

**Tasmanian Council of Social Service
and
Tasmanian Small Business Council**

**Joint-response to the
Tasmanian Economic Regulator's
*2022 Standing Offer Electricity Price
Investigation*
Draft Report**

March 2022



**Tasmanian Small
Business Council**
Uniting Small Business

ACKNOWLEDGEMENTS

TasCOSS and the TSBC acknowledge that we live and work on Aboriginal land, land of the palawa/pakana people of lutruwita (Tasmania). We pay our respects to the Tasmanian Aboriginal community, to elders past and present, and to all who continue caring for country, sharing stories and upholding rights.



We acknowledge the support of Goanna Energy Consulting Pty Ltd (Goanna Energy) in providing technical advice and assistance in preparing this submission, in particular on aspects of OTTER's Draft Report and associated documents including Aurora Energy's Preliminary Submission and the URA and OGW consultants' reports commissioned by OTTER.

Established in 2007, Goanna Energy has undertaken some 40 Energy End User Advocacy projects and submissions, promoting the interests and serving the needs of Tasmania's small and medium sized energy users. Goanna has grown to become Tasmania's most respected energy consultancy as a result of providing independent and unbiased advice that is well researched and fit for purpose.

We also acknowledge this project was funded by Energy Consumers Australia (www.energyconsumersaustralia.com.au) as part of its grants program for consumer advocacy projects and research projects for the benefit of consumers of electricity and natural gas.

Note the views expressed in this submission are those of TasCOSS and the TSBC and do not necessarily reflect the views of Goanna Energy or Energy Consumers Australia.

ABOUT US

The **Tasmanian Council of Social Service (TasCOSS)** is the peak body for the community services industry in lutruwita/Tasmania. Our Vision is of one lutruwita/Tasmania, free of poverty and inequality, where everyone has the same opportunity. Our Mission is to challenge and change the systems, behaviours and attitudes that create poverty, inequality and exclusion, to ensure all Tasmanians have equal opportunity to live a good life.

Our membership includes individuals and organisations active in the provision of community services to Tasmanians on low incomes or living in vulnerable circumstances. TasCOSS represents the interests of our members and their service users to government, regulators, the media and the public. Through our advocacy and policy development, we draw attention to the causes of poverty and disadvantage, and promote the adoption of effective solutions to address these issues.

The **Tasmanian Small Business Council (TSBC)** was founded in 1973 and incorporated in 2000. It has a history of strong advocacy on small business issues ranging from taxation and workplace relations, through to competition law, retail tenancy and energy related matters. It is Tasmania's peak body exclusively representing the interests of small businesses. Its goals are to:

- Promote and support the development of small business in Tasmania.
- Advocate to advance the interests of small businesses in Tasmania through policy change and regulatory reforms.
- Foster an increased awareness and understanding of the role of and needs of the small business sector among elected government officials, the public service, regulators, large business, the media and the general community.

We engage our members and provide opportunities for them to influence outcomes affecting their business, and their industry. We act as a conduit for information from our members to Government, regulators and other organisations, and vice versa.

We exist because small businesses don't have the time, the resources and often the expertise that is required to be alert to the myriad of legislative and regulatory change that affects them on an ongoing basis. Our efforts are focussed on providing accurate, factually based and timely input into decisions which will affect small businesses.

As peak bodies, TasCOSS and TSBC represent more than 270,000 regulated electricity customers in Tasmania and share an interest in ensuring Tasmanian households and small businesses are able to access an affordable, safe and reliable energy supply.

For further information about this submission, please contact:

Adrienne Picone
Chief Executive Officer
TasCOSS
(03) 6231 0755
adrienne@tascoss.org.au
www.tascoss.org.au

Robert Mallett
Chief Executive Officer
TSBC
(03) 6231 9174
robert@thefrontman.com.au
www.tsbc.org.au

ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
AER	Australian Energy Regulator
Aurora	Aurora Energy
CARC	Customer Acquisition and Retention Costs
COVID-19	Coronavirus disease of 2019 (novel coronavirus SARS-CoV2)
CPI	Consumer Price Index
CTS	Cost To Serve
DMO	Default Market Offer
Draft Report	2022 Standing Offer Electricity Price Investigation Draft Report
ECA	Energy Consumers Australia
ESC	Essential Services Commission (Victoria)
ICRC	Independent Competition and Regulatory Commission (ACT)
IPART	Independent Pricing and Regulatory Tribunal (NSW)
IT	Information technology
NEM	National Electricity Market
OGW	Oakley Greenwood
OTTER	Office of the Tasmanian Economic Regulator
PPA	Power Purchase Agreement
Regulator	Tasmanian Economic Regulator
RET	Renewable Energy Target
Small Customers	Household/residential and small business electricity consumers
TasCOSS	Tasmanian Council of Social Service
TSBC	Tasmanian Small Business Council
URA	Utilities Regulation Advisory
VDO	Victorian Default Offer
WEP	Wholesale Electricity Price

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EXECUTIVE SUMMARY

The principal pricing issue facing Tasmanian residential and small business electricity consumers (small customers) is the regulated price of electricity as determined by OTTER.

The importance of the regulated (standing offer) price determination is demonstrated by the fact that 97 per cent of Tasmanian households and 84 per cent of small businesses in Tasmania remain on regulated tariffs. This is in stark contrast to other NEM jurisdictions where customers enjoy greater access to market offers.

TasCOSS and TSBC jointly represent more than 270,000 regulated electricity customers in Tasmania and share an interest in delivering affordable and competitively priced electricity for Tasmanian small customers.

Cost to Serve

We welcome and support the proposed application of an efficiency factor to Aurora's CTS over the next regulatory period. However, there are reasons to suggest that the initial 1.78 per cent proposed by the Regulator in 2022-23 should be higher, while the higher factor of 3.4 per cent to apply in the next two years appears sound.

We are concerned that the Regulator proposes to allow Aurora to recover a CARC allowance (rolled into its CTS). The justification for such an allowance has always been questionable given that Aurora has, until recently, faced only hypothetical (not real) competition and even now retains a dominant market share with limited competition. This does not seem to justify CARC expenditure, certainly not for customer acquisition (which accounts for about 85 per cent of benchmarked CARC).

Aurora has relatively high numbers of customers in debt with a high average-level of debt per customer. Rather than providing for an allowance in the CTS to cover debts, Aurora should be incentivised to find ways to better manage its debt costs and reduce them. The Regulator's proposed application of the efficiency factor to debt costs should assist and we note the ECA's recent call for retailers to improve the ways in which they identify and manage customers experiencing payment and financial difficulty.

The Regulator's proposal to remove the COVID-19 debt premium is supported given that such an allowance was temporary and the ESC and AER do not currently provide a COVID-19 debt allowance.

Labour costs are a significant element of Aurora's retail operating costs. The lack of detail about these costs makes it difficult to properly assess them. However, we support the application of the efficiency factor to Aurora's labour costs.

The Regulator's proposal to switch from the use of national wage and CPI indices to local Tasmanian indices in the next regulatory period will, based on recent trends in both, result in higher annual price adjustments for Tasmanian customers. While it is reasonable to better reflect local factors, the timing of this change is not in the interests of small customers.

The Regulator's proposed use of benchmarks referenced to the CTS of mainland NEM retailers to help set Aurora's CTS is supported. The Regulator should put most weight on the recent ACCC benchmarks, which show quite rapidly falling CTS and evidence of economies of scale. These show a CTS in 2020-21 of \$96

per customer for 'Big 3' retailers and \$170 per customer for 'non-Big 3' retailers. On this basis, we believe that Aurora's CTS for the next regulatory period should sit somewhere around \$130-140 per customer.

However, the Regulator is proposing a CTS for Aurora of \$156.42 per customer for 2022-23. We believe that this is too generous, based on benchmarks that are appropriate to Aurora and other concerns about its cost base being too high. Applying our lower CTS would save regulated Tasmanian small customers around \$6 million per annum compared with the Regulator's proposal and between \$9-11 million per annum less than Aurora's ask.

Retail Margin

The Regulator has referenced benchmarks in setting Aurora's retail margin, which we support. Aurora's current retail margin of 5.7 per cent, or \$101 per customer, compares unfavourably with that of mainland NEM retailers (3.4 per cent or \$49 per customer). Moreover, Aurora's retail margin has not fallen to anywhere near the same extent as mainland NEM retailers.

