



**SUBMISSION ON AURORA'S DRAFT NETWORK
TARIFF STRATEGY (NTS)**

APRIL 2008

Suite 1, Level 2
19-23 Prospect Street
Box Hill VICTORIA 3125
Tel: +61 3 9898 3900

Email: euaa@euaa.com.au
Website: www.euaa.com.au

TABLE OF CONTENTS

1	INTRODUCTION	3
2	THE CONSULTATION PROCESS	5
3	COMMENT ON THE DRAFT NETWORK TARIFF STRATEGY	6
3.1	Changes to current tariffs	6
3.2	Specified Demand Tariff	7
3.3	Cost Allocation Principles	7
3.4	Side Constraints	8
3.5	Time-of Use Tariffs	8
3.6	KVA-based Tariffs	9

1 INTRODUCTION

The EUAA welcomes the opportunity to provide a submission on Aurora's Draft Network Tariff Strategy (NTS) document, dated 28 February 2008, and the Addendum to the draft NTS dated 19 March 2008 (both referred to as the 'draft NTS'). The EUAA understands that the NTS covering the period 1 July 2008 to 30 June 2012, once finalized, will provide the direction for annual Tariff submissions by Aurora to the Office of the Tasmanian Energy Regulator ("Regulator") until the commencement of the new regulatory period in July 2012.

The EUAA is a non-profit organization focused entirely on energy issues. The EUAA has more than 100 members. Members determine the EUAA's policy and direction, and our activities cover both National and State issues. The membership represents a wide spectrum of end users located in all States. Our members are predominantly large business users of energy with activities across all States and many sectors of the economy.

While the EUAA members have the ability to choose their energy retailers in a competitive market, network services are provided to their sites by various monopoly network businesses, whose prices and service levels are subject to regulatory oversight. In Tasmania, distribution services are provided by Aurora Networks. Accordingly, it is important for the EUAA to participate and contribute to the regulatory process to ensure that its members face network tariffs that are efficient and equitable across the board. It is in this context that the EUAA makes this submission on Aurora's draft NTS.

As the market in Tasmania opens up gradually, the process of unbundling previously bundled network and retail prices into separated energy and network tariffs is of significant interest to our members. First, our members are concerned with possible "rate shock" through a rapid acceleration in the level of network and/or energy charges. Unanticipated "rate shocks" are not good for business. Secondly, our members are concerned that there be a transparent process associated with the unbundling of network and retail charges. We are particularly concerned that, in this process, there is not a rapid escalation of network charges relative to retail charges. A transparent approach towards the unbundling of price elements can go some way to ensuring that the process is carried out in a reasonable fashion that does not prejudice the interests of Tasmanian energy users. Finally, if the network charges were to form a significant and increasing proportion of the total bill, then the benefits to customers arising from competition in the retail energy market will be reduced (or even eliminated), and diminish the gains that are available through increased competition in Tasmania.

In the process of unbundling tariffs, the key question for our members concerns price. Will the new post-June 2008 network charges plus the prevailing energy prices in the Tasmanian Region, be less than pre-June 2008 bundled prices? This is a key issue.

As mentioned in the EUAA's letter to the Tasmanian Minister for Energy dated 20 March 2008, our members in Tasmania are concerned at the significant increases in Distribution Use of System (DUoS) charges that were announced by Aurora in January 2008. Our members are also concerned about further increases in DUoS charges outlined in the draft NTS. Increased network charges of this magnitude will have a significant negative impact on energy users in Tasmania. Our members, being among the more energy-intensive users, will be most negatively affected by large and sudden tariff changes. The Tasmanian economy is heavily reliant on energy and its competitive position relative to interstate and international markets is therefore affected by

significant increases in the delivered costs of energy. We are keen to ensure that the changes to DUoS pricing arrangements are kept to a minimum and are not detrimental to Tasmania's economy.

We now turn to make some comments in relation to specific elements of the draft NTS.

2 THE CONSULTATION PROCESS

The draft NTS is dated 28 February 2008 and Aurora requested that responses to the draft NTS be submitted by 28 March 2008, a period which included the Easter break. New material, in the form of an Addendum to the draft NTS was released on 19 March 2008. While recognizing that Aurora is working to a tight timeframe, the EUAA notes that the short consultation period has somewhat curtailed the time available for the EUAA to fully consider the information contained in the draft NTS and the Addendum, consult with its members on the draft, and provide a detailed and comprehensive response. The short time frame for the consultation process and consideration of additional issues raised in the Addendum has limited our ability to respond.

