



Tasmania

DEPARTMENT of
INFRASTRUCTURE,
ENERGY *and* RESOURCES

**Review of
Electricity Arrangements
on the Bass Strait Islands

Discussion Paper**

Working Group of Officials

September 2006

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Glossary of Terms

Aurora Energy	Aurora Energy Pty Ltd
BSI	King and Flinders Islands in Bass Strait ... also referred to as “the Islands”
CSO	Community Service Obligation
DED	Department of Economic Development
DIER	Department of Infrastructure, Energy and Resources
ESI Act	<i>Electricity Supply Industry Act 1995</i>
GBE Act	<i>Government Business Enterprises Act 1995</i>
GPOC	The Government Prices Oversight Commission
GPOC Regulations	<i>Government Prices Oversight Regulations 1998</i>
Hydro Tasmania	Hydro-Electric Corporation, trading as Hydro Tasmania
KWh	One kilowatt of electrical power used for one hour
NAC	Net Avoidable Cost
OEPC	The Office of Energy Planning and Conservation
OTTER	The Office of the Tasmanian Energy Regulator
Regulator	The Tasmanian Electricity Regulator
Service Provider	Hydro Tasmania
Treasury	The Department of Treasury and Finance

1 PURPOSE

This paper has been prepared by a Working Group of officials in response to a request for advice from the Treasurer and Minister for Energy in relation to subsidised electricity on King and Flinders Islands.

This paper reviews issues concerning the tariff structure on the two islands and provides draft recommendations for consideration by key stakeholders before a final report is presented to the two Ministers.

The Working Group would like to invite key stakeholders to provide feedback and comment on the draft recommendations.

Please make your comments in writing to:

**Office of Energy Planning and
Conservation
Department of Infrastructure, Energy and
Resources
GPO Box 963,
Hobart, Tasmania 7001**

Comments are requested by close of business on:

Monday 23 October 2006

2 PREFACE

In 2004, the King and Flinders Island Councils renewed calls for further reductions to the subsidised retail electricity tariff on the Bass Strait Islands (BSI).

At the same time, favourable economic conditions were stimulating renewed interest in industrial development (and consequently electricity demand) on the BSI.

However, the cost of supplying electricity on the BSI had increased at a greater rate than the subsidised retail tariff, resulting in a large increase in the cost of the subsidy to the Government's Consolidated Fund.

Lastly, questions had arisen about the consequences of a reduction in the Federal Government's excise on diesel fuel, as used for electricity generation on the BSI, for a ten-year period beginning on 1 July 2006.

In response to these issues, in July 2005 the then Treasurer and the Minister for Infrastructure Energy and Resources, wrote to the Department of Infrastructure, Energy and Resources (DIER) requesting the formation of a Working Group to investigate and provide a set of recommendations regarding a number of BSI energy issues. The Working Group's Terms of Reference are:

"The Working Group is to investigate and provide a set of recommendations to us regarding the following Bass Strait Islands (BSI) energy issues:

- 1. Recommending the tariff structure in relation to the BSI, including:
 - a) the principle as to how retail electricity prices are set on the BSI;*
 - b) the type of tariff structure that is implemented; and*
 - c) who has responsibility for approving annual tariff rates;**

- 2. Estimating the cost to Government of any new tariff structure introduced and recommending as to how this will be funded;*
- 3. Identifying how increased demand for electricity on the BSI above current generation capacity will be managed;*
- 4. Identifying how cost savings to Government (through the BSI CSO) from a reduction in the Federal Government's diesel fuel excise will be applied; and if it is determined that these savings are to be passed on to the residents of the BSI, recommending an appropriate mechanism to do this".*

The Office of Energy Planning and Conservation (OEPC) within DIER convened and chaired a Working Group consisting of officials from OEPC and the Department of Treasury and Finance (Treasury), with assistance from the Office of the Tasmanian Energy Regulator (OTTER).

Additionally, OEPC sought the views of stakeholders including the Department of Economic Development (DED), the Department of Premier and Cabinet (DPAC), Hydro Tasmania, Aurora Energy and representatives of the King and Flinders Island Councils.

