



Tariff Strategy Report – 2006 to 2010

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TABLE OF CONTENTS

1. INTRODUCTION	4
1.1 Powercor Australia's Operating Environment	4
1.2 The Distribution Network.....	6
2. TARIFF STRATEGY	8
2.1 Regulatory Arrangements	8
2.1.1 Distribution Tariffs.....	8
2.1.2 Transmission Tariffs	8
2.1.3 Prescribed Metering	8
2.2 General Information	8
2.2.1 Powercor Australia's Network Tariff Categories	8
2.2.1.1 <i>Tariff Categories for Network Tariffs</i>	9
2.2.1.2 <i>Distribution Tariffs</i>	9
2.2.1.3 <i>Transmission Tariffs</i>	9
2.2.1.4 <i>Retail Tariffs</i>	10
2.2.2 Anticipated Tariff Directions and Movements	10
2.2.3 Outcomes	10
2.3 Proposed Structure 2006-10.....	11
2.3.1 Block Tariffs.....	11
2.3.2 Time of Use Tariffs	11
2.3.3 Location Based Tariffs.....	12
2.3.4 Interval Meter Tariffs.....	12
2.3.5 Summer and Winter Tariffs	12
2.3.6 Embedded Network Tariffs.....	12
2.3.7 Excessive Reactive Demand Charge	12
2.3.8 Land Tax.....	13
2.4 Excluded Service Charges and Prescribed Metering Service Tariffs	13
2.4.1 Excluded Service Charges.....	13
2.4.2 Prescribed Metering Service Tariffs	13
2.4.2.1 <i>Meter Provision</i>	13
2.4.2.2 <i>Meter Data Services</i>	14
3. TARIFF POLICY FRAMEWORK.....	15
3.1 Pricing Principles and Outcomes.....	15
3.1.1 Distribution Tariffs.....	15
3.1.2 Transmission Tariffs	15
3.1.3 Pricing Objectives.....	15
3.1.4 Compliance with the Pricing Principles	15
4. NETWORK TARIFF METHODOLOGY	17
4.1 2006 Tariffs and Future Developments	17
4.1.1 D1 – Residential Single Rate	17
4.1.2 D1.CS – Climate Saver	17
4.1.3 D3.CS – Climate Saver Interval	17
4.1.4 D2 – Residential Two Rate 5d	17
4.1.5 D2.DK – Docklands Two Rate 5d	18
4.1.6 D3 – Residential Interval	18
4.1.7 DD1 – Dedicated Circuit.....	18
4.1.8 D3.HW – Hot Water Interval.....	18
4.1.9 ND1 – Non-Residential Single Rate.....	19
4.1.10 ND2 – Non-Residential Two Rate 5d.....	19
4.1.11 ND3 – Non-Residential Two Rate-7d	19
4.1.12 ND5 – Non-Residential Interval.....	19
4.1.13 PL2 – Unmetered Supplies	20
4.1.14 DL – Large Low Voltage Demand.....	20
4.1.15 DL.CXX – Large Low Voltage Demand CXX.....	20
4.1.16 DL.A, DL.C, DL.S and DL.DK – Large Low Voltage (Location-Based).....	20
4.1.17 DH – High Voltage Demand.....	20
4.1.18 DH.A, DH.C, DH.DK, DH.D1, DH.D2, DH.D3, DH.D4 and DH.D5 – HV Demand (Location-Based)	21
4.1.19 DS.A, DS.G and DS.S – Subtransmission Demand.....	21
4.2 Tariff Assignment.....	21
4.3 Methodology of Standalone and Avoidable Costs	21
4.4 Fixed and Variable Charges	22

4.5	Future Investment Requirements	22
4.6	Allocation of Transmission Costs	22
4.6.1	Tariff Equalisation	23
4.7	Allocation of Prescribed Metering Service Costs	23
4.7.1	Cost of Service Provision	23
4.7.2	Cost Allocation.....	23
4.7.3	Cost Differentials	23
4.7.4	Simplicity.....	24
5.	CONSUMPTION SIGNALS	25
6.	CONSULTATION	26

TABLE OF FIGURES

Figure 1: Comparison of Distribution Business Characteristics (2004)	5
Figure 2: Powercor Australia's Supply Areas	6
Figure 3: Summary of Powercor Australia's Distribution Network.....	7
Figure 4: X-factors	9
Figure 5: Annual Grid Equalisation Adjustments	10
Figure 6: Small Two Rate Tariff 2003-5.....	10
Figure 7: Tariffs Levels Related to Efficient Bounds	22
Figure 8: Proposed Tariff Structures 2006-10	25

1. INTRODUCTION

Powercor Australia is a Victorian-based electricity distribution company. Powercor Australia is Victoria's largest electricity distribution company in terms of the size of its network and the number of customers it serves, covering 150,000 square kilometres or around 65 percent of the State and serving more than 630,000 customers.

