



Submission on

OTTER Retail Electricity Standing Offer Methodology Review

Draft Approach Paper

Prepared with the Assistance of



14 May 2021

Acknowledgement and Disclaimer

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1 INTRODUCTION

The Tasmanian Economic Regulator (TER) has published a Draft Approach Paper for its forthcoming 2022 regulated Retail Electricity Standing Offer Price Investigation and Determination. Aurora Energy (Aurora) is the sole retailer required to provide regulated Standing Offer prices to Tasmania’s residential and small business customers. The Draft Approach Paper sets out the methodology and approach that the TER intend to apply to the investigation. Given that most residential and small business customers in Tasmania remain on regulated retail standing offer tariffs, this price investigation will have a major bearing on what small consumers pay for their electricity over the next regulatory period commencing on 1 July 2022.

The Tasmanian Council of Social Services (TasCOSS) and the Tasmanian Small Business Council (TSBC) have joined together to provide this submission on the Draft Approach Paper. We welcome the role of the TER in investigating retail standing offer prices and the opportunity afforded by the TER to respond to its proposed approach.

1.1 OUR INTEREST IN THE INVESTIGATION

TasCOSS and the TSBC represent a broad range of the small electricity customer base in Tasmania. TasCOSS has a direct interest in the 97,000 Tasmanian customers who are in receipt of an electricity concession and also has a strong interest in the outcome of the 2022 review on the 151,000 non-concession residential customers, some of whom are on low incomes or otherwise experience energy vulnerability. TSBC represents small business and has a strong interest in the outcomes of the review on the 38,000 small business electricity customers in Tasmania.

At the end of 2019, the great majority of small customers (245,000 or 98.5 per cent per cent of residential and 37,500 or 87.6 per cent of small business customers) in Tasmania remained on regulated standing offers. The TER’s Standing Offer pricing investigation is therefore of significant interest to us and our constituents, beginning with the methodology which the TER will be applying to its investigation as set out in the Draft Approach Paper.

Whilst a few new retailers have entered the Tasmanian retail electricity market recently and are providing a modicum of choice to small electricity customers in Tasmania, this remains limited and their continued operation in Tasmania is not yet assured. Small customers therefore remain highly reliant on regulated standing offers and these continue to play a major role in what they pay for their electricity. As the Draft Approach Paper remarks:

“Regulated prices provide a safety net price for small customers, and are the maximum prices that Aurora Energy can charge small customers under a standard retail contract.” (p. 7)

We note the TER’s comment in the Draft Approach Paper that:

“The Regulator’s objectives under the ESI (Electricity Supply Industry) Act include promoting efficiency and competition while at the same time protecting the interests of electricity consumers. In balancing these objectives, the Regulator is mindful of ensuring that prices do not restrict competition, but are set at a level which reflects efficient costs.” (p. 7, our parenthesis)

Whilst we support the need to promote more competition in the Tasmanian retail electricity market and recognize that the setting of Standing Offer tariffs plays a role in attracting new entrants into the market, we also believe that the TER must ensure its assessment of the competitive environment does not push retail standing offer prices higher than necessary and weaken the safety net they provide..

1.2 STRUCTURE OF OUR SUBMISSION

The remainder of our submission is structured as follows:

- Section 2 comments on the TER's overall approach to this methodological review.
- In Section 3 we comment on the cost build-up approach.
- Section 4 addresses the issue of customer numbers and load.
- The cost components used by the TER in setting Aurora's revenue and standing offer prices are the subject of Section 5.
- Finally, Section 6 comments of the issues of Aurora's Standing Offer Price Strategy, the Annual Price Approvals process, the length of the Regulatory Period and treatment of Aurora's Preliminary Submission.