Meetings were held with Bass Strait Island Councils, Hydro Tasmania, Aurora Energy and relevant Government agencies.

The Working Group considered a wide range of matters including:

- a report presented to the Government by the BSI Councils and Region North in 2004,
- previous practices and policies,
- current related policies of the Tasmanian Government, and
- general objectives of economic efficiency, equity, social welfare and economic development.

The Working Group found little explicit existing policy to guide its deliberations, and that the matters put to it involved wider and more complex issues, such as the overall energy arrangements on the BSI.

The Working Group developed and agreed a set of principles to guide its work, assessed the overall issues and considered and evaluated a range of options for each of the issues.

The Working Group offers the following (draft) package of recommendations in response to the matters put to it in the Terms of Reference.

Once this has received stakeholder scrutiny and comment, a final report and set of recommendations will be made to the Ministers for their consideration.

3 SUMMARY OF DRAFT RECOMMENDATIONS

1. “Recommending the tariff structure in relation to the BSI, including:
 - a) the principle as to how retail electricity prices are set on the BSI;
 - b) the type of tariff structure that is implemented; and
 - c) who has responsibility for approving annual tariff rates.”
-

a) - The principle as to how retail electricity prices are set on the BSI

The level of retail electricity prices on the BSI depends heavily upon the extent of Government subsidy through a Community Service Obligation (CSO).

It is recommended that this continue, but with better focus and clearer responsibilities.

To guide policies on this matter, the following principles/objectives are proposed:

Bass Strait Islands Electricity Pricing Principles/Objectives

Principle 1: The residents of the BSI will have access to affordable electricity consistent with a reasonable household standard of living.

Principle 2: The Government will continue to support electricity tariffs on the BSI at a level commensurate with the social policy objective of Principle 1.

Principle 3: The BSI electricity tariff will be consistent with other economic and environmental objectives.

Principle 4: The regulatory and/or contractual arrangements for supply of electricity on the BSI will promote ongoing efficiency gains and least-cost supply solutions.

Principle 5: The ongoing support for electricity tariffs on the BSI will be targeted to deliver the objectives in an efficient and sustainable manner, with costs balanced against other calls on public funds.

b) - The type of tariff structure that is implemented

The Working Group proposes that the tariff structure on the BSI should be changed in order to align the cost of basic electrical services on the BSI with that on mainland Tasmania, but at the same time to create appropriate incentives for efficient energy use and to limit the growth of the government subsidy over time.

The Working Group is proposing that the current flat rate tariff is replaced with a stepped block tariff. Government would decide the rates for each block and the nature of the thresholds that should apply following advice from the Government Prices Oversight Commission (GPOC).

The Working Group recommends that the Minister for Energy, in consultation with the Treasurer, issue a Terms of Reference to GPOC under the *Government Prices Oversight Regulations 1998* (GPOC Regulations).

These Terms of Reference would include details of the Government's social objectives as articulated in the policy principles together with a range of possible funding levels for the CSO. GPOC would then recommend to Government a tariff that takes into consideration the terms of reference and the current cost structures.

The Working Group has included an example of a four block stepped tariff structure at Appendix A (without prejudice to the advice of GPOC or the decision by Government). In this example, block 1 targets household welfare and recognises the 'essential service' nature of electricity in household lighting and basic appliances.

The Terms of Reference could include a rate equivalent to Aurora Energy Tariff 31 on the initial 500kw block to deliver a block of energy at a comparable price to mainland Tasmania.

Block 2 could be set at a rate not dissimilar to the pre-existing tariff with allowances for general cost increases and inflation. Block 3 and 4 progress tariff rates towards the efficient cost of supply.

c) - who has responsibility for approving annual tariff rates

The Working Group recommends the Minister for Energy should have responsibility for overall energy policy on the BSI, including approval of annual tariff rates.

Once the structure of the tariff is determined, the Minister for Energy, in consultation with the Treasurer, will seek advice from GPOC on the details of the tariff rates and thresholds to apply for the next period.