The Regulator has argued that several factors could skew the use of mainland NEM retail margins in setting a retail margin for Aurora. The Regulator refers to the potential unreliability of the difference between electricity retailers' annual revenues and costs, the inclusion of 'Big 3' retailer margins (expected to be lower) and the impacts of vertical integration in reducing mainland NEM retailer margins. We accept the logic in these points, but they should not be exaggerated and it is open to the Regulator to make adjustments (up or down) to Aurora's retail margin to reflect factors specific to Aurora. The Regulator appears to have made an upwards adjustment but has not explained how.

We agree with the Regulator's assessment that Aurora faces less wholesale electricity price risk due to the regulation of wholesale prices in Tasmania, which provides Aurora with more certainty than retailers operating in competitive NEM markets.

We also concur with the Regulator that Aurora faces less volume related wholesale electricity price risk than mainland retailers in the NEM, given Aurora's dominant 97 per cent share of smaller customers and the limited threat to its market share that it faces.

Added to this, Aurora also has other advantages not enjoyed by retailers faced with competition that reduce its risks (and retail margin). It can recover a range of under-estimated costs through annual adjustments, material changes in its costs or taxes, and under-forecast RET costs, and in the next regulatory period its CTS allowance will be able to vary as customer numbers fluctuate.

The Regulator proposes to set the retail margin at 5.25 per cent, which equates to \$96.25 per customer in 2022-23 (in 2020-21 dollars), indexed by the Hobart CPI. We are concerned that this is well above the 3.4 per cent and \$49 per customer recently estimated by the ACCC for mainland NEM retailers and that the impact of this on standing offer customers in Tasmania will be higher electricity prices. The Regulator has used 4.8 per cent as a lower bound in setting this margin, but this is based on a 2019 estimate that does not include further subsequent retail margin reductions captured by the ACCC estimates.

Using the ACCC's estimate of the retail margin of 3.4 per cent as the lower bound and using the Regulator's selection of the mid-point between the lower bound estimate and Aurora's current margin (5.75 per cent), suggests a significantly lower retail margin of around 4.5 per cent, or \$82.50 per customer, for the next regulatory period. This would save regulated Tasmanian small customers more

than \$3.7 million per annum compared to the Regulator's proposal and is around \$8 million less than Aurora's ask.

aurora+ Costs

We note that retailers in competitive retail markets provide access to digital apps as part of their market offers and have a market discipline to keep the functionality and cost of their apps relevant to customers' needs. The Regulator should seek to replicate this in the case of *aurora+*.

A relatively recent entrant into the Tasmanian electricity retail market, 1st Energy is marketing its offers with free access to its app. Competing retailers develop apps to reflect customer needs and fund them by means including the ability of apps to reduce costs and enhance their revenue positions.

We support the inclusion of *aurora+* into the CTS, but have raised a number of questions about the application of these costs across the whole customer base without access to the product, and the lack of transparency and justification for the additional costs.

We note the Regulator's rationale for reducing Aurora's proposed marketing costs for *aurora+* by half, but also query if a larger rollout of the app might require additional funding for awareness and digital literacy activities. We also support that Aurora should be asked to justify the high growth it is forecasting for *aurora+* take up, which seems quite optimistic.

The Regulator estimates that Aurora's revenue from *aurora+* will increase from \$1.5 million per annum currently, to \$3.8 million per annum (assured through inclusion in its regulated costs), at a cost per customer of \$14.15 (currently around \$40). We do not consider the case has been made for this additional cost across the customer base and seek a demonstration from the Regulator of benchmarking with other app costs, beneficial user functionality and efficiencies gained by Aurora from greater digitisation of its services to customers.

Recommendations

1. We recommend that the Regulator seek a review of its current information and associated confidentiality provisions such that there is a greater onus on making information public.
2. We support the Regulator's proposal to apply an efficiency factor to Aurora's retail operating costs and recommend the NEM-wide factor of 3.4 per cent apply to each year of the next regulatory period. The efficiency factor is based on empirical data and appears to be robust, therefore, we see little justification for applying a lower 1.78 per cent efficiency factor in 2022-23.
3. There is little justification in an allocation for CARC (even if rolled into the CTS) other than a 'retention' component, which Frontier Economics estimates to be only a 15 per cent proportion of the allowance. We therefore recommend that, perhaps apart from some modest retention costs, CARC is removed from the CTS given Aurora is unlikely to face strong retail competition over the next three years.
4. We support the application of the efficiency factor to Aurora's bad debt expense and the removal of Aurora's COVID-19 debt allowance. We recommend Aurora be expected to identify ways to better manage and reduce its debt costs.

5. We recommend the Regulator maintains national wage and price indices rather than moving to Tasmanian indices for annual CTS adjustments, as the latter have recently been significantly higher and will add additional costs to small customers.
6. We support the Regulator's proposal to apply benchmarks to Aurora's CTS that reflect both significant recent reductions in the CTS of mainland NEM retailers and economies of scale. We recommend a CTS for Aurora for the next regulatory period somewhere between \$130-140 per customer, rather than the Regulator's proposal of \$156.42 per customer for 2022-23. This would save regulated customers \$6 million per year compared with the Regulator's proposal..
7. We consider the Regulator's proposal to apply a 5.25 per cent retail margin, which equates to \$96.25 per customer in 2022-23 (in 2020-21 dollars), is too generous and recommend a retail margin of 4.5 per cent, or \$82.50 per customer. This is based on the relatively low risks that Aurora faces and the lower retail margins in the NEM.
8. We support the product fee being removed from the *aurora+* digital app but consider the CTS allowances of \$17.33 requested by Aurora and \$14.15 proposed by the Regulator are unreasonably high. We do not believe a case has been made that justifies these costs and recommend the Regulator undertakes a comparison of expenditure forecasts for similar apps, benchmarking of app costs and a more robust assessment of user benefits and experience.
9. We recommend that the inclusion of *aurora+* in the CTS is supported by a digital and energy literacy campaign and seek the Regulator's view as to whether the costs of these activities is the responsibility of regulated electricity customers, or if digital inclusion and energy literacy should be funded by the State Government through the State Budget.
10. If *aurora+* is included in the CTS, we recommend the application of the allowance be set proportionate to the annual rollout of advanced meters, and/or the uptake of the app. This would provide an incentive for Aurora to ensure it meets its meter rollout milestones and targets, as well as encourage Aurora to support customers to connect to and use the app.
11. We recommend the Regulator undertakes additional work to establish that *aurora+* costs are efficient and its functionality is beneficial to customers, as well as require Aurora to demonstrate how it can use *aurora+* to reduce its costs and enhance its revenue to offset its inclusion in the CTS.

PURPOSE

TasCOSS and TSBC have worked together to present this joint submission representing regulated small Tasmanian electricity customers. Our aim is to ensure the needs and concerns of small customers are at the forefront of regulatory decision-making processes.

We aim to influence OTTER's decisions in relation to the retail electricity prices that small customers will pay over the period 1 July 2022 to 30 June 2025, given that a significant majority of small customers in Tasmania remain on regulated retail tariffs.

We seek to influence the delivery of affordable and competitively priced electricity that will support households to maintain healthy homes and a decent standard of living, and small business to thrive.

For Tasmanian households, electricity bills typically represent the 2nd-largest expense, after housing costs. For residential customers on low incomes, electricity costs consume a higher proportion of their incomes than other customers. In a retail electricity market where there is little competition and 97 per cent of households are on standing offers, it is incumbent on the Regulator to ensure that customers with limited market power and limited resources are protected and have access to the lowest possible electricity prices. The Draft Report acknowledges this:

By examining all of Aurora Energy's costs, including allowances set by the Regulator, the Regulator seeks to ensure that customers pay no more than necessary for the services they receive. (p.5)

We support the Regulator in this endeavour and our submission sets out our key considerations for driving greater efficiency and delivering lower costs, so that households and small businesses in Tasmania benefit from more affordable and competitively priced electricity.

INTRODUCTION

The principal pricing issue facing Tasmanian residential and small business electricity consumers (small customers) is the regulated price of electricity as determined by OTTER.

The importance of the regulated (standing offer) price determination is demonstrated by the fact that around 270,000 small customers in Tasmania remain on regulated tariffs. This represents around 97 per cent of Tasmanian households (240,000 residential customers) and 84 per cent of small businesses (30,000 small business customers).

This is in stark contrast to other NEM jurisdictions where customers enjoy greater access to market offers, with only 23 per cent of residential customers and 35 per cent of small business customers on regulated prices NEM-wide.

Regulated retail electricity prices in Tasmania are set through a determination process conducted by OTTER. Determinations are made for a period of three years, with annual price adjustments.

