energy also noted that its proposal for a demand-based tariff is solely based on the 'Residential time of use demand tariff' proposed by TasNetworks in its Tariff Structure Statement.

TasCOSS

TasCOSS supported the introduction of an opt-in ToU tariff as a standing offer tariff on the condition that all terms and conditions must be made clear so that customers are fully informed prior to taking up the tariff.

TasCOSS was however concerned about Aurora Energy's conflicting proposals to introduce ToU tariffs while at the same time increasing the daily supply charge relative to variable charges for all standing offer tariffs. TasCOSS believed that increasing the daily supply charge works against customers being able to benefit from ToU pricing and could result in confusion amongst customers. In this context, TasCOSS urged Aurora Energy to reconsider its proposed tariff structure.

TasCOSS stated that it supports the introduction of demand-based tariffs however its support is conditional on:

- robust consumer impact modelling be undertaken and made public;
- for consistency and simplicity, the retail demand-based tariff should mirror TasNetworks' proposed demand-based ToU network tariff in relation to its time-of-use periods (including off-peak weekends);
- the tariff remains a product of choice, that is, the tariff is available on an opt-in basis;
- the billing cycle for the demand-based retail tariff is monthly, to enhance the ability of customers to link their demand to their costs in a realistic timeframe; and
- clear, comprehensive and easy to understand information about the demand-based time-of-use tariff is provided to customers to enable them to consider whether the tariff will suit their circumstances and to ensure that they are able to provide explicit and informed consent.

TasCOSS were unsure whether this type of tariff should be offered as a regulated standing offer or as a market contract. However in the instance the Economic Regulator decides to allow a demand-based tariff as a standing offer product, TasCOSS recommended that the Economic Regulator develop a method for assessing tariffs similar to that used by the AER for assessing the underlying network tariff, as network and retail tariffs may differ from one another and there may be different criteria for approval of a retail tariff.

TasCOSS considered that the Draft Strategy should be amended to clarify that the proposed ToU tariffs, demand-based tariffs and all new tariffs will also be subject to the 1.5 per cent limit on rebalancing increases.

In addition, TasCOSS stated that it was uncertain whether future tariffs should be approved as standing offer tariffs or be offered as market contracts, but agreed that if the Economic Regulator decided to consider additional standing offer tariffs in the future, then the proposed criteria should be used to assess them.

Tasmanian Government

In its submission, the Tasmanian Government expressed its support of the introduction of new standing offer ToU tariffs. The Tasmanian Government stated that the standing offer process provides confidence and oversight, giving customers more confidence to elect to opt in to new tariff structures. The Tasmanian Government also stated that having a choice between existing tariffs and a new ToU tariff will also allow consumers, including those with solar PV installations, to choose the tariff product that best suits their circumstances. In addition, consumers with grid-connected solar PV systems will be able to offset solar generation against on-site consumption.

TasNetworks

TasNetworks supported Aurora Energy's proposal to introduce ToU and demand-based standing offer tariffs and for those tariffs to be made available on an opt-in basis, as this will align with the ToU network tariffs TasNetworks either currently offers and is planning to offer from 1 July 2017.

TasNetworks also contended that as Tasmanian customers are unfamiliar with market contracts providing cost-reflective ToU tariffs as regulated standing offer products would provide customers with reassurance.

Energy Networks Association

The ENA expressed support for best practice regulation as agreed by COAG whereby regulatory intervention occurs on the basis of demonstrated need and is fit for purpose, without unnecessary impacts on competitive markets.

The ENA believed that the Economic Regulator should take into account the circumstances of the Tasmanian electricity market with Aurora Energy holding a dominant position across all markets when considering the regulatory framework for retail pricing.

Tasmanian Renewable Energy Alliance

TREA expressed support for the introduction of a ToU tariff and a demand-based tariff as a regulated standing offer tariff to ensure that it is available to all customers with adequate consumer protection.