It is anticipated that a review of the tariff structure would occur at three yearly intervals in association with the terms of the CSO contract, or more often if special circumstances dictate (i.e. a material change in the generation or supply of electricity on the BSI).

For the years between the Commission's reviews, the BSI tariff structure would be escalated annually by the Australian Consumer Price Index.

2. Estimating the cost to Government of any new tariff structure introduced and recommending as to how this will be funded.

The Working Group proposes that the current arrangement, under which the CSO is funded from consolidated revenue while the tariff raises an equitable contribution from electricity users on the BSI, should continue.

The cost to Government of the CSO will be the difference between the efficient cost of supply on the BSI and the revenue likely to be raised by the proposed tariff.

By issuing GPOC with Terms of Reference, which include the possible funding levels Government is prepared to contribute in order to meet its social objectives as articulated in the policy principles, GPOC will have clear parameters for undertaking its review.

3. Identifying how increased demand for electricity on the BSI above current generation capacity will be managed.

The service provider (Hydro Tasmania) will be required to augment generation capacity on the BSI in an efficient manner to meet increases in demand caused by normal endogenous growth. Appropriate incentives to invest in new capacity are created by ensuring the service provider is entitled to a commercial return on efficient operations.

The Working Group recommends new loads with the capacity to take more than 5% of installed system firm capacity will be required to negotiate individual commercial power purchase arrangements and the supplier will be expected to offer them fair and reasonable terms. This ensures efficient pricing of electricity for new large loads.

It is possible that the supplier and prospective customer might be unable to reach a commercial agreement on supply for a very large new load. The customer is entitled to supply itself, or find another party willing to supply it, subject to satisfactory connection arrangements.

Concerns arising from the possible stranding risk if the new large loads leave the Islands are addressed by the requirement for customers with large new loads and the service provider to negotiate a commercial power purchase arrangement on fair and reasonable terms.

4. *Identifying how cost savings to Government (through the BSI CSO) from a reduction in the Federal Government's diesel fuel excise will be applied. If it is determined that these savings are to be passed on to the residents of the BSI, recommending an appropriate mechanism to do this."*

Since the Federal Government announced the reduction in the diesel fuel excise, the savings arising from the reduction in excise have been offset by increases in the underlying diesel price.

4 BACKGROUND

Electricity on the BSI is supplied by Hydro Tasmania using a combination of wind and diesel generation, while Aurora Energy provides operational, distribution and retail services under contract to Hydro Tasmania. Due to the remote nature of the Islands and reliance on diesel generation, the cost of supplying electricity is significantly higher than on mainland Tasmania.

Historically, the Government has supported the BSI community by subsidising the retail electricity tariff significantly below the cost of production (the subsidised retail tariff).

Prior to 1995 the Government funded the subsidised tariff by accepting a reduced return from the Hydro-Electric Commission.

In 1998 the Hydro-Electric Commission was disaggregated and its generation, transmission, distribution and retail functions were corporatised into separate businesses under the *Government Business Enterprises Act 1995* (GBE Act) and the *Electricity Companies Act 1997*.

On the BSI, Hydro Tasmania retained an integrated generation, distribution and retail business. At that time (and in line with national competition policy) the Government used the CSO provisions under the GBE Act to make transparent non-commercial activities undertaken by Government owned businesses at the direction of the Government.

Since 1998, electricity on the BSI has been supplied by Hydro Tasmania under a CSO contract with Government. The subsidised component of the retail tariff is directly funded from the Consolidated Fund.

Currently the Government subsidises about two thirds of the cost of supplying electricity on the BSI. An amount of \$7.022 million has been included in the Budget for this purpose in the 2005-06 financial year, equating to an average subsidy of around \$2,600 for every resident of King and Flinders Island.

With most of the electricity used on the BSI being generated from diesel, the actual cost of generation is rising, with higher diesel prices offsetting the recent introduction of a rebate on the excise component of these costs.

Hydro Tasmania's operations on the BSI are not the subject of a licence issued by the Regulator with associated licence conditions under the ESI Act.