Given these circumstances, in the absence of strong competition in the Tasmanian retail electricity market, OTTER determinations have a significant and sustained impact on the electricity prices for small customers in Tasmania.

It is therefore imperative that the small customers' voice is considered in the OTTER regulatory process and for OTTER to respond in a manner that ensures electricity costs are efficient and small customers benefit from the lowest-possible regulated retail electricity prices.

OTTER's 2022 *Standing Offer Electricity Price Investigation Draft Report* (Draft Report) outlines the "building block" approach adopted by the Regulator to setting retail prices. As some of the cost components of retail prices are set by other processes, our submission focuses on those elements that are approved by the Regulator, with particular reference to:

- Ensuring Aurora's CTS allowance is efficient, noting there is evidence in other parts of the NEM of more efficient costs.
- Ensuring Aurora's Retail Margin is efficient and prudent, noting it appears high compared to other parts of the NEM after allowing for the higher risks associated with competitive retail markets elsewhere and after consideration of what local factors, if any, could account for the (higher) margin.
- An assessment of Aurora's proposed costs for maintaining its *aurora+* digital app, and justification for this addition to its regulated cost base.

Given the importance of OTTER's final determination to electricity prices Tasmanian small customers will be subjected to over the next three years, this submission highlights the key consumer issues of affordable and competitively priced electricity.

CONSTRAINTS

Our ability to assess and comment on the Draft Report has been constrained by a lack of access to important and relevant information. In particular:

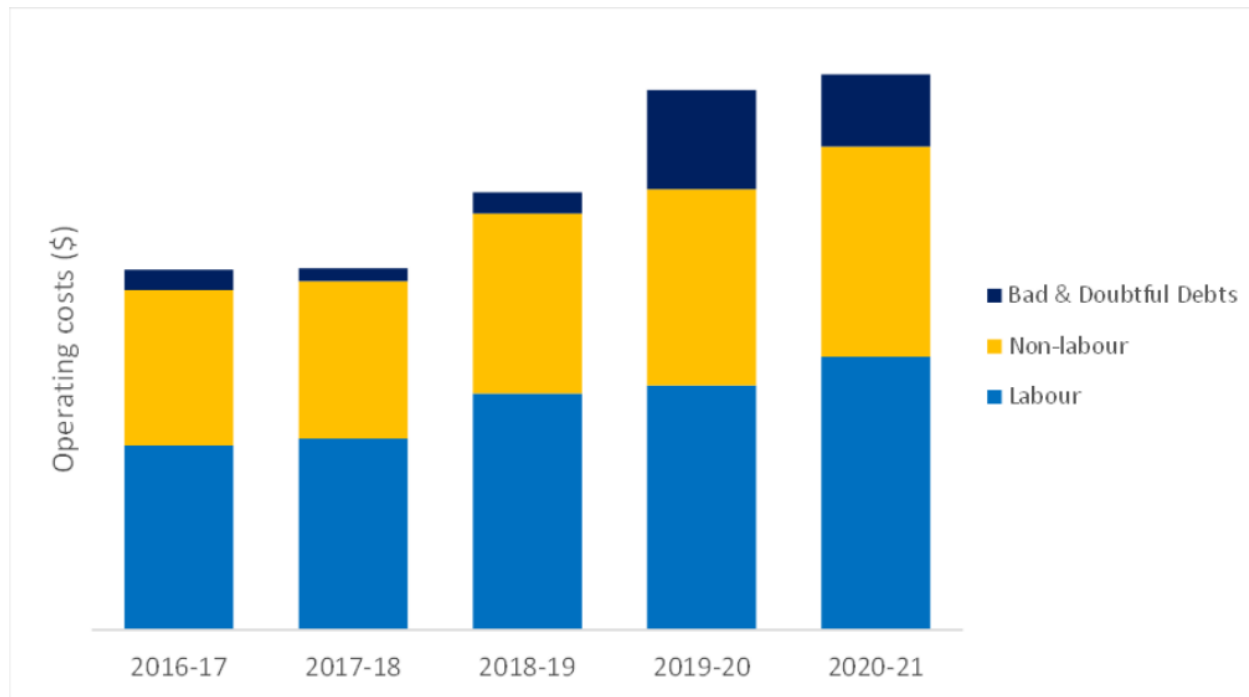
- The full URA/OGW report on the CTS commissioned by OTTER has been withheld from public scrutiny on commercial confidentiality grounds. Only a high-level (2 page) summary of the report has been published, which provides extremely limited information.
- Aurora commissioned Frontier Economics to provide advice on benchmarking of the retail margin. This advice has also been withheld from public scrutiny on commercial confidentiality grounds.
- The full version of Aurora's Preliminary Submission has been withheld from publication on commercial confidentiality grounds with only a summary being published.

To properly scrutinise all information relevant to the setting of standing offer prices, it is important that all relevant information is made public. Without this, the role of consumers, consumer advocates and other interested parties in the regulatory process is constrained and jeopardises the ability for genuine input.

Figure 7.1 (page 23) of the Draft Report, which shows Aurora's retail operating costs (and its various components) over the period 2016-17 to 2020-21, provides a case in point. Whilst we welcome that the

Regulator has included this in the Draft Report, the decision to withhold dollar amounts makes it more difficult to assess this important chart.

Figure 7.1 Trends in Aurora Energy’s retail operating costs (\$nominal)



Source: Aurora Energy.

While we understand there may be grounds for withholding some information due to commercial confidentiality (especially in a competitive market), it must also be recognised that Aurora is a government-owned, dominant, retailer in Tasmania that enjoys access to the vast majority of small customers who remain on standing offer tariffs in Tasmania.

Given this position, there should be a stronger obligation to share information with Aurora’s customers and their advocates. We believe there is a case for stronger requirements for Aurora and the Regulator to release regulatory information for public scrutiny, similar to the stronger guidelines regarding the release of information for public scrutiny that the AER has in place for network revenue determinations.

Recommendation:

- 1. We recommend that the Regulator seek a review of its current information and associated confidentiality provisions such that there is a greater onus on making information public.***

RETAIL COST TO SERVE

Consultant's Review of Aurora's CTS

We welcome the Regulator's engagement of URA and OGW to assess Aurora's CTS proposal. Adding additional layers of scrutiny and expert advice ought to deliver better outcomes to this regulatory process and greater comfort to consumers, especially as most of the details of Aurora's Preliminary Submission have been withheld from public scrutiny.

However, equally important is the reassurance that the approach taken is rigorous and the findings arrived at are substantiated. Unfortunately, the Regulator has only published a high-level summary of the consultants' report with the main report kept confidential. This adds to the difficulty for consumer advocates to assess and interrogate the validity of information that is made available.

Within these substantial constraints, we have examined the URA/OGW summary and the Regulator's commentary on it. In relation to the consultants' findings about Aurora's treatment of costs, we are concerned that:

- Aurora does not have a documented process setting out how shared costs - such as labour, communications and IT - are allocated between Aurora's regulated and unregulated activities. Although the consultants comment that, in the absence of this data, they found that the application of cost allocations based on billing outcomes and customer numbers was conceptually appropriate and based on data, it remains a concern that Aurora, as a regulated business, is not required to separate shared costs between its regulated and unregulated activities, as is the case in some other regulatory determination processes.
- There was insufficient activity level cost data over recent years to assess whether Aurora's base year costs are efficient. Instead, the consultants assessed base year costs against (less precise and specific) publicly available costs for retailers across Australia to reach 'a high level' finding on the efficiency of Aurora's costs.

This formed the basis for URA/OGW's "on balance" conclusion that Aurora's costs were "reflective of efficient costs". This amounts to a qualified assessment, which is a less than complete endorsement of Aurora's costs as efficient.

By contrast, in other regulatory determination processes (such as those of the AER) regulated entities are required to provide standardised cost data based on Regulatory Information Notices, which are publicly available.

Productivity Improvements

The Regulator has formed the view that an efficiency factor should be applied to Aurora's CTS over the coming regulatory period, noting that there have been significant reductions in retailer costs per customer over recent years and that this has not been reflected in Aurora's CTS for this period. This difference has resulted in higher electricity prices for small customers in Tasmania.

Aurora did not propose explicit productivity gains for CTS expenditure in its Preliminary Submission (other than allowing for labour cost savings). Using ACCC retail cost per customer data for the period 2017-18 to 2020-21 for retailers other than the 'Big 3' as a proxy for productivity, URA/OGW observed that this increased by 3.4 per cent per annum and recommended that the Regulator apply this approach to Aurora.