2 TER'S APPROACH TO THE METHODOLOGICAL REVIEW

The TER proposes to make a number of fairly modest changes to the current methodology. All things considered this may be appropriate, but we find it difficult to draw firm conclusions because the option of a more fundamental review of the current approach has received little attention in the Draft Approach Paper. In addition, as the paper notes:

"This review is particularly relevant as the 2016 Determination was made almost five years ago. During this period, the expiry date of the 2016 Determination has been extended twice by the Tasmanian Government. The regulatory framework has also been subject to various changes and interventions that have affected Aurora Energy's annual pricing proposals and the Regulator's assessment and approval of those proposals." (p. 6)

In view of the above and the significant impact of regulated standing offers on small Tasmanian electricity consumers, we support the need for the TER to review the current approach. However, we would have also welcomed a more fundamental review of the methodology that discussed the pros and cons of alternatives and an opportunity for consultation on this.

3 COST BUILD-UP METHODOLOGY

The TER currently uses a cost build-up methodology to determine Aurora's notional maximum revenue (NMR). This is applied to a notional tariff base (NTB) to determine maximum prices. The TER proposes to continue to use this approach on the basis that it:

- Meets the legislative requirements.
- Is transparent.
- Is relatively simple.
- Is used by other regulators to regulate electricity prices and is a well-established and accepted methodology.

We provide the following comments on these points:

- Whilst the current approach meets the legislative requirements, there are other approaches that also meet them. There is limited discussion of this in the Draft Approach Paper and we are left wondering which approach best serves consumers' needs.
- We agree that the current approach provides a degree of transparency and simplicity, however, how other approaches compare is not discussed. In this regard, we note that the current approach is not transparent and simple to consumers, thus creating an element of consumer information asymmetry.
- It is not disputed that the TER's approach is a well-established and accepted methodology in use by other regulators. However, this is not a guarantee that it delivers the best possible outcome to small consumers. It is also possible that there is a circularity in this argument, with broad acceptance across regulators locking in less-than-optimal outcomes for consumers. We discuss some of the issues with specific components of the cost build-up approach in Section 5 of this submission.
- As mentioned in the Draft Approach Paper, it has been five years since the last approach review, with some significant changes that impact the TER's pricing investigation having taken place in the interim. However, the impact of these on the cost build-up methodology is not discussed.
- If this method is to be used then Aurora should report on cost reductions that it has achieved. For example, these may come from more efficient purchasing practices by Aurora, efforts to lower the cost of borrowings or other cost efficiencies.

Given the timing of the TER's pricing investigation, we somewhat reluctantly accept the TER's proposal to continue with the cost build-up approach but not without qualification.

4 CUSTOMER NUMBERS AND LOAD

Customer numbers and customer load are used in estimating a number of the cost components that are, in turn, used in determining maximum prices. We discuss our position on the TER's proposals on each of these below.

4.1 CUSTOMER NUMBERS

We note that for the 2016 pricing investigation, the TER changed its previous approach of relying on a forecast of customer numbers for the next price period, to using actual customer numbers at a point in time, and accounting for a change in customer numbers in retrospect rather than in advance. The change was proposed due partly to concerns about the accuracy of the forecasts, and partly due to all customers in Tasmania having the option of choosing an unregulated market contract, if offered. With the introduction of competition, the forecast customer numbers needed to factor in customers changing to and from market retail contracts. This made forecasting customer numbers more difficult. TER therefore decided to use, for the following year, the customer numbers as at 31 March as provided by Aurora Energy to the AER each year.

The TER is now proposing to return to a forecast of customer numbers. Options canvassed include taking the mid-point of forecast customer numbers at the start and end of the relevant year, or taking the mid-point of actual customer numbers as at 31 March before each year and a forecast as at 31 March during the year. The TER propose to use the latter, although there is little discussion about the pros and cons of each option.

We can see that the use of a hybrid approach involving the mid-point of an actual and a forecast number would help to overcome some of the TER's concerns about the impact of forecasting errors on the NTB, which we share. We also note that very low customer churn in Tasmania in the intervening years has not been as significant a factor in forecasting Aurora's customer numbers as the TER envisaged.

The Draft Approach Paper points out that, under the current approach, different customer numbers are used to calculate different cost components. The TER considers that all cost components that relate to customer numbers, which includes load and billing days, should be calculated on a consistent basis, as it is undesirable for different customer numbers to be used to calculate different cost components which may impact on prices. We concur with this view and support the TER's proposal.