Nevertheless, the ESI Act does apply to Hydro Tasmania on the BSI but it is an incomplete application, with the tariffs effectively set through the CSO contract rather than by the Regulator and with no explicit Code requirements for the performance targets and standards.

On the BSI, Hydro Tasmania operates under a deemed licence in accordance with the *Electricity Supply Industry (Transitional Provisions) Act 1995*. This allows it to continue to undertake those operations that it was lawfully undertaking prior to the licensing requirement under the ESI Act until such time as the deemed licence is replaced by a licence issued by the Regulator.

In recognition of the circumstances on the BSI, operations on the BSI have been kept separate from regulatory changes in the Tasmanian electricity market as it entered the National Electricity Market (NEM).

5 DISCUSSION OF DRAFT RECOMMENDATIONS

5.1 The principle as to how retail electricity prices are set on the BSI

Recommended Option –

Targeted subsidy aligned with social objectives

The Working Group considered the social policy objectives Government is seeking to progress by funding the subsidised retail tariff on the BSI, such as household welfare, industry support and industry development. Progression of these objectives was further considered in terms of the range of Government assistance measures available including the subsidised retail tariff.

There is a need to more clearly define the entitlement to subsidised electricity on the BSI. Existing residents and enterprises are entitled to a confirmation of their expectations, if these are valid and reasonable.

The Government is entitled to be able to know what the arrangements are likely to cost. New entrants to the BSI, particularly large industrial concerns, are entitled to know what the policies are in regards to connection and whether or not they will be able to get supply, and on what basis.

Under the terms of the CSO contract, an eligible customer for the subsidised retail tariff must be a resident of the BSI. This suggests that the intended social policy outcome of the subsidised retail tariff is that it contributes to the social welfare of the residents of the BSI rather than the progression of industry support and/or development activities. (Furthermore, the establishment of the Department of Economic Development suggests that the Government believes that economic and regional development should be progressed explicitly).

In light of these considerations and the broader policy objectives of Government, the Working Group developed the following guiding principles for the electricity tariff on the BSI.

Principle 1: The residents of the BSI will have access to affordable electricity consistent with a reasonable household standard of living.

Principle 2: The Government will continue to support electricity tariffs on the BSI at a level commensurate with the social policy objectives of Principles 1.

Principle 3: The BSI electricity tariff will be consistent with other economic sustainability and environmental objectives.

Principle 4: The regulatory and/or contractual arrangements for supply of electricity on the BSI will promote ongoing efficiency gains and least-cost supply solutions.

Principle 5: The ongoing support for electricity tariffs on the BSI will be targeted to deliver the objectives in an efficient and sustainable manner, with costs balanced against other calls on public funds.

The Working Group recommends that there be a clear delineation of the processes that determine:

- (i) the subsidised retail tariff on the BSI, and
- (ii) (ii) the basis of remuneration to the service provider(s).

This will provide a practical framework by which the subsidised retail tariff can be set with due consideration of government's social objectives, the impact on the Consolidated Fund and efficiency considerations.

Keeping the responsibility for determination of the subsidised retail tariff separate from negotiations on the remuneration of the supplier of electricity on the BSI ensures that the Government has the option to enhance the arrangements for either of these aspects in isolation, avoiding the practical difficulties of complex linkages.

Within the constraints of the current legislative and contractual arrangements, the basis of remuneration for supply of electricity is dictated by the current CSO declaration and subsequent contract. Under this framework, the Treasurer can seek advice as to the tariff structure by issuing terms of reference provided to GPOC under Regulation 20 of the GPOC Regulations.

The Working Group recommends that these terms of reference include the details of Government's social objectives and tariffing principles, together with a range of funding levels. Separately, but within the same terms of reference, advice should be sought as to the efficient cost of supplying electricity on the BSI. This advice would then inform the Treasurer in the administration of the CSO contract.

This approach is generally consistent with what has gone before with GPOC and the 1999 Determination, which was undertaken in accordance with terms of reference provided by the Government.

It is intended that this mechanism will ensure that Hydro Tasmania is entitled to a commercial return on efficient operation in the same manner as a commercial entity operating under an incentive based economic regulation regime.