The Powercor Australia network links southwest Victoria, the Murray and Goulburn Valleys and the Wimmera region stretching from the western suburbs of Melbourne to the South Australian and New South Wales borders.

Victoria's key regional cities, including Bendigo, Ballarat, Geelong, Horsham, Mildura, Shepparton and Warrnambool, depend on Powercor Australia's network to meet their electricity demands.

Powercor Australia's distribution business was purchased by Cheung Kong Infrastructure Holdings Limited (CKI) and Hongkong Electric Holdings Limited (HEH) in September 2000. CKI and HEH are both publicly listed companies on the Hong Kong Stock Exchange, and form part of the Cheung Kong Group. CKI is the largest diversified infrastructure company listed in Hong Kong with investments in energy, transport and infrastructure materials businesses around the world. HEH is the listed vehicle of the Hongkong Electric group of companies which comprises the Hongkong Electric Company, one of the world's oldest power companies.

1.1 Powercor Australia's Operating Environment

Powercor Australia's network is the largest in Victoria in terms of its size and the customers it serves. The Powercor Australia network has the following key statistics.

- 150,000 square kilometres;
- Over 7,000km of underground line;
- More than 500,000 poles;
- 66 zone substations;
- Over 75,000km of overhead line;
- More than 67,000 distribution substations;
- Over 9,000 GWh of electricity distributed per year;
- More than 630,000 customers;
- 4 customers per square kilometre.

Powercor Australia has a number of unique characteristics that distinguish it from the other Victorian distribution businesses. The Powercor Australia region is subject to tough and variable geographic and climatic conditions that impact on the cost and service levels provided to its customers. These include:

- An average of 7.6 customers per kilometre of distribution line representing the most sparsely populated areas of Victoria;
- Powercor Australia's distribution area has the least diversified economy in Victoria. The economy in the Powercor Australia region is heavily reliant on manufacturing industries, particularly resource processing. These industries are significantly exposed to international trade and changes in government policy. Many of the towns and cities in the Powercor Australia region are dependent on these industries which through their exposure to international trade and government policy are subject to industry downturns and closures. These factors make Powercor Australia's customer load some 15-30 percent more volatile than total Victorian customer load;

- A distribution area covering some of the most fire-prone country in the world. The combination of oil-bearing eucalyptus trees, dry grass, low humidity and hot gusty winds exacerbate the likelihood of bushfires;
- High levels of termite infestation contributing to pole deterioration;
- Sections of the mid Murray Valley area experience high groundwater salinity. This can damage concrete poles through corrosion. There are vast numbers of concrete poles throughout the Powercor Australia region;
- Harsh windy conditions around the south coast contributing to salt build up on insulators and causes premature failure of steel pole hardware;
- The south coast features rugged mountainous terrain, particularly in the Otways; and
- The nature of the Powercor Australia service territory and the design of the network necessitates a number of long feeders in rural areas which results in longer restoration time in fault situations.

These features result in a distribution network with relatively high capital, operating and maintenance costs and great susceptibility to supply interruption and faults.

In order to illustrate the relative cost drivers imposed by the geography of the Powercor Australia area, the chart below shows a comparison between the Powercor Australia infrastructure requirement and those of the other Victorian distribution businesses. Powercor Australia has 28 percent of the Victorian customer base but 65 percent of the area and 57 percent of line kilometres. This situation leads to higher costs per customer for Powercor Australia than for other electricity distribution businesses in Victoria.

Figure 1: Comparison of Distribution Business Characteristics (2004)

Network Assets by Distribution Business								
Company	Poles ('000)	Line (Km)			Zone Sub-Stations	Distribution Sub-Stations	Coverage (Sq km)	Customers ('000)
		Total	Over-head	Under-ground				
Powercor Australia	525	82,701	75,379	7,322	66	75,500	150,000	629
Other distributors	638	62,024	53,725	8,299	142	64,044	82,557	1,584
Total	1,163	144,725	129,104	15,621	208	139,544	232,557	2,213
Powercor Australia % of total	45%	57%	58%	47%	32%	54%	65%	28%

Powercor Australia's cost drivers depend on a number of inter-related factors as follows:

- The capacity of Powercor Australia's existing assets to meet the new requirements that will be placed on it over the regulatory period;
- The likely growth in demand across the network driven by new customers and increased electricity demand, particularly due to the growth in the penetration of air-conditioners;
- The need to maintain network utilization at sustainable levels to ensure reliability and operational flexibility; and
- The need to progressively replace Powercor Australia's ageing network assets. The ageing of our assets increase the expenditure required on our renewals and replacement programs.