4.2 LOAD

The TER proposes that the load in the NTB is a forecast of the total amount of electricity consumed by the forecast number of customers over the 12-month period from 1 April to the following 31 March. This appears to be a sensible approach provided robust data is used.

5 COST COMPONENTS

In this section we respond to the TER's proposed approach to each of the cost components used in the cost build-up approach, namely, wholesale costs, network costs, renewable energy target (RET) costs, metering costs, retail costs (cost-to-serve and retail margin), AEMO costs and adjustments.

5.1 WHOLESALE ELECTRICITY COSTS

The TER proposes to retain the current approach to setting the Wholesale Electricity Cost used in determining Aurora's annual NMR. This involves:

- Recognising that hedging by a prudent retailer is likely to involve progressively building its contract book over a period of time and the TER has therefore developed a weighted average method for calculating the single Wholesale Electricity Price (WEP) to apply for the year.
- Including provision for transmission and distribution loss factors given that electricity flows involve losses and requires Aurora to use the loss factors published by AEMO each year.
- Application of the WEP to the loss adjusted electricity load (discussed in Section 4.2).

We support the approach to loss factors and recognise the inherent appeal of the weighted average method of calculating a single WEP. However, we note that the approach taken to the WEP is rather convoluted and difficult for consumers to understand.

In relation to the WEP, we wish to raise an important concern regarding the impact of the current method in a market with low and falling wholesale prices, whilst recognising that regulatory approaches can never accurately predict market dynamics and forecast where a market might head.

The TER's current approach essentially sets a WEP for up to a year in advance using a load following swap instrument based on Victorian wholesale electricity prices.

This method has the potential to benefit small Tasmanian electricity consumers when wholesale prices are high and increase further than expected in the year ahead. This was the case in 2017/18 and 2018/19. However, since then the wholesale price in Victoria has steadily fallen to record low levels. Furthermore, it has continued its fall in 2020/21 beyond the expectations of the market. The TER set the WEP for 2020/21 at 7.962 cents per kilo Watt hour (c/kWh) in May 2020. We note that the current average spot price in Victoria is sitting at around 4.1 c/kWh, whilst Q1 base contract prices for Victoria are around 2.5 c/kWh and that wholesale prices have continued to fall throughout the current financial year. These outcomes are well below the WEP used in the WEC. This suggests that small electricity consumers in Tasmania have been paying too much for their electricity throughout 2020/21 due to rigidities and shortcomings in the current regulatory approach, recognising that these effects could also work in the favour of small customers in a rising wholesale electricity market. Meanwhile, electricity consumers in Victoria on market contracts have had access to significant reductions in their electricity prices throughout 2020/21.

We trust that the TER can respond to this concern in its approach to its forthcoming price investigation and in its application of the WEC approach to annual price setting.

5.2 NETWORK COSTS

The TER propose to continue with the current approach, which is that the network cost component of Aurora Energy's NMR is determined by multiplying the applicable TasNetworks network tariff by forecast billing days and customer load for each retail tariff and then summing the resultant values. We have no objections to this approach continuing.

However, the TER proposes reconciling the billing days used in deriving network costs with the forecast of the customer numbers used in the NTB, i.e., the billing days used when forecasting network costs are to relate directly to the number of customers forecast in the NTB. We support this method.

5.3 RENEWABLE ENERGY TARGET COSTS

We have considered the discussion in the Draft Approach Paper on the treatment of RET costs and the proposal to continue with the same approach. We note that other regulators use much the same method, although there are some differences.

However, compared to its current approach, in estimating the price of Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs), the TER proposes using forward prices for each price period at a point in time close to the time when standing offer prices are approved for the following period. Moreover, the Draft Approach Paper notes that the TER may need to engage a consultant or purchase data to estimate forward prices. *Prima facie*, we believe that an approach that is based on the latest available LGC and STC data should be a preferable one and should be seriously considered.

In our view, the objective should be to use the most robust and accurate estimate of LGC and STC prices possible and one that minimises the cost of the RET. Consumers should benefit from such an approach through lower prices.