5.2 Type of tariff structure

Recommended Option —

Target Subsidy aligned with social objectives

The Working Group proposes that the tariff structure on the BSI should be changed in order to align the cost of basic electrical services on the BSI with that on mainland Tasmania, but at the same time to create appropriate incentives for efficient energy use and to limit the growth of the government subsidy over time.

The Working Group is proposing that the current flat rate tariff is replaced with a stepped block tariff. Government would decide the rates for each block and the nature of the thresholds that should apply following advice from the Government Prices Oversight Commission (GPOC).

The Working Group recommends that the Minister for Energy, in consultation with the Treasurer (as administer of the CSO contract), seek advice as to the

tariff structure by issuing a Terms of Reference provided to GPOC under Regulation 20 of the GPOC Regulations.

These Terms of Reference would include the details of Government's social objectives as articulated in the policy principles, general tariffing principles (including a stepped tariff), together with a range of possible funding levels. The Minister for Energy would then advise the Treasurer as to the BSI tariff to be applied, on the basis of advice provided by GPOC.

The Working Group has included an example of a four block stepped tariff structure at Appendix A (without prejudice to the advice of GPOC or the decision by Government). In this example block 1 targets household welfare and recognises the 'essential service' nature of electricity in household lighting and basic appliances.

The Terms of Reference could include rate equivalent to Aurora Energy Tariff 31 on the initial 500kw block to deliver a block of energy at a comparable price to mainland Tasmania. Block 2 is set at a rate not dissimilar to the pre-existing tariff with allowances for general cost increases and inflation. Block 3 and 4 progress tariff rates towards the efficient cost of supply.

5.3 Responsibility for approving annual tariff rates

Recommended Option –

Government to approve the subsidised retail tariff level and separately negotiate the remuneration of the supplier

The recommendation is that the Minister for Energy is to have responsibility for approving the subsidised retail tariff on the BSI, in consultation with the Treasurer (as the purchasing Minister for the CSO contract).

Regulation 20 of the GPOC Regulations provides that the Treasurer (as the Minister responsible for these Regulations) may direct the Government Prices Oversight Commission (the Commission) to inquire into and report on, a

matter relating to or affecting the pricing policies of a prescribed body. For the purposes of the Regulations, Hydro Tasmania is a prescribed body.

An inquiry undertaken under Regulation 20 is flexible in that the Commission may conduct the inquiry in such a manner as it considers appropriate. Similarly, the final report is provided to the Treasurer, the Minister for Energy and the prescribed body (unless directed otherwise).

The Treasurer may make a direction at his own discretion or at the request of a Minister for Energy. Under the second scenario, the Minister for Energy would request the Treasurer to direct the Commission to investigate and report on an appropriate tariff structure that would apply to the BSI.

A direction is to be made in writing and contain the Terms of Reference for the enquiry, as described above. It is possible that the terms of reference could require a link between the first tariff band and the Aurora Energy Tariff 31.

The Government would assess the recommendations returned by the Commission to ensure that the recommended tariff structure appropriately meets the policy principles. The Minister for Energy, in consultation with the Treasurer, would approve the tariffs to apply to the BSI and Hydro Tasmania will publish and apply the tariffs.

It is anticipated that this process would occur at three yearly intervals in association with the terms of the CSO contract, or more often if special circumstances dictate (i.e. a material change in the generation or supply of electricity on the BSI). For the years between the Commission's reviews, the BSI tariff structure would be escalated annually by the Australian Consumer Price Index.

The negotiation of the CSO contract is seen as a matter between the Government and the supplier. It is envisaged that this negotiation would be

informed by an expert assessment of the efficient costs of supply. The Government could seek to obtain this advice from GPOC.

It should be noted that GPOC has no prescribed information requisition power to enable it to undertake the inquiry as specified in the terms of reference. However, this should not lead to difficulties as the Treasurer and Minister for Energy have information gathering powers in their capacity as shareholders of Hydro Tasmania and Aurora Energy, and under the *Energy Co-ordination and Planning Act 1995*.