1.2 The Distribution Network

Powercor Australia's supply areas are depicted in Figure 2. The distribution network is summarised in Figure 3.

Figure 2: Powercor Australia's Supply Areas

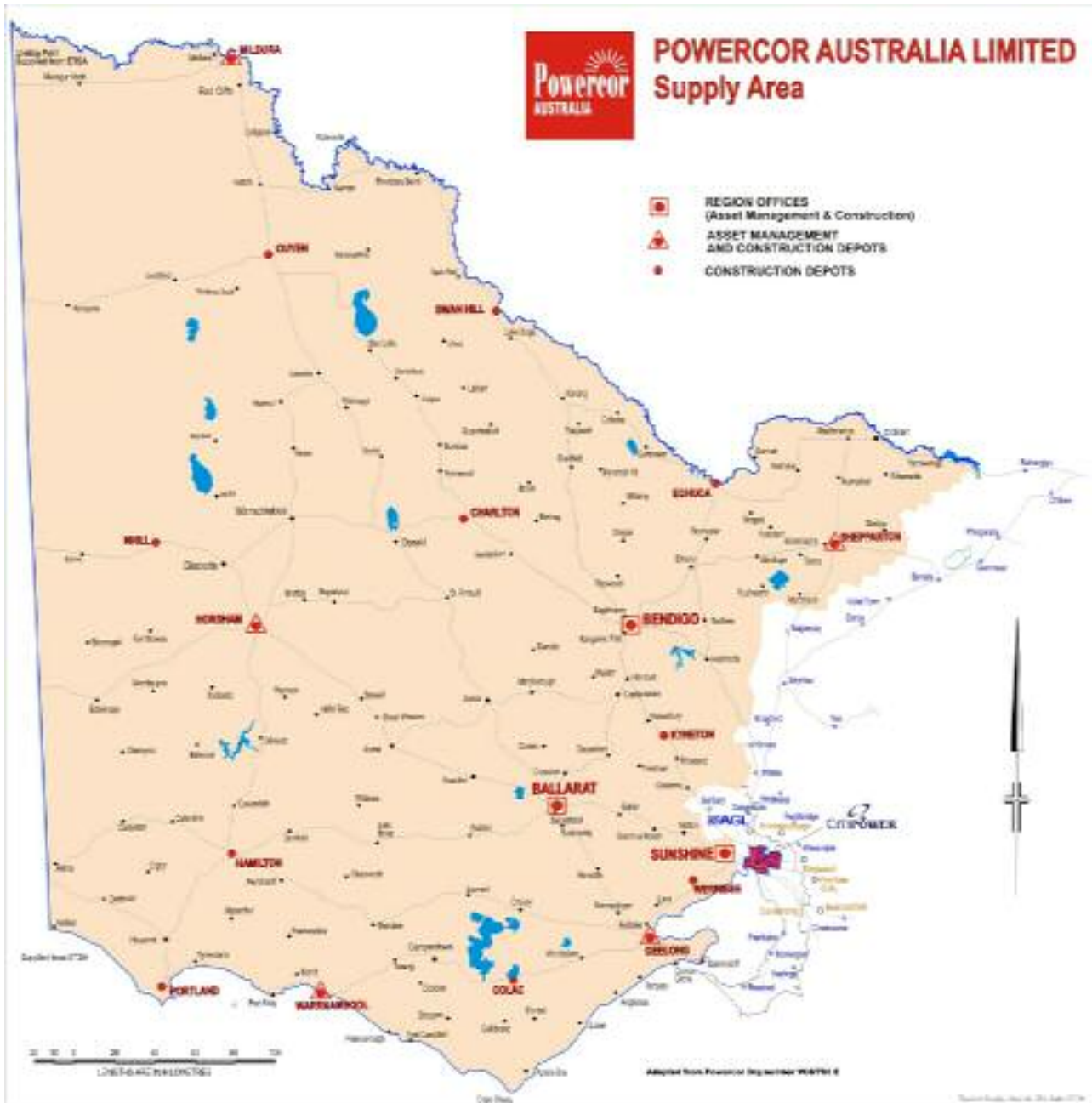
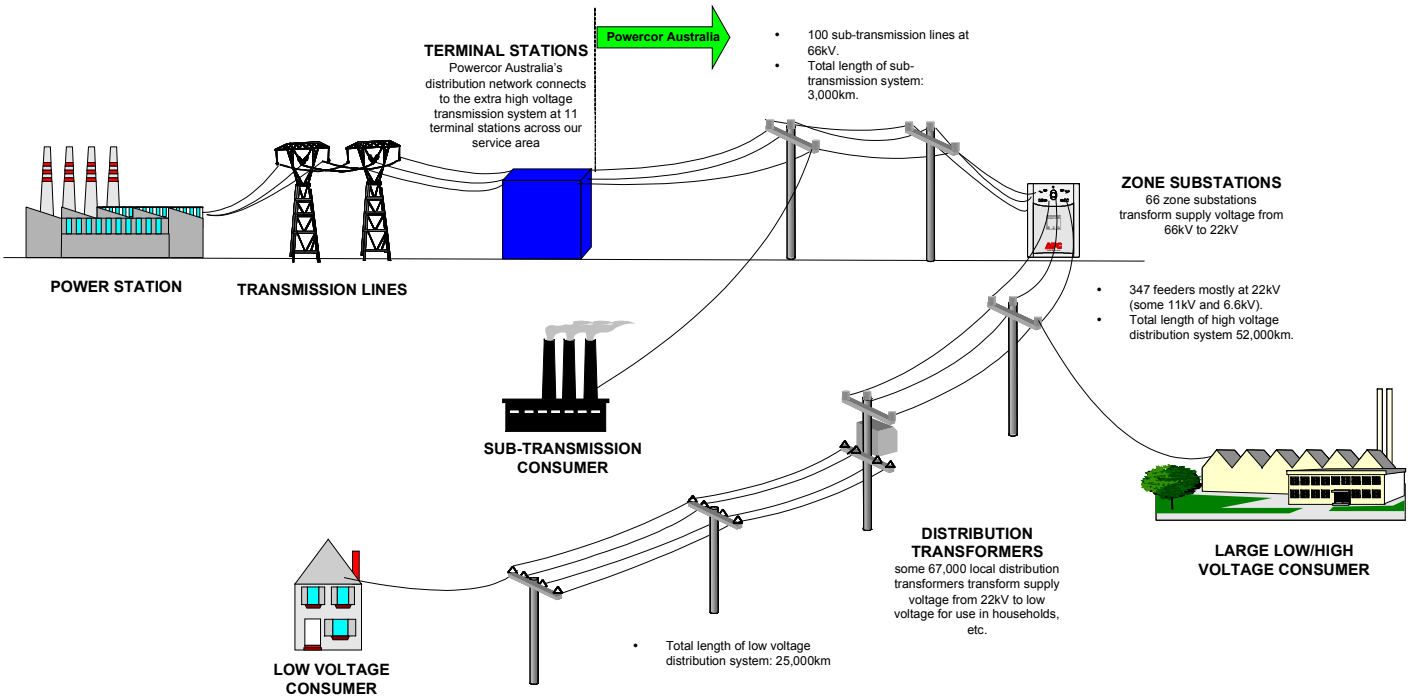