We appreciate that the TER's proposal is intended to achieve such an outcome for regulated standing offer prices in Tasmania and that the complexities of the RET scheme, its operation and its markets make this a challenging task for retail price regulation. The Draft Approach

Paper discusses some of the advantages it sees in its proposed changes to the treatment of RET costs and, as noted above, we believe that these are worthy of serious consideration.

It is also worth noting that the submission from Aurora is opposed to these proposals. From a small consumer point of view, we particularly note its comments that:

- The LGC market is volatile and prudent retailers not only purchase their LGC obligations through the forward market but also through long-term PPAs, which the TER's proposal has not taken into account. We would be interested in the TER's response to this but we note that the objectives of the TER, as regulator, do not and should not necessarily always align with those of Aurora.
- Whilst LGC market prices currently sit below Aurora's LGC purchase costs, this does not recognise that longer term PPA's are no less efficient than the TER's proposal whilst also reducing customer exposure to RET market volatility. In comparing the outcome over the past 12 years, Aurora says that prices under its actual approach compared to the 12-month average spot price of LGCs are "just 1.6 per cent higher" and suggest that lower volatility compensates for this. Taken over 12 years, this is not an insignificant impact on standing offer prices. They have not quantified their claim on volatility.
- Aurora also says that over the period 2015 to 2018, when LGC market prices were high, its PPAs resulted in LGC costs in standing offers that were 19 per cent lower. They appear not to have compared periods when market prices were low.
- Aurora also acknowledges that application of the TER's proposed approach for the remainder of the RET obligation period (until 2030), could produce an outcome where long term PPA prices may not be "comparably efficient" to market prices. We note that this would work to lower RET costs in standing offer prices.

It would be helpful if the TER could undertake its own comparative analysis of the current approach versus its proposal.

We support that the TER should consider not only the latest available RET prices but also sound out the RET markets to help verify that these are likely to result in the best possible estimate of RET costs.

We also note that, if Aurora Energy's actual RET prices over the year are different from the forward prices, this will not be included in any adjustments for over or under recoveries. We support this approach as Aurora should adopt an approach to RET costs for its small consumer load that encourages it to manage the associated risks well

We note a concern, however, that we can see little in the TER's approach that will encourage Aurora to minimise its RET costs over time whilst sharing these benefits with its small customer load. Although the proposed approach has the intent of using prices and power percentages (quantities) that are as recent and accurate as possible, it does not seem well suited to minimising RET costs. In this regard, we note the favourable impacts on consumers of the various efficiency benefit sharing schemes used by the AER in regulating network prices and raise this as a possibility for consideration by the TER in relation to the treatment of RET costs, provided these costs are amendable to such an approach.

We have concerns about the trend in RET costs going forward and these are heightened by outcomes in electricity market since 2019, with data showing that falling wholesale prices have been partially offset by the rising cost of RET obligations, including in Tasmania (see <https://energybyte.com.au/enviro-costs-surge/>). The analysis shows that this has been

driven particularly by the increased uptake of solar PV systems (with STC prices rising from \$10.55 per MWh in July 2019 to \$11.13 in May 2021) and also by an increase in the price of LGC's (from \$2.28 per MWh in July 2019 to \$6.38 per MWh in May 2021). Consequently, RET costs have increased from 15 per cent of the forward bundled Tasmanian electricity price to 28 per cent. We believe that the TER needs to consider this situation and the possibility of using the regulatory regime for Tasmanian Standing Offers to encourage Aurora to minimise its RET costs going forward.

5.4 METERING COSTS

Bearing in mind that both our organisations are interested in seeing regulated Standing Offer prices in Tasmania that result in fair, affordable and competitively-priced electricity provided to small customers, we are keen to see that metering costs reflect this. We have considered the TER's proposed approach to metering against this objective.

We note that, in a competitive market, metering costs would be driven down by competition (shown to be the case in Tasmania's larger customer base and elsewhere in the NEM) and we are seeking a similar outcome from the TER's forthcoming pricing investigation. We believe that it is important that the TER provide Aurora with regulatory incentives to achieve this and not simply pass on costs without regard to a cost minimisation objective.