We welcome and support the Regulator's draft decision to apply an efficiency factor to Aurora's CTS. However, we note two issues with the Regulator's proposed approach:

- Given that URA/OGW estimated a 3.4 per cent reduction in retail costs per customer, it seems odd that the Regulator proposes a much lower efficiency factor of only 1.78 per cent for 2022-23. This is not explained in the Draft Report, other than by reference to URA/OGW's recommendation (the basis of which is also unclear and presumably contained within its confidential full report).
- Aurora's CTS has not kept pace with the reductions in retail costs per customer observed for mainland retailers. We can see no reason why Aurora has not captured such gains itself, other than not being required to by its regulatory environment. This argues for the application of a higher efficiency factor going forward.

Recommendation:

- 2. We support the Regulator's proposal to apply an efficiency factor to Aurora's retail operating costs and recommend the NEM-wide factor of 3.4 per cent apply to each year of the next regulatory period. The efficiency factor is based on empirical data and appears to be robust, therefore, we see little justification for applying a lower 1.78 per cent efficiency factor in 2022-23.***

CTS Components

CARC Allowance

The Regulator provided Aurora with a significant allowance to cover CARC for the six years of its previous Determination. It proposes to allow Aurora to include some CARC costs in the next regulatory period, on the basis that it faces some retail competition, and to roll this into the overall CTS.

We note that this allowance is intended to allow Aurora to retain and acquire customers while operating in a competitive environment. To date, Aurora has not experienced sustained retail competition and even its current competition is limited. In the intervening years, Aurora's regulated customers have provided it with significant revenue through the CARC allowance, which it arguably has not needed. This has increased regulated prices for small customers in Tasmania.

We consider that the Regulator should not provide Aurora with any additional CARC costs until there is a competitive justification for them, which there is currently not given the limited competition it is facing. Given Aurora has previously been in receipt of CARC during periods in which there was no retail competition, it has arguably received money for no apparent purpose.

CARC has previously been provided to Aurora as a separate item in its CTS. This had the advantage of making the CARC allowance transparent to consumer advocates. With the proposal to roll the CARC allowance into the CTS, Aurora will need to manage its CARC as part of its CTS which may have an efficiency benefit. On the other hand, it will make the CARC less transparent, a matter of concern to us.

We note that as a dominant retailer facing limited competition, Aurora is potentially able to use its CARC allowance to fend off its competitors, both existing and potential. We also note that the CARC allowance covers costs for both the acquisition of new customers and the retention of existing ones. In our joint submission to OTTER on its Draft Approach Paper, TasCOSS and TSBC pointed out:

“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.”¹

This has not been mentioned by The Regulator in its Draft Report in relation to Aurora’s CARC going forward.

Recommendation:

- 3. *There is little justification in an allocation for CARC (even if rolled into the CTS) other than a ‘retention’ component, which Frontier Economics estimates to be only a 15 per cent proportion of the allowance. We therefore recommend that, perhaps apart from some modest retention costs, CARC is removed from the CTS given Aurora is unlikely to face strong retail competition over the next three years.***

Bad Debt Expenses

Aurora has the highest proportion of in-debt residential customers of any retailer in an AER jurisdiction. The average level of debt per customer is also higher (\$1,300 and \$1,000 respectively). However, the proportion of Tasmanian small business customers in debt was much lower than in other jurisdictions, at around half of the overall average percentage and the average debt was also somewhat lower (\$2,400 compared with \$2,500).

The Regulator proposes to accept Aurora’s debt expense estimate but to apply its efficiency factor to it on the basis that Aurora expects a significant increase in the take up of its *aurora+* digital app and its claims that this will assist customers to better manage their electricity use and costs.

We support the application of the efficiency factor. However, we question whether there are other ways in which Aurora could be reducing its debt expenses.

We note that Aurora’s percentage of in-debt residential customers has declined from 5.2 per cent in 2019-20 to 3.5 per cent in 2020-21. Moreover, the Regulator has reviewed Aurora’s estimates of its debt costs expenses per customer and considers that they are reasonable but has given little explanation for this finding. A fuller explanation of this finding would be beneficial.

As Aurora has a high level of customer indebtedness, especially for residential customers, it should be seeking ways to reduce this further and have internal incentives to do so. The application of the proposed efficiency dividend provides one form of incentive. It should be noted that ECA has recently called on retailers to do more to earlier identify customers who are financially struggling and offer them assistance. According to ECA, retailers also need to consider options for supporting customers who are struggling to pay their bills before they need or are eligible for hardship or payment schemes, as well as support their customers with access to tools and information available to help them.²

¹ TasCOSS & TSBC (2021), *Submission on OTTER Retail Electricity Standing Offer Methodology Review – Draft Approach Paper*, p.10.

² See <http://energyconsumersaustralia.com.au/news/hardship-is-hiding-in-plain-sight-its-time-we-opened-our-eyes>

Bad Debts Associated with COVID-19

The Regulator proposes not to accept Aurora's COVID-19 premium on its bad debt allowance for the next regulatory period, which Aurora proposes to phase down to zero by the end of that period, citing the 2022 VDO determined by the ESC which has removed the temporary COVID-19 allowance.

We support the Regulator's proposal on the basis that:

- Any allowance for COVID-19 related bad debts should be seen as temporary and related to the period covered by the AER's *Statement of Expectations* that ended 30 June 2021.
- The ESC's 2022 VDO no longer includes a COVID-19 debt allowance.
- The AER's DMO determination for 2021-22 reached a view that COVID-19 related debt costs (estimated at \$9 per customer) were not material enough to warrant an additional debt allowance with no evidence that it was materially impacting retailers' financial positions.

We note that at \$4 per customer a COVID-19 debt premium would add over \$1 million to Aurora's CTS in 2022-23 and at \$2 per customer a further \$0.5 million in 2023-24. These are cost levels that Aurora should be able to manage without a need for additional allowances.

Recommendation:

- 4. We support the application of the efficiency factor to Aurora's bad debt expense and the removal of Aurora's COVID-19 debt allowance. We recommend Aurora be expected to identify ways to better manage and reduce its debt costs.**

Platform and IT Costs

Aurora is in the process of moving to a new cloud-based billing system (expected to be fully operational by late 2022) and transitioning out of its current Customer Care and Billing system.

The Draft Report notes that Aurora has removed the implementation costs for the migration of the billing system, but appears to have included some costs (licences, support and maintenance) that relate to its legacy billing system. The Regulator considers that these costs should be removed given that the current system is in the process of being decommissioned and will not be in operation for the bulk of the regulatory period.

We support the Regulator's intention to remove these costs from the CTS.

Labour Costs

Labour costs account for around half of Aurora's retail operating costs (Figure 7.1 above). We have a number of concerns around the size of these labour costs, in particular:

- the lack of detail made publicly available;
- little ability to identify and discuss specific cost drivers (due to a lack of information); and
- justification for increasing labour costs couched in broad terms such as "changes in operating environment".

We support the Regulator's proposal to apply an efficiency factor to labour costs.

Unspecified Project Costs

Aurora has proposed the inclusion of some costs related to projects that have not been specified. The Draft Report comments in relation to these:

“The Regulator considers that it is difficult to justify allocating costs to, and expecting regulated customers to pay for, projects that are unknown or uncertain at this time. The Regulator therefore intends to not include these costs in the CTS allowance.” (p. 31)

We support the Regulator’s position and the exclusion of these costs from the CTS.

Determining Actual CTS Allowances

The Draft Report proposes some changes in the way the Regulator will determine annual adjustments to Aurora’s CTS allowance. Labour costs will be indexed by the Tasmanian wage price index (previously the national CPI), non-labour costs by the Hobart CPI (previously the national CPI) and an adjustment will be made for changes in customer numbers.

In our joint submission to OTTER’s Draft Approach Paper, we did not oppose adjustments based on changes in customer numbers and sought further information on the likely impacts of changes to the indices used for labour and non-labour costs.

Our concern in relation to this proposed change is the timing. The Tasmanian wage price index and the Hobart CPI have been running higher than their national equivalents in recent times and, should this continue, will result in higher annual regulated price adjustments.

While we accept the rationale that these changes in the CTS allowance may more accurately reflect underlying cost changes for Aurora, if the change were implemented in previous Determinations, small customers would have benefited from lower regulated price adjustments.

At a time when households and small businesses are still being impacted by COVID-19 – in particular rising cost of living pressures, escalating supply chain costs and inflation in Tasmania outstripping the mainland – a deferral of this measure would provide some relief to household and small business budgets.