A significant advantage of the process described above is that it aligns outcomes and funding responsibilities with the relevant portfolio responsibilities. This is particularly relevant as the BSI are excluded from the State's National Electricity Market regulation (being unconnected) and the Regulator does not have the same pricing responsibilities on the BSI as with the rest of the State.

5.4 Managing increases in demand

Recommended Option –

An obligation to augment efficiently

Managing increases in demand is complicated by uncertainties about the obligations on Hydro Tasmania to connect and supply new loads on the BSI. On mainland Tasmania the retailer has an exclusive retail franchise for non-contestable customers, and this is formally recognised. Accompanying this status is an obligation to supply.

On the BSI the obligation to supply is determined by Ministerial direction. This is not very specific as to detail. Obligation to supply mechanisms may have worked well enough to date, but could be regarded as an issue that would benefit from greater clarity in future.

A question that needs to be answered is whether or not the supplier on the BSI has an exclusive retail franchise, and if so what are the bounds on such a

franchise, and if not, what are the detailed obligations on the supplier to connect and supply.

The recommendation is that the supplier will be required to efficiently augment generation capacity at tariff levels for normal endogenous growth (including all residential growth), and that new connections with provision to take capacity over 5% of installed system firm capacity will be expected to negotiate a power purchase agreement with the supplier.

The supplier (i.e. Hydro Tasmania) will be required to offer a commercial (cost reflective) power purchase contract to such new connections on fair and reasonable terms. This ensures efficient pricing of electricity for new large loads.

It is possible that the supplier and prospective customer might be unable to reach a commercial agreement on supply for a very large new load. The customer is entitled to supply itself, or find another party willing to supply it, subject to satisfactory connection arrangements.

Previously such a straightforward solution was precluded by uncertainty in allocation of risk between the supplier (Hydro Tasmania), new large customers and Government as provider of the CSO.

Should the recommendations in regard to tariff structure be adopted, these risks would be explicitly allocated in an efficient manner. Specifically remuneration of the supplier is set as being 'a commercial return on efficiently incurred costs', so removing the regulatory uncertainty surrounding the likely returns on new investment in generation.

Further, the requirement for new large loads to negotiate power purchase from the supplier on fair and reasonable 'commercial terms' allows the supply to appropriately price and allocate the 'stranding risk' associated with generation investment to supply such loads.

5.5 Reduction in diesel fuel excise

Recommended Option – Offset rising CSO costs to the Consolidated Fund

The Working Group was asked to recommend how cost savings to Government (through the BSI CSO) from a reduction in the Federal Government's diesel fuel excise will be applied, and if it is determined that these savings are to be passed on to the residents of the BSI, recommending an appropriate mechanism to do this.

The Federal Government has announced that from 1 July 2006 to 30 June 2021 there will be a reduction in excise of 38.142 cents per litre on diesel used in commercial power generation (this represents a reduction in the current price of diesel of approximately 35%).

Under the existing CSO contract arrangements, cost savings attributable to a reduction in the diesel excise will reduce the cost to the Consolidated Fund for the BSI CSO. These cost savings would not flow through to electricity prices as there is no mechanism under the current arrangements to do so.

The cost of the diesel fuel excise to Government is approximately \$1.6 million per year, while the increased cost to Government arising from diesel fuel price rises over the last two years is around \$1.5 million per year. Should the current upward trend in diesel prices continue, the reduction in cost due to removal of the diesel fuel excise would be absorbed by the increase in the underlying diesel fuel price.

Under the existing CSO arrangements, the Government has been bearing the diesel price risk because annual adjustments to the subsidised retail tariff on the BSI have been limited to movements in the Australian Consumer Price Index.

Since the Commonwealth announced the pending reduction in the diesel fuel excise, the 'savings' arising from the reduction in excise have been fully

absorbed by increases in the underlying diesel price. As such the term 'savings' refers to costs that would otherwise have been borne by Government, rather than a reduction in cost to Government relative to historical levels of funding.

The recommendation is that CSO should continue to absorb fluctuations in the costs of supply brought about by changes in diesel fuel costs and the reduction in the diesel fuel excise will offset the Government's rising costs from the CSO.