Figure 3: Summary of Powercor Australia's Distribution Network



2. TARIFF STRATEGY

This section outlines Powercor Australia's overarching tariff strategy for the 2006-10 regulatory period.

2.1 Regulatory Arrangements

The Essential Services Commission (ESC) regulates charges for connection to a distribution system, use of the system and for certain other charges called "Excluded Services".

2.1.1 Distribution Tariffs

Distributors' tariff structures must conform to price controls and rebalancing constraints set out in the *Electricity Distribution Price Review 2006-10 Final Decision Volume 2 Price Determination* ("Determination"). Further information on the operation of these price controls is provided in Section 2.2.1.2.

2.1.2 Transmission Tariffs

Transmission use of system charges are levied on Powercor Australia by Vencorp and SP AusNet. Powercor Australia recovers those costs through transmission tariffs regulated by the ESC as set out in the *Determination*. The transmission charges that Vencorp and SP AusNet levy upon Powercor are regulated by the Australian Energy Regulator and subject to review every five years.

2.1.3 Prescribed Metering

As of 1 January 2006, Powercor Australia will be the distributor responsible for providing metering services to customers who have annual consumption less than 160 MWh/pa and do not have a remotely read interval meter. Powercor Australia will be responsible for meter provision and for meter data services to all customers within its supply area.