Recommendation:

- 5. We recommend the Regulator maintains national wage and price indices rather than moving to Tasmanian indices for annual CTS adjustments, as the latter have recently been significantly higher and will add additional costs to small customers.***

CTS Allowances in Other Jurisdictions

While the continued use of benchmarking of the CTS as a means of cross-checking the efficiency of Aurora’s retail operating costs is not perfect, we support this approach as a means of comparing Aurora’s CTS with the CTS of mainland retailers operating in competitive markets.

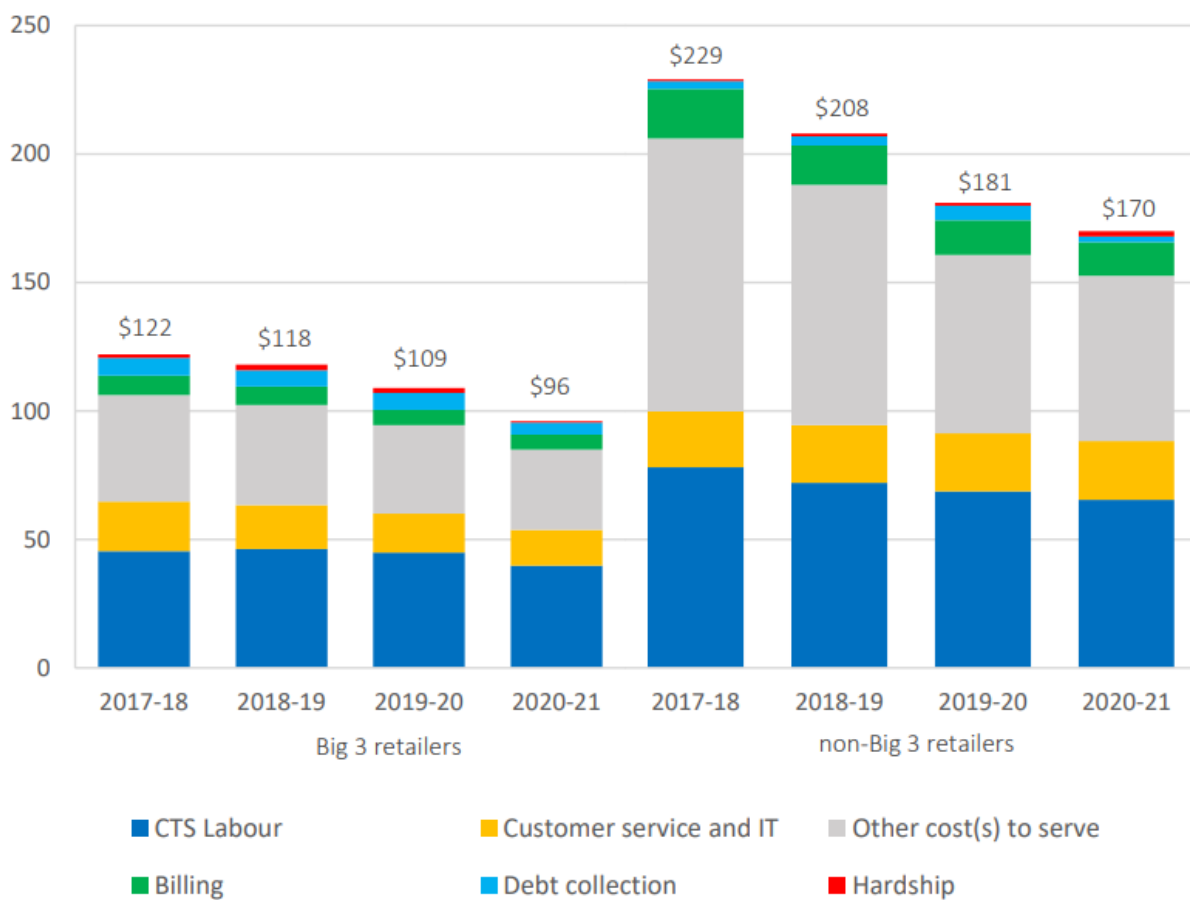
In the Draft Report, the Regulator has relied heavily on CTS benchmarks obtained from the URA/OGW consultant’s report, which drew on recent ACCC data on retail operating costs for the period 2017-18 to 2020-21 for the ‘Big 3’ and ‘non-Big 3’ retailers.

This was supplemented by reference to the CTS decisions of other regulators, especially the ICRC and ESC. However, their decisions are older and referenced back to a base established by IPART in 2014, which has been indexed for subsequent years. In our view, this is less relevant – and is becoming more so over time – given both changes in the retail environment since 2014 and the significant cost reductions made by retailers in recent years (referred to in the Draft Report).

The Draft Report highlighted two important findings emerging from the URA/OGW report:

- Retail operating costs for all retailers have fallen significantly in recent years (Figure 7.3). This contrasts to Aurora, whose costs have not fallen.
- Economies of scale are evident in electricity retailers’ operations. The average CTS of the ‘Big 3’ retailers was estimated to be a little more than one half of the CTS of smaller retailers.

Figure 7.3 Average retail and other costs per customer¹⁹, 2017-18 to 2020-21 (\$2020-21, excluding GST)



Source: Based on information from the ACCC’s Inquiry into the National Electricity Market - November 2021 report, pages 34 and 37.

URA/OGW found that Aurora Energy’s proposed CTS (\$172.54 per customer) aligns closely with the average costs incurred by ‘non-Big 3’ retailers (\$170 per customer for 2020-21). However, as Aurora Energy’s customer base is around three times the average of the ‘non-Big 3’ retailers, it provides opportunities for scale economies. Accordingly, the Regulator expressed the expectation that an efficient level of CTS for Aurora would be below the average of the ‘non-Big 3’ retailers.

We agree with the Regulator's finding and expect an efficient level of CTS for Aurora should be significantly below the 'non-Big 3', given Aurora's customer base is almost three times larger.³

The Regulator's Draft Proposal

The Regulator is proposing a CTS for Aurora of \$156.42 per customer for 2022-23, which represents a significant component of Aurora's revenue and of the prices faced by small customers. This is 9.4 per cent below Aurora's proposal of \$172.54 but over 60 per cent higher than that of the Big 3 (\$96 in 2020-21).

This suggests that the Regulator is being overly generous to Aurora in setting the CTS. The Draft Report says that the CTS estimate of \$156.42 per customer is within the level of CTS allowances in recent decisions by regulators in Australia. However, the ICRC determination in 2020 calculated a CTS per customer of \$127.84 in 2020-21, significantly below the Regulator's proposal.

We consider a CTS that is nearer the mid-range between the 'Big 3' and 'non-Big 3' to be a reasonable allowance, that is, \$130-140 per customer. The difference amounts to around \$6 million per annum compared with the Regulator's proposal and between \$9-11 million per annum compared with Aurora's ask, which is additional revenue for Aurora that in our view is better going in the pockets of small customers in the form of lower regulated prices, rather than to Aurora as a generous CTS.⁴

As further justification for our position, we note that Aurora has the advantage of being an incumbent retailer in Tasmania and retains a dominant market share which is unlikely to be significantly challenged by new entrants over the next three years. Aurora has also benefitted from being in receipt of a CTS allowance in the past that has included costs that were either problematic (e.g. CARC when there was no competition) or set at the higher end of what could be considered reasonable.

We note that current maximum market offer discounts in Tasmania amount to only around 5 per cent and that market offers tend to track Aurora's regulated prices closely. Therefore, reductions in regulated prices due to lower costs are likely to be matched by lower market offers, leaving all Tasmanian residential and small business customers the beneficiaries, not just regulated customers.

Recommendation:

- 6. We support the Regulator's proposal to apply benchmarks to Aurora's CTS that reflect both significant recent reductions in the CTS of mainland NEM retailers and economies of scale. We recommend a CTS for Aurora for the next regulatory period somewhere between \$130-140 per customer, rather than the Regulator's proposal of \$156.42 per customer for 2022-23. This would save regulated customers \$6 million per year compared with the Regulator's proposal.***

³ Aurora has a customer base of around 270,000 whereas the 'non-Big 3' have less than 100,000 customers each.

⁴ \$6m is the difference between our preferred CTS at a mid-range number of \$135/customer and the Regulator's draft assessment of \$156.42. The \$9-11m is the difference between our preferred CTS (using \$130-\$140/customer range) and Aurora's proposed CTS (\$172.54). All numbers are for 2022-23 expressed in \$2021.