APPENDIX A: ILLUSTRATIVE EXAMPLE OF A STEPPED TARIFF

The Working Group is proposing that the current flat rate tariff be replaced with a stepped block tariff. Government would decide the rates for each block and the thresholds that would apply following advice from GPOC in accordance with Terms of Reference provided to it. For illustrative purposes, the Working Group includes the following example of a four block stepped tariff.

Fixed charges

Fixed and metering charges to be set following general tariffing principles.

Variable Charges

The energy component of the tariff would consist of four (increasing) blocks, as described below:

Block 1: Block 1 targets household welfare. This recognises the ‘essential service’ nature of electricity in household lighting and basic household appliances (as opposed to heating or cooling) and delivers a block of electricity at a comparable price to that on mainland Tasmania. For example, instead of paying 20.89c/KWh, customers on the BSI might pay a rate equivalent to Aurora Energy Tariff 31 on the initial 500 KWh block, saving up to \$28 per quarter.

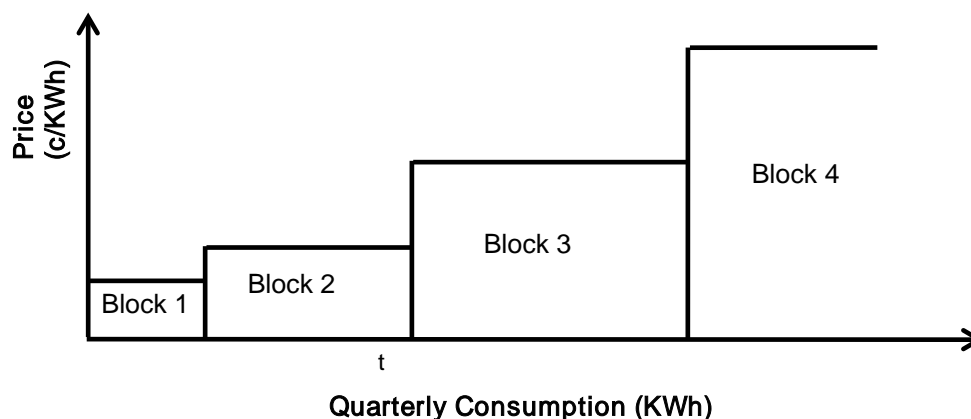
Block 2: Block 2 recognises the need to avoid price shocks for existing commercial and industrial activities on the BSI and would be set at a rate not dissimilar to pre-existing tariffs, with allowances for general cost increases and inflation.

Block 3: Block 3 provides limited price relief to support organic growth of existing enterprises and softens the step towards the full cost pricing in Block 4. To the extent that the pricing of this block is reflective of efficient cost, it is intended to avoid displacement of more efficient fuels and support efficient

arrangements for supply. Block 3 is a step closer to the true cost of supply, thereby increasing incentives on large users to consider cost efficient energy alternatives for incremental demand.

Block 4: This block is unsubsidised. It is only likely to be relevant for large users. The principle is that such large volumes of electricity should be related to the true costs of efficient supply. If Government assistance is warranted then it should be targeted, and delivered in an efficient way, and not cause a large distortion towards electricity at the expense of other fuels.

Example: Illustrative Tariff Structure



The tariff structure is based on the concept of blocks of energy at tariff rates that are stepped upwards towards the efficient cost of supply. The illustrated (conceptual) design gives an additional discount to all BSI customers for the first block of energy used each quarter, providing approximate equivalence to mainland Tasmania for basic light and power. The rates for each block, and the nature of the thresholds and block sizes, would be decided by Government following advice from the Government Prices Oversight Commission.

The need to define thresholds for block sizes is one of the matters on which feedback is being sought. The Working Group is not opposed to specific Government assistance for existing, new or expanding commercial and

industrial developments on the BSI. However, it is considered that the blanket discounting of electricity gives little comfort that the social policy gains are commensurate with the level of subsidy provided. Support for existing industry, new industry or substantive expansion of existing industry is better progressed through regional development mechanisms in order to deliver support in the most efficient way.