TREA considered that these tariffs should be introduced on an opt-in basis and these tariffs would provide a number of benefits, including an incentive for the Tasmanian electricity industry to offer new production and services, as well as providing customers with an incentive to modify their consumption in a which saves them money and reduces long term network costs.

TREA also stated that it was not opposed to the introduction of additional tariff types provided:

- that they are offered on an opt-in basis,
- that customer impact modelling is undertaken; and

- the metering implications of introducing new tariff types is taken into account.

TREA also supported the adoption of the criteria proposed by the Economic Regulator for assessing future tariffs.

Discussion

The Economic Regulator notes the support provided by submitters for both ToU and demand-based tariffs to be offered as standing offer products. The Economic Regulator considers that the risks associated with approving these offerings as standing offer products is low. Additionally, in a market where customer choice is limited, having ToU and demand-based tariffs as standing offer tariffs does, at least, provide customers with some choices in relation to meeting their energy requirements.

The Economic Regulator also notes that there is also support for future tariffs to be treated as standing offer products.

Regulator's Decision

The Economic Regulator will allow Aurora Energy to propose ToU and demand-based tariffs as standing offer products.

However, the Economic Regulator will require Aurora Energy to amend its Draft Strategy to state that ToU and demand-based tariffs will be subject to the same assessment framework as existing tariffs and any constraints on price changes will also apply to any new tariffs in addition to existing tariffs. Aurora Energy will also be required to amend its Draft Strategy to clarify that only demand-based tariffs based on network tariffs approved by the AER will be considered for approval as standing offer products, where applicable.

The Economic Regulator will also amend its Draft Guideline to include the following criteria which it will use to assess the suitability of future tariff types proposed by Aurora Energy as part of the annual price approval process:

- the tariff is offered on an opt-in basis;
- the tariff is subject to the same constraints on price movements as those that may apply to existing tariffs;
- the tariff reflects the relevant underlying costs;
- the tariff is not linked to the provision of non-electricity services or products;
- the tariff promotes efficiency and competition in the electricity supply industry;
- introduction of the new tariff is in the long-term interests of electricity customers;
- the tariff price/s enables Aurora Energy to recover the cost of providing the product to a customer;

- the description of the tariff and the terms and conditions are provided in clear, easily understood language;
- Aurora Energy has consulted with its customers on the proposed new tariff; and
- adequate modelling has been conducted to determine the impact of the proposed new tariff on typical customers.

4.4 Pricing period for Time-of-Use Tariffs

In its Draft Strategy Aurora Energy presented an example of ToU tariffs with three separate pricing periods - peak, shoulder and off-peak. This structure was based on 2015-16 network tariffs. However, TasNetworks' proposed network tariff structure for 2016-17 includes only two pricing periods: peak and off-peak.

Submissions

Subsequent to its submission to the Consultation Paper on the Draft Strategy, Aurora Energy advised the Economic Regulator that it will amend its proposal to align with the pricing periods for ToU network tariffs in the interests of simplicity and avoiding customer confusion.

In their respective submissions, TasCOSS and TREA also supported a two pricing period model rather than three pricing periods, for the same reasons cited by Aurora Energy.

Discussion and Regulator's Decision

The Economic Regulator agrees with Aurora Energy's desire to maintain consistency with network tariffs and considers a two pricing period model appropriate. The Economic Regulator also notes the support for a two pricing period model in the submissions therefore requires Aurora Energy amend its Draft Strategy to reflect two pricing periods for any proposed ToU products.

4.5 Move from Uniform Price Changes to Cost-Reflective Tariffs

In its Draft Strategy Aurora Energy nominated a proposed move from uniform price changes to price changes which reflect the cost for providing individual tariffs as one of the key principles of the Strategy. In the Draft Strategy this process was intended to begin in Period 1 of the regulatory period.