RETAIL MARGIN

Aurora’s retail margin was \$101 per customer in 2021-22, which is a significant component of Aurora’s regulated revenue and therefore a significant component of residential and small business electricity bills. For regulated customers, it is therefore important that the Regulator reach a well informed and robust position on Aurora’s retail margin for the 2022-23 to 2024-25 regulatory period.

Retail Margins in Other Jurisdictions

The Regulator has referred to benchmarks in setting Aurora’s retail margin. Benchmarks have an important role to play in setting retail margins for regulated entities like Aurora and if used well, help to ensure that customers pay fairer electricity prices.

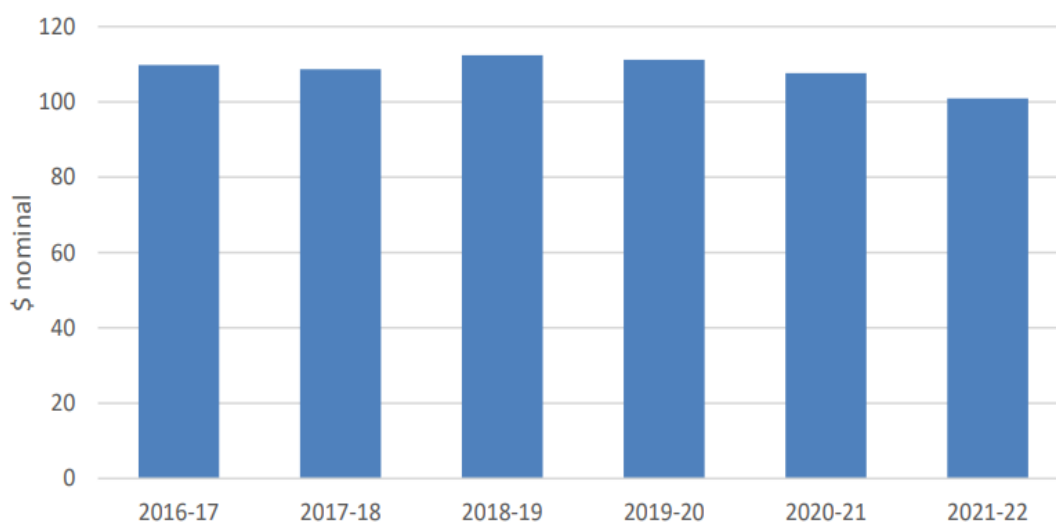
Of the information set out in the Draft Report, we found the ACCC’s November 2021 update of its Inquiry into the National Electricity Market the most timely, relevant and useful in establishing retail margin benchmarks.

The ACCC found that the average retail margin across the NEM was \$49 per residential customer in 2020–21, which equates to around a 3.4 per cent margin on their actual costs. This compares to Aurora’s current retail margin of \$101 per customer or 5.7 per cent (2020-21).

The ACCC also reported that there has been a substantial decline in retail margins from 2016-17, when retail margins peaked at \$137 per average residential customer. This is a decline in the retail margin per customer of around 64 per cent from 2016-17 to 2020-21. The decreases in retail margins were observed for all mainland NEM regions.

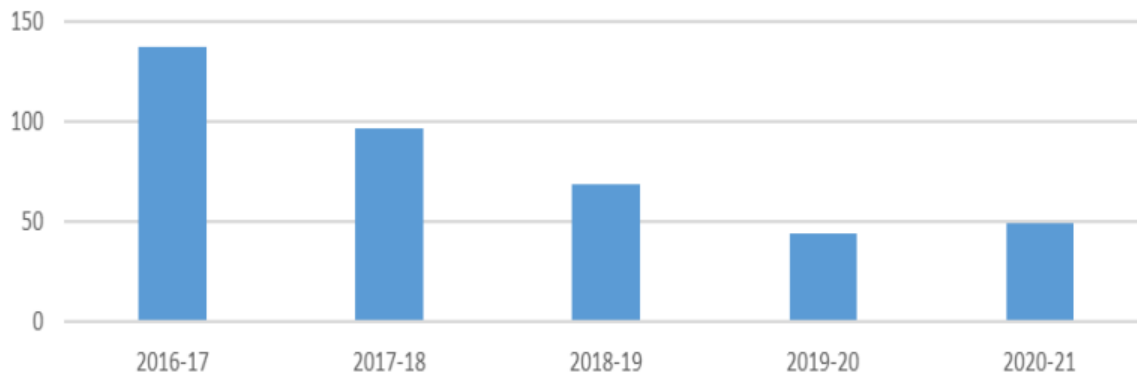
Comparing trends in Aurora’s retail margin from 2016-17 to 2020-21 (Figure 8.1 Draft Report) with the ACCC’s national trends over the same period (Figure 8.2), it is clear that Aurora’s retail margin is far higher than the retail margins of mainland NEM retailers and has not seen the same rate of decline.

Figure 8.1 Aurora Energy’s allowed retail margin per customer (\$ nominal)



Source: Aurora Energy’s approved retail margin and customer numbers.

Figure 8.2 Estimated retail margin per average residential customer in the NEM (\$/customer)



Source: ACCC Inquiry into the National Electricity Market (November 2021), page 31.

Aurora's retail margin per customer declined by 7.5 per cent from 2016-17 to 2020-21, whereas the retail margin per customer of mainland NEM retailers fell by 64 per cent over the same period. Moreover, Aurora's retail margin in 2016-17 was around \$109 per customer, whereas for mainland NEM retailers it was significantly higher at \$137. This has subsequently turned around with Aurora's retail margin of \$101 per customer in 2020-21 comparing very unfavourably with just \$49 per customer across the NEM. This situation is short-changing small customers in Tasmania.

It is incumbent on the Regulator to ensure Aurora's retail margin more closely reflects these downward trends in retail margins.

We note the Draft Report identifies a number of matters which the Regulator considers limit the ACCC's findings in relation to Aurora's retail margin. While the retail margin estimated by the ACCC may not be a perfect benchmark for setting regulated retail margins, the trends are clear and should serve as a useful benchmark. Tasmania's regulated customers should see the same order of magnitude reductions in retail margins as have small customers elsewhere in the NEM.

The ACCC did not separate its retail margin benchmarks into 'Big 3' and 'non-Big 3' retailers, so the average retail margin would be heavily influenced by the 70 per cent customer share of the 'Big 3'.⁵ However, the Regulator has not demonstrated how significant this is in setting Aurora's retail margin. We would welcome a further explanation from the Regulator on whether it is material, its magnitude and if an adjustment should be made in setting Aurora's retail margin. The Regulator may consider seeking such a breakdown of the data from the ACCC.

The Regulator claims that vertical integration within mainland NEM retailers is also a factor in lowering risk and hence the retail margin of mainland NEM retailers. However, this overlooks some key points:

- Vertical integration has been a significant presence in the NEM for at least two decades and well before the time of the ACCC's analysis. It is unlikely to have made a significant contribution to recent trends in retail margins.

⁵ The average number of customers of the largest three retailers is just under two million, whereas Aurora has around 270,000 regulated customers.

- Over the period 2016-17 to 2020-21 there has been a significant deterioration in Aurora’s retail margin position when compared with mainland NEM retailers (with retail margins of the latter falling rapidly and much faster than Aurora’s).
- Aurora’s ownership structure displays elements of vertical integration. Its owner, the Tasmanian Government, also owns Hydro Tasmania and TasNetworks, all of which are dominant players in their respective segments of the Tasmanian electricity market.

Discussion of Risks

We recognise that in determining a retail margin for Aurora there must be regard to the risks it faces or is likely to face.

Energy Price Risk

The Regulator has determined that, compared to standalone retailers in other NEM jurisdictions, Aurora has lower than average risks relating to the WEP, setting aside volume-related risks. This is based on:

- Extensive regulation of the WEP in Tasmania and the method used being well known to Aurora, who can adopt strategies to manage this and reduce the risks. This contrasts to the riskier market settings faced by mainland retailers in the NEM.
- How the WEP is calculated being well known to Aurora, who can therefore adopt strategies, using the load following swap offers from Hydro Tasmania, to reduce their WEP risk for a specified volume of electricity, such as its forecast total load.

The Draft Report also raises the possibility that Aurora could face the risk of the Regulator changing its approach to calculating the WEP, but largely dismisses this as unlikely and subject to implementation over time.

We agree with the Regulator’s assessment that Aurora has lower than average risks relating to the WEP.