We note and welcome the TER's comment in the Draft Approach Paper that"

"With respect to metering costs, the Regulator has considered the costs and benefits to customers arising from the introduction of advanced (eg Type 4) meters in Tasmania, the arrangements and experience in other jurisdictions, and the pricing of meter-related costs under market contracts in Tasmania."
(p.24)

Given the relative paucity of market contracts for small customers in Tasmania at this time, we would also encourage the TER to consider the pricing of meter-related services in other NEM jurisdictions, including those under market contracts where possible, in its pricing investigation and seek to benchmark these as a basis for setting Aurora's metering costs.

The Draft Approach Paper says that the TER is considering including in its 2022 Price Approval Guideline a requirement on Aurora Energy that the prices charged to a customer reflect the metering costs Aurora Energy incurs with respect to: the tariff(s) that customer is on; whether that customer has an advanced (e.g., Type 4) meter or meters or an accumulation (Type 6) meter or meters; and whether the advanced meter is replacing an accumulation meter that still has a useful life.

A concern we have with this proposal is that it appears to reflect the costs that Aurora incurs without any benchmarking of these costs or what constitutes efficient metering services. This would not seem to be in accord with the interests of small consumers and also appears to be at odds with the legislative requirement on the TER to promote efficiency and competition while at the same time protecting the interests of electricity consumers. Due to the limited competition, there seems to be few incentives to minimise these costs under the proposed approach and share the efficiencies gained with standing offer customers. The comparatively recent introduction of advanced meters into Tasmania makes this even more problematic.

We would urge the TER to find a better way to deliver this requirement in the 2022 pricing investigation. We have mentioned the possibility of benchmarking meter costs and it may

also develop a scheme that provides Aurora with an incentive to minimise these costs over time and share the benefits with its customers.

In the interests of transparency and given the recent introduction of advanced meters, we would favour the inclusion of a separate meter charge in customers' bills. If meter costs are to be absorbed into the daily supply or some other charge, which we would be reluctant to support, metering costs should be clearly identified in the annual price approval process.

We note that, under the TER's proposed approach, customers with an accumulation meter would face lower meter charges than those with an advanced meter. This appears to reflect lower costs associated with an accumulation meter. Whilst the principle of cost reflective charging has some attractions and Tasmania's low income and experiencing vulnerability are more likely to have an accumulation meter, this proposal also needs to consider that:

- The higher cost of an advanced meter may create a disincentive for low income and vulnerable consumers to opt for such a meter and forego any pricing benefits.
- The related proposal to replace accumulation meters with advanced meters, including under conditions of mandatory replacement, will increase charges to Tasmanians who can least afford it.
- Aurora's former PAYG customers have mandatorily had their meters replaced with an advanced meter on the understanding that this would cost no more. However, the TER's proposal would change this and increase their electricity bills. Some of these customers are on low incomes.
- Residential and small business consumers need to be in a position where they can make a well-informed assessment of the costs and benefits of installing an advanced meter and any tariff benefits this would bring. Low levels of education and literacy throughout Tasmania, particularly among Tasmanians on low incomes, means this may not be the case for these customers.

5.5 COST-TO-SERVE

We have considered the TER's approach to estimating Aurora's cost-to-serve over the next regulatory period. We note that the cost-to-serve and the retail margin (discussed in the following section) are key components of the NMR and important outcomes of the TER's forthcoming price investigation. Decisions made by the TER will have an important bearing on future Standing Offer tariffs, as well as impacting the environment for retail competition in Tasmania.

We acknowledge that the cost-to-serve approach proposed by the TER is based on a generally accepted one, using as it does, benchmarking combined with a cost build-up. Nevertheless, we have some concerns with the TER's proposal, that we discuss below.