In its submission to the Consultation Paper on the Draft Strategy, Aurora Energy recommended that the move to more cost-reflective pricing be delayed for one year ie commencing in Period 2 of the regulatory period.

The Economic Regulator understands that this change has occurred as a result of feedback Aurora Energy received from stakeholders at the Economic Regulator's workshop on the Price Strategy, which was held on 23 March 2016. As a result of this feedback, Aurora Energy stated that it now has a greater understanding of the time required to successfully implement a new tariff setting framework that is well

understood by its stakeholders and Aurora Energy will use this additional time to consult with, and communicate the changes to, customers.

Discussion

The Economic Regulator supports Aurora Energy's recommendation and considers that more time is needed to communicate the changes to customers. However, the Economic Regulator notes that at the Price Strategy workshop of 23 March 2016 the Tasmanian Small Business Council was very supportive of Aurora Energy moving towards cost-reflective tariffs as soon as possible, as these changes are likely to benefit its members.

Regulator's Decision

The Economic Regulator will require Aurora Energy to amend its Draft Strategy to reflect the fact that the move from uniform price changes to cost-reflective tariffs will not commence until Period 2 of the regulatory period.

The Economic Regulator will also amend its Draft Report to reflect this change.

5 SUMMARY OF AMENDMENTS FROM PUBLIC SUBMISSIONS

The following table summarises the amendments to the Draft Report, Draft Determination and Draft Strategy arising from comments made in submissions. A reference is included to where these amendments are discussed in this paper.

Draft Report and Determination Consultation Paper Section reference	Amendments to Draft Report/Draft Determination
Section 2.1 of this Statement	The Economic Regulator will amend the Draft Determination to clarify that Aurora Energy may include the applicable retail margin in the calculation of the adjustment value when seeking the Economic Regulator's approval for an adjustment to be included in the NMR calculation.
Section 6 (Section 2.2.1 of this Statement)	The Economic Regulator will amend the Draft Report and Draft Determination so that the same methodology is used to calculate customer numbers for Period 1 as was proposed in the Draft Report for Periods 2 and 3 ie customer numbers are to be set in reference to actual customer numbers rather than based on a churn rate assumption.
Section 6 (Section 2.2.2 of this Statement)	The Economic Regulator will amend the Draft Report so that small contract customer costs are reinserted into the cost-to-serve allowance cost build-up.
Section 6 (Section 2.2.3 of this Statement)	The Economic Regulator will amend the Draft Report to allow all costs relating to standing offer bad debts to be included in the cost-to-serve allowance.
Section 6 (Section 2.2.4 of this Statement)	The Economic Regulator will amend the Draft Report to delete Table 6.4 and to more clearly explain the Economic Regulator's approach.
Section 3 (Section 4.1 of this Statement)	The Economic Regulator will amend the Draft Guideline to include criteria and require Aurora Energy to provide sufficient information that will enable the Economic Regulator to assess price impacts for customers and the respective

Draft Report and Determination Consultation Paper Section reference	Amendments to Draft Report/Draft Determination
	<p>advantages and disadvantages of the proposed price change. These criteria and requirements will be grouped into the following three categories:</p> <ul style="list-style-type: none"> ▪ uniform price changes for both existing and new standing offer tariffs; ▪ non-uniform price changes for both existing and new standing offer tariffs; and ▪ Introduction of new time-of-use (ToU), demand-based and as yet unknown future tariffs. <p>The Economic Regular will amend the Draft Guideline to include the following criteria for existing tariffs to be assessed against as part of the annual price approval process:</p> <p>For proposed uniform price changes, the Standing Offer Pricing Proposal must:</p> <ol style="list-style-type: none"> 1. set out and describe the tariffs and charges that will apply for the relevant period, including the terms and conditions that will apply to each tariff and charge; 2. set out for each tariff the draft standing offer prices that are proposed to apply for the relevant period; 3. detail and justify any proposed changes to the tariffs and charges including any changes to definitions, terms and conditions that are to apply, and; 4. demonstrate the impact on a typical customer's electricity bill including any changes to tariff components. <p>For proposed non-uniform price changes, the Standing Offer Pricing Proposal must:</p> <ol style="list-style-type: none"> 1. demonstrate how the proposed price changes meet the following price impact assessment criteria:

<p>Draft Report and Determination Consultation Paper Section reference</p>	<p>Amendments to Draft Report/Draft Determination</p>
	<p>(a) the price changes promote efficiency and competition in the electricity supply industry;</p> <p>(b) the price changes are in the long-term interests of electricity customers;</p> <p>(c) the price changes enable Aurora Energy to recover the cost of providing the product and/or service to the customer, and;</p> <p>2. demonstrate the impact on a typical customer’s electricity bill including any changes to tariff components.</p>
<p>Section 4 (Section 4.2 of this Statement)</p>	<p>Aurora Energy will amend the Draft Strategy to clarify that customers on Tariff 34 will remain on this Tariff until they elect to move to an alternative tariff. The Economic Regulator also approves Aurora Energy’s proposal to make Tariff 34 obsolete given the abolition of the underlying network tariff.</p> <p>Additionally, as there are existing customers on this tariff Aurora Energy’s annual standing offer price schedule will need to continue to present fixed and variable charges for this tariff.</p>
<p>Sections 5 & 6 (Section 4.3 of this Statement)</p>	<p>Aurora Energy will amend the Draft Strategy to state that ToU and demand-based tariffs will be subject to the same assessment framework as existing tariffs and any constraints on price changes will also apply to any new tariffs in addition to existing tariffs.</p> <p>Aurora Energy will amend the Draft Strategy to clarify that only demand-based tariffs based on network tariffs approved by the AER will be considered for approval as standing offer products, where applicable.</p> <p>The Economic Regulator will amend the Draft Guideline to include the following criteria by which the suitability of future tariff types proposed by</p>

Draft Report and Determination Consultation Paper Section reference	Amendments to Draft Report/Draft Determination
	<p>Aurora Energy as part of the annual price approval process will be assessed:</p> <ul style="list-style-type: none"> (i) the tariff is offered on an opt-in¹ basis; (ii) the tariff is subject to the same constraints on price movements as those that may apply to existing tariffs; (iii) the tariff reflects the relevant underlying network tariffs; (iv) the tariff is not linked to the provision of non-electricity services or products; (v) the tariff promotes efficiency and competition in the electricity supply industry; (vi) introduction of the new tariff is in the long-term interests of electricity customers; (vii) the tariff price/s enables Aurora Energy to recover the cost of providing the product to a customer; (viii) the description of the tariff and the terms and conditions are provided in clear, easily understood language; (ix) Aurora Energy has consulted with its customers on the proposed new tariff; and (x) adequate modelling has been conducted to determine the impact of the proposed new tariff on typical customers.
Section 5 (Section 4.4 of this Statement)	Aurora Energy will amend its Draft Strategy to reflect the change from three to two period pricing in relation to time-of-use tariffs.

¹ References to customers opting in and choosing to be supplied under new standing offer tariffs do not relate to customers moving premises. Where customers move premises, Aurora Energy will impose charges based on standing offer tariffs that align with the meters at those premises. Customers wishing to change tariffs may incur metering costs.

Draft Report and Determination Consultation Paper Section reference	Amendments to Draft Report/Draft Determination
Section 4.5 of this Statement	<p>Aurora Energy will amend its Draft Strategy to reflect the fact that the move from uniform price changes to cost-reflective tariffs will not commence until Period 2 of the regulatory period.</p> <p>The Economic Regulator will also amend its Draft Report to reflect this change.</p>

5.1 Additional changes

In addition to the specific changes discussed in this document, a limited number of other changes have been made to the Draft Report, Draft Determination, Draft Guideline and Draft Strategy to correct minor errors and to improve clarity