We also note that the Regulator's remit does not include a requirement to authorize the NTS. There is a risk that without the requirement to obtain the Regulator's authorization, and with limited consultation with stakeholders (including large users) that are affected by the strategy, the consultation process may be less effective in allowing stakeholders to understand and develop responses to issues of concern. There is also the risk that, as a result of the short discussion period and (arguably) less-vigorous regulatory oversight, Aurora itself will be limited in its ability to respond to any concerns raised by users.

We note also that the development by Aurora of the Tariff Strategy at the end of 2007 appears to have occurred in less than ideal circumstances. From publicly available material, we can see that there appears to be a severely curtailed public consultation process associated with the approval by the Regulator of Aurora's NTS (for the period 1 January 2008 – 30 June 2008) at the end of 2007. This resulted in the regulator approving network tariffs for the first half of 2008, on a date after the commencement of that tariff period. It is possible that, due to the rushed nature of the process, the Regulator did not have time to comprehensively consider all aspects of Aurora's proposed NTS. We consider that this highlights the need to allow time for considered assessment of network tariff issues by stakeholders.

As mentioned above, the short period for consultation on the draft NTS (particularly in relation to the material contained in the Addendum) has hampered our ability to respond to relevant issues in a comprehensive and constructive manner.

Going forward, the EUAA would be happy to develop effective formal and informal consultative processes and mechanisms on various regulatory issues affecting the EUAA's members, particularly regulatory issues relating to network tariffs and the provision of network services. This could include a more informal and / or more regular exchange of information or updates on relevant network issues, and a closer association between the EUAA and Aurora. We see benefits for both parties from establishing closer links, particularly in relation to issues that are of critical relevance to large users. Firstly, future consultation processes about network tariffs could be improved. Secondly, closer links between our organizations may provide our members with the opportunity to contribute their concerns and ideas to Aurora on a continuous basis, and provide Aurora with scope to address those concerns and respond to those ideas as and when they arise, outside of the tariff-setting process. Thirdly, it could be used to assist the growing number of EUAA members in Tasmania to understand and adjust to future changes in tariffs or other network issues.

3 COMMENT ON THE DRAFT NETWORK TARIFF STRATEGY

EUAA has read the letter to Aurora from the Regulator dated 12 March 2008, available on Aurora's website. The EUAA strongly endorses all specific points about the draft NTS made in that correspondence. In relation to the specific issues that are contemplated by the Regulator, the EUAA makes the following comments.

3.1 Changes to current tariffs

The EUAA echoes the concerns of the Regulator in relation to proposed changes to be made to the current network tariff structure, outlined in the draft NTS. Changes to network tariffs will necessarily lead to changes in customer behaviour, and may impose costs on users that are incurred due to changes in electricity consumption behavior that result from changed network tariffs. These tariff changes may also impose expected or unexpected costs on Aurora in terms of reacting to changed consumption patterns. To offset the costs associated with these tariff changes, it is necessary for Aurora to demonstrate that proposed changes also bring benefits in service provision and operating efficiencies.

As an integral part of this process, Aurora should demonstrate that it has assessed likely behavioral responses that will be undertaken in relation to its proposed NTS, and the types of costs that might be incurred by users responding to tariff changes. From the draft NTS, it is not clear whether Aurora has considered these behavioural impacts, and associated likely costs and benefits.

The EUAA considers that it is important that, in changing network tariff structures, Aurora describe both the issue or problem that the change in tariff structure is designed to solve, and the measures that are to be put in place to overcome the issue or problem. Most importantly, it is important that Aurora demonstrate the nexus between the identified problem and the proposed solution, and the assessment that underpins the consideration of this nexus. Aurora should also identify any expected costs associated with the proposals, as well as 'winners' and 'losers'. Without a complete understanding of *why* Aurora is introducing specific changes to its tariff structure, the EUAA is not able to offer its unqualified support for the changes even though they may be well conceived, and introduced for sound policy and fundamentally economically justifiable reasons.