Volume Related Wholesale Electricity Price Risks

The Regulator has assessed that Aurora faces lower risks than other mainland NEM retailers from changes in the volume of Standing Offer electricity it sells and the number of customers it sells this to. The Regulator notes in the Draft Report:

“Aurora Energy’s customers comprise around 97 per cent of all residential and small business customers in mainland Tasmania. This is a much larger share than for all mainland retailers, including retailers with regulated tariffs. The Regulator’s draft assessment is that Aurora Energy is subject to less risk (compared to other retailers) of large scale changes in load due to customer switching. It is not possible, for example, for Aurora Energy to experience a large increase in customer load due solely to customer switching, given its current market share. Aurora Energy may also expect to lose a smaller percentage of its customers than many retailers due to the small number of other retailers in Tasmania and their very small market share.” (p.44)

We agree with the Regulator’s comments regarding the circumstances Aurora faces and consider that Aurora’s lower risk should be reflected in a lower retail margin.

Other Risks

A range of other risks are identified in the Draft Report that should reduce the retail margin:

- Aurora can recover the difference between estimated and actual outcomes for a range of costs in subsequent years. Market facing retailers do not have this luxury and would need to internalise this difference.
- The Regulator has agreed that Aurora's CTS allowance will be able to vary as customer numbers fluctuate. Retailers in competitive markets that lose market share are less able to increase their prices to recover their fixed costs as this could lead to further losses in market share.
- Aurora can seek the Regulator's approval for an adjustment to compensate for the impacts of a material change in its costs or tax changes.
- The Regulator has agreed to include in Aurora's RET costs, the prices in its long-term PPA with Cattle Hill Wind Farm. While unregulated retailers do enter into PPA's to reduce their exposure to short term RET prices, there is no guarantee that they can recover these costs, if they face competition.

We agree with this assessment.

The Regulator's Draft Proposal

We welcome the Regulator's draft determination that Aurora's retail margin is too high and not consistent with that of mainland NEM retailers. However, we urge the Regulator to go further than reducing the retail margin from the current 5.7 per cent to its proposal of 5.25 per cent.

The significantly lower risks faced by Aurora overall (as highlighted above) and the results of recent benchmarking of retail margins suggest that this is an inadequate reduction. In particular, we refer to the most recent evidence from the ACCC's estimates from November 2021. This found an average retail margin of 3.4 per cent for mainland retailers in the NEM.

The Regulator has pointed to a lower bound of 4.8 per cent, estimated by Frontier Economics in 2019 (a less recent estimate than the ACCC's and, therefore in our view, less relevant). The Regulator's proposed retail margin does not allow for the further reductions in retail margins experienced by mainland retailers in the NEM, since 2019. This contrasts to the CTS, where the ACCC's most recent data has been used. The more recent ACCC estimate suggests to us that 3.4 per cent should be used as a lower bound and that Aurora's retail margin should be reduced further and significantly to reflect this more recent information.

Allowing for this and the lower risks faced by Aurora compared to retailers operating in competitive markets, but accepting that Aurora has fewer economies of scale than the 'Big 3', suggests to us a retail margin of around 4.5 per cent. This figure has been arrived at by using the Regulator's same approach of taking the mid-point between the lower bound – in this case estimated by the ACCC (3.4 per cent) – and Aurora's current margin (5.7 per cent), which produces a retail margin of 4.5 per cent.

The Regulator's proposal equates to a retail margin of \$96.25 per customer in 2022-23 (in 2020-21 dollars), indexed by the Hobart CPI. We note that this is well above the \$49 per customer recently estimated by the ACCC and that the impact of this on regulated customers in Tasmania will be higher electricity prices. Our derived retail margin would reduce the cost per customer to \$82.50, still \$33.50 per customer above the ACCC's estimate, but well below Aurora's ask of \$111.94 per customer.

The retail margin should also exclude *aurora+* costs if these are added to the CTS. The case has not been made in either Aurora's publically released Preliminary Submission or the Regulator's Draft Report for the

amount of the allowance in the CTS. Further, if *aurora+* costs are recovered across the whole customer base, Aurora is already profiting from those customers that either cannot access it, or choose not to use.

Recommendation:

- 7. We consider the Regulator's proposal to apply a 5.25 per cent retail margin, which equates to \$96.25 per customer in 2022-23 (in 2020-21 dollars), is too generous and recommend a retail margin of 4.5 per cent, or \$82.50 per customer. This is based on the relatively low risks that Aurora faces and the lower retail margins in the NEM.***

AURORA+

Aurora has proposed that *aurora+* costs, currently paid on a user pays basis, be included in the regulated cost base under the 2022 Determination, such that customers would no longer pay separately for accessing this app.⁶

We agree that customers should not have to pay a separate fee to access the *aurora+* product.

aurora+ provides benefits to customers with an advanced meter, including greater visibility and control over their electricity usage. It also provides a number of benefits to Aurora, including lower levels of customer debt, improved bill payments, cost savings driven by digital efficiencies and customer retention.

However, there are also a number of barriers to the take up of the app that must be considered in the context of including *aurora+* in the cost base:

- Tasmania is the most digitally disadvantaged state, meaning we have the lowest levels in the country of digital access, affordability, skills and digital literacy.⁷
- Costs will be spread across all regulated customers, regardless of whether or not they use or value *aurora+*.
- Around half of the regulated customers will not have advanced meters at the start of the next regulatory period and therefore will not be able to access the benefits of *aurora+*, but nevertheless will be required to pay for access.
- Aurora's own projections estimate that more than half of their customers will not adopt the app by the end of the next regulatory period, but nevertheless will be required to pay for access.

Including *aurora+* in the Cost Base

We query the level of the CTS allowance both requested by Aurora and proposed by the Regulator. Prima facie, they are an unreasonably high amount.

Expenditure Forecasts

The expenditure forecasts for *aurora+* have remained confidential, providing no transparency or opportunity for scrutiny on the proposed expenditure, especially the claim for an allowance of \$17.33 per customer.

As a result, consumer advocates are not able to perform any scrutiny of the proposed allowances and rely on the Regulator to undertake this analysis on our behalf, to ensure the expenditure forecasts claimed by Aurora are efficient, reasonable and provide value for money.

We encourage the Regulator to undertake an analysis of digital apps similar to *aurora+* for a comparison or benchmarking of expenditure. The Tasmanian Government may be able to provide details for a number of digital apps it has commissioned, such as the *Check In Tas* app or Metro Tasmania app. Alternatively, information may be available relating to other utility (energy, telecommunications, banking) retailers' costs, or independent advice sought from app developers.

⁶ Customers using *aurora+* are currently charged 11 cents per day. With Aurora reporting 36,000 *aurora+* users in October 2021, this amounts to revenue of around \$1.5 million per annum.

⁷ Thomas, J., Barraket, J., Parkinson, S., Wilson, C., Holcombe-James, I., Kennedy, J., Mannell, K., Brydon, A. (2021). *Australian Digital Inclusion Index: 2021*. Melbourne: RMIT, Swinburne University of Technology, and Telstra.

As an example, a federal parliamentary committee heard the overall cost for the build and operation of the Commonwealth Government's *COVIDSafe* app was \$7.7 million with ongoing hosting and performance improvement costs of around \$60,000 per month.⁸ This app has been operational for more than two years, has been downloaded by more than seven million people and updated at least 17 times.

By way of comparison, Aurora has stated the costs of the initial development of *aurora+* were approximately \$4 million. It is currently earning more than \$1.5 million per year in product fees and Aurora is seeking more than \$315,000 every month in maintenance costs to service an estimated 130,000 customers by the end of the next regulatory period.

While acknowledging the different functionality between the *aurora+* and the *COVIDSafe* apps, it is apparent the *aurora+* expenditure forecasts and claims for a CTS allowance warrant some serious auditing and assessment, in particular, an accounting for the value of its benefits to Aurora from efficiency gains, lower levels of debt and improved bill payments. Aurora's claims about the benefits of *aurora+* to its users and their customer experience also need to be assessed more robustly if it is to be included in the CTS and passed on to all of Aurora's regulated customer base.

Small customers are relying on the Regulator to undertake this analysis to ensure they are not burdened with inefficient costs for a product that other retailers are able to provide for free as a service offering.

Recommendation:

- 8. We support the product fee being removed from the *aurora+* digital app but consider the CTS allowances of \$17.33 requested by Aurora and \$14.15 proposed by the Regulator are unreasonably high. We do not believe a case has been made that justifies these costs and recommend the Regulator undertakes a comparison of expenditure forecasts for similar apps, benchmarking of app costs and a more robust assessment of user benefits and experience.**

Labour Costs

Aurora provided separate expenditure forecasts for *aurora+*, including an allocation of labour costs relating to its customer service centre. However, as commented earlier in this submission, there is not a process for allocating shared costs between regulated and unregulated activities, so the robustness of the allocations for expenditure forecasts appear open to question.