First, the use of benchmarking raises some issues. The TER has acknowledged that benchmarking of the cost-to-serve has become more difficult as other NEM jurisdictions have moved away from regulating retail electricity prices. However, the Draft Approach Paper points out that additional benchmarking data can now be obtained from the ACCC electricity inquiry and from the setting of the DMOs and VMO (from a report on retail costs by Frontier Economics for the Victorian Essential Services Commission). Whilst this may well improve the comparative data set for benchmarking purposes, the Draft Approach Paper does not assess the veracity of these data or their suitability for robust benchmarking of the cost-to-serve. We note that there are inherent dangers in relying on a small set of benchmarks. In this case, it is a matter of potential concern that some of the benchmarks

would be based on data that is quite old (e.g., developed by IPART in 2014), has been indexed by the CPI over a number of years (rather than being recalibrated) and use the same source information, which may create circularity issues. We also note that robust benchmarking requires a consistent ‘apples with apples’ approach. We would urge the TER to undertake a robust assessment of the benchmarking it proposes to use as part of its price investigation and to share its analysis with stakeholders.

Secondly, turning to the cost build-up approach, the Draft Approach Paper proposes to calculate the cost-to-serve using cost data (presumably provided by Aurora) and compare this to its benchmarks. This raises the question of whether Aurora’s costs are efficient which, under the TER’s proposed approach will only be revealed with robust benchmarks. As the benchmarks to be used by the TER are all publicly available, they will also be known to Aurora and the TER will need to guard against any associated risks.

Thirdly, in relation to the issue of Customer Acquisition and Retention Costs (CARC), which form part of the cost-to-serve, the TER proposes to continue to provide Aurora with a CARC allowance over the next regulatory period. We note that CARC relates to the costs incurred by incumbent retailers in contestable markets where new entrant retailers endeavour to attract customers away from incumbent retailers. We also note that the cost-to-serve allowance provided to Aurora by the TER over the course of the current Determination included a CARC allowance on the assumption that Aurora would be operating in a competitive market. However, this turned out to be an overly optimistic assumption given that retail competition for small consumers has only recently emerged in Tasmania and remains very limited.

The upshot of this is that small consumers in Tasmania have been providing Aurora with additional costs (i.e., paying higher electricity prices) over most of the last six years on the basis of a hypothetical situation that retail competition exists (or would soon emerge). It is also plausible that spending this CARC allowance has inadvertently increased barriers to entry for potential new competitors.

We note that the ESC has sought to provide a CARC cost in its regulated VDO that is “modest”. We suggest that the TER needs to adopt a similar approach in relation to Aurora’s regulated Standing Offers. It should also consider that switching in Tasmania remains very low (significantly less than anywhere else in the NEM), which would appear to support a low CARC allowance. In addition, regulated Standing Offers generally do not require the more elaborate sales approach needed for market offers and generally focus on retention rather than acquisition costs, which based on Frontier’s analysis appear to account for only about 15 per cent of CARC.

We support a review of the CARC allowance to be provided to Aurora over the period of the next regulatory Determination, to ensure it is justified and (if provided) is modest and limited to retention costs.

Consideration should also be given to an adjustment to Aurora’s NMR if retail competition did not exist or was insufficient to warrant CARC expenditure in the previous year.

The TER proposes to continue the use of CPI to adjust Aurora’s annual cost-to-serve. We note that a measure of general price inflation like the CPI may not be a good measure of annual changes in the cost-to-serve. It would be useful if the TER undertook an analysis of changes in the cost-to-serve to better inform its approach.

Finally, we draw to the attention of the TER that the closure of Aurora Online during 2020, means that Aurora's standing offer customers (residential and small business) no longer have direct on-line access to their account information as part of the standing offer price. Instead, Aurora now offers a lower level of online access and uses a forms-based enquiry service where we understand that a customer service operator must frequently intervene to provide the consumer with information previously available online. We understand that the costs of Aurora Online and its replacement form part of Aurora's cost-to-serve. Aside from a concern about the change seeming to be a retrograde step for customer access and customer service, if this additional administration proves more costly, it should not be permitted to raise Aurora's cost-to-serve. The only way Aurora's standing offer customers seem to be able to avoid this cumbersome approach is to sign up for the *aurora+* app, for which they are charged an annual fee - currently \$40 each year. Hence, they must pay extra for a similar service to that previously provided as part of their Standing Offer. By way of contrast, market offer retailers in the NEM, including new entrants operating in Tasmania, often include online and app access as part of their offers.