Changes in the NTS for various classes of tariff would be expected to have a significant impact on customer choice of the type of tariff that most suit their needs. If customers have a choice of different tariffs and there is significant difference in the way that these alternative tariffs are structured, this will have an effect on the tariffs that are taken by customers and revenue for Aurora. This will occur quite apart from whether divergences in tariff structure mirror the cost differences in servicing different classes of customer.

For example, there is a low network tariff component in tariff class N2 for the general business tariff which is scheduled to increase by 4 – 5 % per annum. Similarly, there is a more significant (8 – 10% per year) increase in the network tariff component of the LV tariff. In terms of incentivizing behavior, this raises the 'load factor' bar at which customers would choose to move to the LV tariff, and likewise disincentivizes users to move to that tariff. If this occurs, fewer customers will be subject to price signals to moderate and smooth demand that are present in LV tariffs. This does not appear to be an economically efficient outcome.

3.2 Specified Demand Tariff

This new tariff will impact all customers with greater than 2 MVA demand. This category of user is likely to include mostly EUAA members. The EUAA has noted Aurora Network comments that this type of tariff has been introduced in response to customer demand. However, the EUAA agrees with the Regulator that further understanding of this tariff class, and the design of this tariff, is needed. The EUAA would like to know the number and types of customers affected, likely net effect on customers' bills, and any likely impacts on load shape and incentives to move load?

The need for users to keep their demand within the Specified Demand is very important as the Excess Demand Charge is 3 times that of the Specified Demand charge. Factors such as the choice of the Specified Demand, the mechanisms of monitoring it, the appropriate energy management systems and prevention of unexpected *ad-hoc* demand spikes that could exceed Specified Demand, all play a critical role in determining whether a customer benefits from, and would voluntarily choose to move to this tariff. In our view, Aurora needs to consider and comment on these issues in the formulation of this new tariff class.

The draft NTS, in section 4.5.4., envisages that "retailers will help customers select their specified demand level". This may be somewhat optimistic in the retail market where competition is mainly centered on retail energy prices. The EUAA considers that Aurora should play an active role in advising large users about whether they will be better off under this new tariff structure. Incentives for users and Aurora do not coincide at this point, and the involvement of retailers in 'assisting' users to specify their demand levels is not a guarantee that this exercise will be performed with any degree of precision in any case.

As noted by the Regulator, the introduction of a Specified Demand Tariff is a very significant change in tariff policy for Tasmanian users. In order to understand the effects on our members, and to better understand the rationale behind the move away from Demand Tariffs to Specified Demand Tariffs, the EUAA needs to understand, in greater detail, why this change in tariff policy is being introduced. In addition, we would like the opportunity to comment on any research that Aurora has conducted into the likely effect on consumption patterns, the expected change in customer behaviour, the identification of specific groups of customers that may be adversely or beneficially affected by this proposal, and how Aurora or identified customers may manage the transition process, and any effects. This information is relevant not only in the context of the current network tariff review, but also in the context of future distribution revenue reviews. In the review process, the Regulator has an obligation to understand and allow for efficient costs that are incurred in delivering services. If changes have been introduced for the purpose of reducing network costs in Tasmania, it is also fair that a significant portion of these savings are passed on to users when price reviews are completed.

3.3 Cost Allocation Principles

The pricing principles published by the Regulator require that tariffs be determined having regard to the fixed and variable charges that are incurred by Aurora in delivering specific services, and the level of similar charges applied in other National Electricity Market (NEM) jurisdictions for similar services. Although Aurora claims to have taken this into account, there is little evidence that they have done so within the draft NTS.

As Aurora has discussed in the draft NTS in section 4.2.3.2, an assessment of incremental and stand-alone costs in determining cost bases for tariff classes is of limited practical use, as the 'subsidy-free' range from

such an approach will be quite large. The large degree of flexibility that Aurora Networks has in determining the costs of delivering various services makes it even more important to users that the basis on which cost allocation is performed is transparent and follows a methodology that reflects sound economic principles.

We note that Aurora itself recognizes, in section 4.3 of the NTS, the need to improve the cost-reflectivity of network tariff structures. To this end, we consider that the draft NTS document should contain a greater level of detail about the steps that Aurora has taken or proposes to take to implement more cost-reflective structures. This would highlight the areas in which certain classes of customers are subsidizing other classes of customers. This analysis could also be used as a platform for more informed debate. The EUAA would also be in a better position to provide information to its members on the changing nature of tariffs and opportunities under any new revised tariff structure, if this information was available. We would like to see the release of more half-hourly customer demand data and data on tariff class contribution to system peak demand to support the allocation of cost-pools to customer groups. This will ensure, to the maximum extent possible, that different tariff classes have been developed along cost-reflectivity principles.