The consultant's review of Aurora's allocation of costs to *aurora+* found:

*"... the proposed expenditure on *aurora+* was separately and appropriately accounted and that Aurora Energy's assumed call rate for *aurora+* customers was reasonable."*⁹

We note this finding relates to the way *aurora+* expenditure is presented and does not comment on whether the proposed expenditure is efficient or provides value for money. Unfortunately, due to the lack of access to important and relevant information, we are not able to assess or verify these claims and must rely on the Regulator to do so.

⁸ Official Committee Hansard (2021), *Senate Finance and Public Administration Legislation Committee Estimates*, Parliament House, Canberra, 24 May 2021, p.117.

⁹ Draft Report, p.29.

Marketing Costs

We note the Regulator's finding that a significant proportion of the proposed costs for the *aurora+* app relate to marketing. The Draft Report notes:

"A high level of expenditure may have been reasonable when Aurora Energy was trying to encourage customers to take up the app. However, the Regulator considers that the type and overall level of marketing that is needed if an app has a separate cost to customers is different from the marketing needed if the app is free to users." (p.29)

While we acknowledge the Regulator's effort to differentiate between selling and marketing costs, we would argue that a reasonable level of awareness and consumer education is required once the app is available to all customers.

Further, we would consider that including *aurora+* in the CTS should be supported by a digital and energy literacy campaign and would welcome the Regulator's view as to whether the costs of these activities should be recovered from regulated electricity customers through higher costs, or if digital inclusion and energy literacy are broader policy remits of government which the State Government is responsible for funding through the State Budget.

Recommendation:

- 9. We recommend that the inclusion of *aurora+* in the CTS is supported by a digital and energy literacy campaign and seek the Regulator's view as to whether the costs of these activities is the responsibility of regulated electricity customers, or if digital inclusion and energy literacy should be funded by the State Government through the State Budget.***

Rate of Adoption

If *aurora+* costs are included in the CTS, at the start of the next regulatory period around half the regulated customer base would face electricity bills that include the *aurora+* costs but would not be able to access the benefits of *aurora+* due to not having an advanced meter.

The *aurora+* cost estimates assume an increasing rate of adoption of the app, from a current level of 40,000 customers to 100,000 customers in 2022-23 to 130,000 customers by the end of the regulatory period in 2024-25. Given the large increase in the rate of adoption, the Regulator is seeking further information as to the plausibility of these projections. Even if these levels are reached, it means that over half of Aurora's customers will not access the app, but will nevertheless be paying for it.

If *aurora+* is included in the CTS, we recommend the application of the allowance be set proportionate to the annual rollout of advanced meters, and/or the uptake of the app. That is for example, if half of the customers have advanced meters at the start of the regulatory period, only 50 per cent of the CTS allocation is applied and is adjusted each year to match the proportionate rollout of meters.

Alternatively, if one-third of customers take up the app, then only one-third of the CTS allowance is applied and is adjusted each year to match the proportionate uptake of the app. This would provide an incentive for Aurora to ensure it meets its meter rollout milestones and targets, as well as encourage Aurora to support customers to take up connection to the app.

Recommendation:

10. If aurora+ is included in the CTS, we recommend the application of the allowance be set proportionate to the annual rollout of advanced meters, and/or the uptake of the app. This would provide an incentive for Aurora to ensure it meets its meter rollout milestones and targets, as well as encourage Aurora to support customers to connect to and use the app.

Other Considerations

Electricity retailers operating in more competitive mainland jurisdictions provide customers with access to digital apps as part of their competitive market offers. A search on “Finder.com.au” for energy providers with apps, rates 11 brands including Aurora. Of the 11 brands, it notes Aurora’s is “*the only app on the list that isn’t free*”, as well as identifying other apps with additional functionality, including solar management.¹⁰

These retailers do not charge their customers for this service offering and use apps as part of their efforts to attract and retain customers. The cost of the service offered by the app is recovered through retaining existing customers, attracting new customers and saving business costs.

It could be argued the development of additional products and service offerings to attract and retain customers is the purpose of a CARC allowance. Aurora customers have already paid millions in CARC allowance, with *aurora+* customers paying an additional product fee as well.

It must also be considered that up until June 2020, Aurora provided an online portal (Aurora Online) that provided customers with **free** access to their personal energy and metering data, including: account details; current bill balance; historic bill information; energy usage and metering data over time; bill estimation; bill payments; and balance and transaction requests.

Aurora Online was delivered under Aurora’s CTS but was removed and replaced with:

- an inferior online service that is forms-based, laborious (for both the customer and Aurora), slow and therefore a more costly system, that hinders a customer’s ability to access their personal energy usage data conveniently and efficiently; or
- paying an additional \$40 per year in product fees to access the same benefits and features through *aurora+*.

This was a retrograde step that fails to meet the efficiencies and level of service that Aurora understands customers have come to expect:

“Aurora Energy is aware of increasing customer expectations regarding the digitalisation of customer services, particularly within the utilities sector.”¹¹

Mainland retailers also tailor the functionality of their apps (and costs) to the needs of their customers through their participation in a competitive market. If they get it wrong, they bear the costs of having done so. Competition inhibits them from passing on the costs to their customers. Including the costs of *aurora+* in its CTS allowance would remove the user-pays discipline on Aurora to provide an app that meets customers’ needs and keep its costs efficient.

¹⁰ See <https://www.finder.com.au/energy-provider-apps#which-11-brands-offer-apps-and-what-do-they-do>

¹¹ Aurora Energy, 2022 Price-Regulated Retail Service Pricing Investigation – Preliminary Submission, p.25.

In the Tasmanian retail market, 1st Energy is currently embarked on an advertising campaign in which it compares itself to its main competitor (Aurora) on a number of measures, one such being its free app. This provokes a number of questions:

- What would Aurora's competitive response be if this advertising campaign was successful in attracting a large proportion of *aurora+* customers to 1st Energy?
- Would Aurora maintain, reduce, or remove its app fee to attract and retain customers?
- If it removed the fee how would it then fund its app costs without a CTS allocation? Would it have to look to other efficiencies in order to remain competitive?
- What would 1st Energy's reaction be in response to the Regulator's decision to bestow \$11.4 million to Aurora for providing a product/service that it provides for free? Would they feel that the Regulator has granted an unfair competitive advantage to Aurora by including the app in its regulated CTS?
- What would small customers' response be to the Regulator's decision to bestow \$11.4 million to Aurora for providing a service that other energy retailers, utilities and businesses can provide for free?

We urge the Regulator to carefully consider these questions before determining a CTS allowance for *aurora+*.

The Regulators Draft Proposal

The Regulator's draft proposal will result in *aurora+* costs of an average of \$14.15 per customer (\$2020-21) over the next regulatory period (down from around \$40 presently and Aurora's proposal of \$17.33). This proposal will increase *aurora+* revenue from \$1.5 million per annum (on current customer numbers) to \$3.8 million per year, assured through inclusion in regulated costs.

We are not convinced that this is a good outcome for small customers, even allowing for the larger *aurora+* user base that is forecast by Aurora and the resultant reduction in costs per customer. Further, we do not believe both Aurora and the Regulator have sufficiently or reasonably justified the cost per customer allowance in the CTS proposed in the Draft Report.

The lack of transparency in the *aurora+* expenditure forecasts makes it difficult for Aurora or the Regulator to justify these costs, or for consumer advocates to undertake any reasonable assessment as to whether the app costs are efficient or comparable to similar products in the market.

Given the concerns we have raised, while we support the product fee being removed from *aurora+* and the app being available to all customers for free, we seriously question Aurora's claim for a \$17.33 CTS per customer and the Regulators proposal of a \$14.15 CTS per customer.

We do not accept the case has been made for this additional cost without the evidence that demonstrates:

- the costs are efficient;
- the costs have been compared and benchmarked with similar apps;
- the product functionality meets customers' needs.

We expect the Regulator to act in the interests of small customers and rigorously interrogate and assess *aurora+* costs and functionality, as well as require Aurora to demonstrate how *aurora+* can reduce its costs and deliver greater efficiencies from digitalising its product offerings.

Recommendation:

- 11. We recommend the Regulator undertakes additional work to establish that aurora+ costs are efficient and its functionality is beneficial to customers, as well as require Aurora to demonstrate how it can use aurora+ to reduce its costs and enhance its revenue to offset its inclusion in the CTS.***