Whilst Aurora has apparently provided free access to *aurora+* to its 30,000 YES program, we note that this does not presently extend to concession customers (of which there are around 97,000 in Tasmania).

5.6 RETAIL MARGIN

The Draft Approach Paper says that the TER intends to take the same approach to estimating Aurora's retail margin as in the 2016 Determination, namely, adopting a benchmarking approach, taking account of the risks Aurora faced in delivering retail services under standard retail contracts. Whilst we have no conceptual objection to this approach, we note that it is subject to the same practical qualifications about benchmarking as we raised in Section 5.5 in relation to the cost-to-serve. Nevertheless, we recognise that the alternative method of calculating Aurora's expected return would not appear to deliver any material advantages to Tasmanian standing offer customers.

In relation to the matter of risk adjustment to Aurora's retail margin we note that, after undertaking its analysis at the time of the 2016 pricing investigation and Determination, the TER reached the view that there should be no risk adjustment to the retail margin on the basis of either the price or volume risks faced by Aurora compared to other retailers in the NEM.

So what, if anything, has changed since then? We submit that:

- In relation to price risk, the regulatory environment facing Aurora remains essentially the same as it was. Wholesale prices at that time were very high and expected to stay high, but have now sunk to historically low levels and have kept falling. This has led to a situation in recent years where the WEP has been set far higher than actual wholesale prices in that year. Aurora has been in a position to benefit from such outcomes.
- In relation to volume risk, the TER's 2016 conclusion that variations to customer numbers, load and load profile associated with customers switching between retailers, are such that Aurora Energy will not face greater risks than retailers operating in other NEM jurisdictions still seems to be the case (noting the TER's proposed changes to approach regarding customer numbers and the cost-to-serve). The TER also concluded that it was not possible to quantify the net impact of the

effects of risks associated with changes in economic conditions, variations in weather, uptake of energy efficiency measures and competition from other fuel sources in Tasmania and other NEM jurisdictions. There appears to be no apparent reason why this has changed. Further, in relation to risks associated with customer switching due to more intense retail competition, it seems to be the case that Aurora still faces far less risk from this than retailers in other NEM jurisdictions, as the low rates of switching to date demonstrate.

The Draft Approach Paper makes the point that the retail margin is currently applied to the sum of Aurora's cost components, so that an increase in costs leads to a bigger retail margin in dollar terms and vice versa. We agree that there appears to be no justifiable reason for this. To mitigate against this outcome, the TER is therefore considering calculating the retail margin on a dollar amount per customer basis and including this amount as part of the cost-to-serve. *Prima facie* this approach seems to have some attractions to customers who would benefit from containing the impact on costs of the retail margin. We support further investigation of this proposal and look forward to the TER outlining its impacts in more detail so that it can be subject to further scrutiny, including its impacts of standing offer prices. We note that a method for calculating a retail margin on a dollar amount per customer – and presumably a discussion as its impacts – will be set out in the Regulator's draft investigation report and/or draft Determination.

5.7 AEMO Costs

We have no objection to the TER continuing with its current approach to calculating NEM fees in Aurora's NMR and support the removal of national transmission planner fees. We also support the continuation of the existing approach to determining ancillary service costs.

5.8 ADJUSTMENTS

We note the TER's desire to keep adjustments due to over- and under-recovery of Aurora's NMR to a minimum and its mention of the pricing equity considerations involved in such adjustments.

We do not object (for now) to the inclusion of K_y and CF_y components in the calculation of the NMR but intend to consider our position further, including the impacts of these adjustments on small customers. Apart from our proposals in relation to adjustments for the cost-to-serve, we support containing adjustments to network costs, metering costs, RET costs and AEMO charges to the extent that the relevant cost component per unit price is not known at the time prices are set. We also support only updating the RPP and STP in RET costs and not changing LGC and STC prices, and adjusting ancillary service charges using the actual fees, applied to the load in the NTB for that period.