Additionally, as an aid to the analysis of Aurora's cost structures, more information is needed as to how the proportions of fixed and variable charges that have been applied to different tariff classes compare with similar costs in other NEM jurisdictions for similar services. We note that the Regulator has also raised this point in correspondence with Aurora.

3.4 Side Constraints

As noted by the Regulator, the scheme for the network tariff approval adopted in the *Guideline for Approval of Network tariffs in accordance with the 2007 Determination (November 2007) - ('Guideline')* is based on the parallel provision of the *National Electricity Rules (NER)* which would apply to Aurora if the Determination had been made under the NER rather than under the *Tasmanian Electricity Supply Industry (Price Control) Regulations 2003*. There are side-constraints included in the NER that would restrict absolute movements of tariffs for particular classes of user by reference to the average rate of change generally, or by the consumer price index. However, Aurora does not appear to consider that the implementation of side-constraints is appropriate or needed. We consider that if Aurora is going to develop tariffs in accordance with the *Guideline* they should embrace the NER framework for the development of network prices, and this should include observing the need to implement side constraints. Aurora will soon be regulated by the Australian Energy Regulator (AER) in any case and will be required to adopt the NER principles.

The 'pick and choose' approach adopted by Aurora, and the non-consideration of side-constraints as a smoothing mechanism to protect large users from volatile price swings indicates to the EUAA that there may be benefit in Aurora re-considering the effects of volatile changes to its pricing structure. It should introduce those changes over a longer period, and in a more 'across the board' manner. Under the current draft NTS, large users do not have the protection of side constraints. They do in other NEM states.

3.5 Time-of Use Tariffs

The EUAA notes the proposal advanced by Aurora in section 4.5.3 of the draft NTS that "time of use energy components will become part of all future HV Demand Tariffs, HV Specified Demand Tariffs and LV KVA

Specified Demand Tariffs". We also note Aurora's proposal to introduce "time of use energy tariffs for both small and large customers that do not include a demand component".

We support the principle behind the introduction of time-of-use tariff arrangements. These measures will provide incentives for customers to better manage their demand. However, there is also a need for Aurora to undertake consultation with affected users and ensure that there is a staged process to the introduction of new tariff arrangements, to protect users that require longer transition periods to these tariffs. Finally, as raised elsewhere in this submission, there is a need to ensure that, to the maximum extent possible, these changes reflect the costs of providing electricity supply services, and charging arrangements are not used to cross-subsidise other users.

Aurora has stated in section 1.4 of the draft NTS (Addendum) that it "will amend its Network Tariff Applications guide to include a clause that defines all time periods as being Australian Eastern Standard Time". This statement appears to have been made in the context of two specific tariffs namely N 06 and N 08. We would suggest that this statement has wider application, and can be applied to all tariffs, not just these tariffs. In addition, clarifying definitions should also be on the relevant tariff sheets, for ease of reference by users.

3.6 KVA-based Tariffs

The EUAA supports Aurora's move to a progressive introduction of kVA-based tariffs and the phased withdrawals of kW-based tariffs, as outlined in Section 4.5.6 of the draft NTS. However, this needs to be accompanied by Aurora Networks undertaking significant consultations with affected customers. Changes to the tariff structure to implement kVA-based tariffs also need to be introduced over an extended period, and not be forced on major users. As major users of electricity in Tasmania, many of our members have undertaken significant long-term capital investment in heavy equipment that is not able to be immediately replaced or upgraded to operate more efficiently with respect to the power system, without substantial cost. This investment has taken place in response to existing tariff structures, and to penalize those members by forcing them on to kVA-based tariffs (for example, by progressively introducing charging arrangements that impose significant unexpected cost increases on existing users on KW tariffs, over a short period, is unfair).

We consider that there are substantial benefits for both Aurora and our members, and other large users in Tasmania, from Aurora undertaking an appropriate and well-targeted consultation process. A targeted consultation process will assist our members to understand the implications of changes in tariff structure. The process can be used to inform users of the impact of the introduction of KVA-base tariffs on their businesses, and can be used to assist members in understanding how to moderate the impact of the introduction of these tariffs.