We note that the TER proposes no changes to the current approach to calculating A_y . Whilst we recognise that there may be a legitimate need for adjustments due to errors or omissions, these need to be kept to a minimum and should not reward poor standards.

We have concerns about the possible application of the retail margin to adjustments, given the current application of the retail margin to all costs. The TER's proposal to add an allowance for the retail margin exclusively to the cost-to-serve may mitigate these concerns.

6 REMAINING ISSUES

In this section we address several remaining issues raised in the Draft Approach Paper in relation to the Standing Offer Price Strategy, Annual Price Approvals and the length of the Regulatory Period, and also comment on two additional issues, the treatment of Aurora's preliminary submission and the impacts of new entrants into the retail market for small customers.

6.1 STANDING OFFER PRICE STRATEGY

The TER proposes requiring Aurora Energy to submit for approval a Standing Offer Price Strategy that will apply for the regulatory period covered by the 2022 Determination. It further proposes that this include the high-level principles that would underpin its Price Strategy. We support these proposals and welcome the opportunity to respond to them.

As identified in the Draft Approach Paper, we believe that it is appropriate that this Strategy include how Aurora will meet shareholder directives and expectations, the structure of its tariffs (including the extent to which its non-electricity related costs may be recovered from fixed daily charges) and any rebalancing of standing offer prices.

6.2 ANNUAL PRICE APPROVALS

We support the continuation of an annual tariff approval process supported by a standing offer price approval guideline. We also support the release of a draft price approval guideline for public consultation during the 2021-22 price investigation.

6.3 LENGTH OF THE REGULATORY PERIOD

We welcome the TER's decision to seek comments from stakeholders and interested parties on the proposed duration of the next regulatory period.

Given that there is no legislative requirement for a specific period, the TER has some discretion in this matter. We have considered both the TER's comments on this question in the Draft Approach Paper and the impact of regulatory period length on small consumers.

Having regard to these matters, we intend to support the TER's proposal to set a three-year regulatory period, but are interested in the views of other stakeholders on this matter. We also note that the recent entry of new retailers into the Tasmanian market and uncertainty about how sustainable and beneficial to consumers their presence proves to be supports a shorter rather than longer regulatory period.

6.4 TREATMENT OF AURORA'S PRELIMINARY SUBMISSION

Consistent with the TER's 2016 price investigation and Determination, we expect that Aurora will provide a preliminary submission to the TER, but note with considerable concern that its 2016 preliminary submission was treated confidentially by the TER. We believe that it is in the interests of an open, public, transparent and fair process that this submission be made public with consumers afforded an opportunity to respond. If there are commercially sensitive issues raised, then the TER should test Aurora's claims on these and, if justified, redact relevant parts from a public version, with consumers made aware of what these areas are and why confidentiality is appropriate. It is noteworthy that the AER follows a similar approach. Public consultation on all key documentation and an opportunity for stakeholders

to respond to a preliminary submission are in the interests of the TER making well-informed decisions.

6.5 ENTRY OF NEW RETAILERS

As mentioned earlier, a few new retailers have recently entered the Tasmanian electricity retail market for small customers. According to the AER's most recent Quarterly Retail Performance Report (December 2020), residential consumers now have a choice of 3 retailers (including Aurora) and small business have a choice of 4 (including Aurora), although not all of these are what might be described as 'active'. This is far less than in other parts of the NEM. Whilst it has provided small customers with access to market contracts, discounting and customer churn remain modest at best and far less than elsewhere in the NEM. There is also a risk that this entry is being driven by opportunistic factors (e.g., low wholesale prices well below the WEP) and could easily disappear. It is made up entirely of second tier retailers with none of the 'big 3' involved.

The TER's approach to the Standing Offer price investigation and Determination will need to consider the impact of this new entry. For example, it will need to balance the desire to keep retail electricity prices as low as possible and need to continue to use Standing Offers as an affordable safety net with the realistic desire to encourage competition.