For 2006, Powercor Australia is required to set tariffs to constrain revenue to within \$15.8M (\$2004). Prescribed metering charges may fall within one of two categories; meter provision or meter data services charges. For the years 2007-10, meter provision charges may vary in accordance with the following three factors:

- *X-factor*: the X-factor accounts for the assumption that distributors will experience year-on-year cost increases and that these gains will be passed on to consumers. In 2006 there are no prescribed metering service tariffs to which an X-factor is applied. For the calendar years 2007-2010 Powercor's X-factor increases prescribed metering service tariffs by 20 percent in real terms.
- *M-factor*: the M-factor is an incentive mechanism that rewards distributors for accelerating the rollout of interval meters over the price review period.
- *CPI*: prescribed metering charges may be indexed to account for inflation.

Rebalancing constraints are also in place to limit price changes within prescribed metering tariff categories.

2.2 General Information

2.2.1 Powercor Australia's Network Tariff Categories

Network tariffs are a charge for the services associated with using the network to transport electricity from the generator to the end-use customer. Network tariffs consist of two components, a transmission tariff and a distribution tariff. Both transmission and distribution tariffs have fixed and variable components. A variable component may vary according to time of use (for example, the time of day or day of the week) or it may vary depending on the level of consumption.

2.2.1.1 Tariff Categories for Network Tariffs

Tariff category segmentation is based on connection requirements of the end-use customer. Powercor Australia has the following network tariff categories:

CUSTOMER	DEMAND (kW)	VOLTAGE	SEGMENT
Residential	Less than 120 kW	< 1 kV	Residential
Non-Residential	Less than 120 kW	< 1 kV	Commercial / Small Industrial
Large low voltage	Greater than 120 kW	< 1 kV	Small to Medium Industrial/ Large Commercial
High voltage	Greater than 1 MW	6.6 <= kV <= 22	Industrial
Subtransmission	Greater than 10 MW	> 22 kV	Industrial

Distribution tariffs are set to allow Powercor Australia to recover its costs and earn a regulated profit on its assets. Transmission tariffs are set to recover Powercor's costs for the use of transmission services. The allocation of distribution and transmission charges across tariff categories is designed to be cost reflective. Each network tariff rate comprises a distribution tariff component and a transmission tariff component.

2.2.1.2 Distribution Tariffs

Powercor Australia has designed its distribution tariffs to reflect the average costs imposed upon the distribution system by each class of customers. The principle cost drivers in the distribution system are the supply voltage and the connection characteristics of the customer.

The *Determination* provides an overarching price control formula that specifies a maximum limit on annual tariff changes. The maximum limit is based on four control levers:

- *X-factor*: the X-factor accounts for the assumption that distributors will achieve year-on-year efficiency gains and that these gains will be passed on to consumers. Figure 4 sets out the average real decreases in distribution tariffs required for the calendar years 2006-2010.

Figure 4: X-factors

Year	2006	2007	2008	2009	2010
X	17.3%	2.5%	2.5%	2.5%	2.5%

- *S-factor*: the S-factor provides an incentive for distributors to meet service obligations. It allows tariff augmentation where service targets are exceeded and compensates customers by reducing tariffs where service levels do not meet the required standards.
- *L-factor*: distributors must pay a licence fee, which is factored into distribution tariffs. The L-factor allows licence fee costs to be passed through to end users.
- *CPI*: tariffs are indexed to account for inflation.

The price control formula ensures that aggregate tariff revenue increases do not exceed the limit allowed by these four factors. In addition, the *Determination* specifies a rebalancing control that prohibits individual tariff increases by more than CPI + 2 percent (adjusted for S-Factor and L-Factor).

2.2.1.3 Transmission Tariffs

Powercor Australia's transmission tariffs are regulated by the ESC and designed to recover charges levied by Vencorp and SP AusNet for use of their transmission systems. The ESC sets price controls and rebalancing constraints on Powercor's transmission tariffs. Individual transmission tariffs are constrained to increase by no more than 2 percent more than the average increase in transmission costs per annum. The average increase in transmission costs may not exceed 18 percent in any one year. Transmission tariffs are designed to be cost reflective within the limitations of price controls and rebalancing constraints.

Powercor Australia's transmission costs are subsidised through a mechanism known as the Grid Equalisation Scheme. The Grid Equalisation Scheme transfers transmission charges from rural and remote customers to

urban customers, thus reducing the differential between urban and rural transmission tariffs. Figure 5 shows historic and forecast annual transmission cost subsidies received by Powercor Australia.

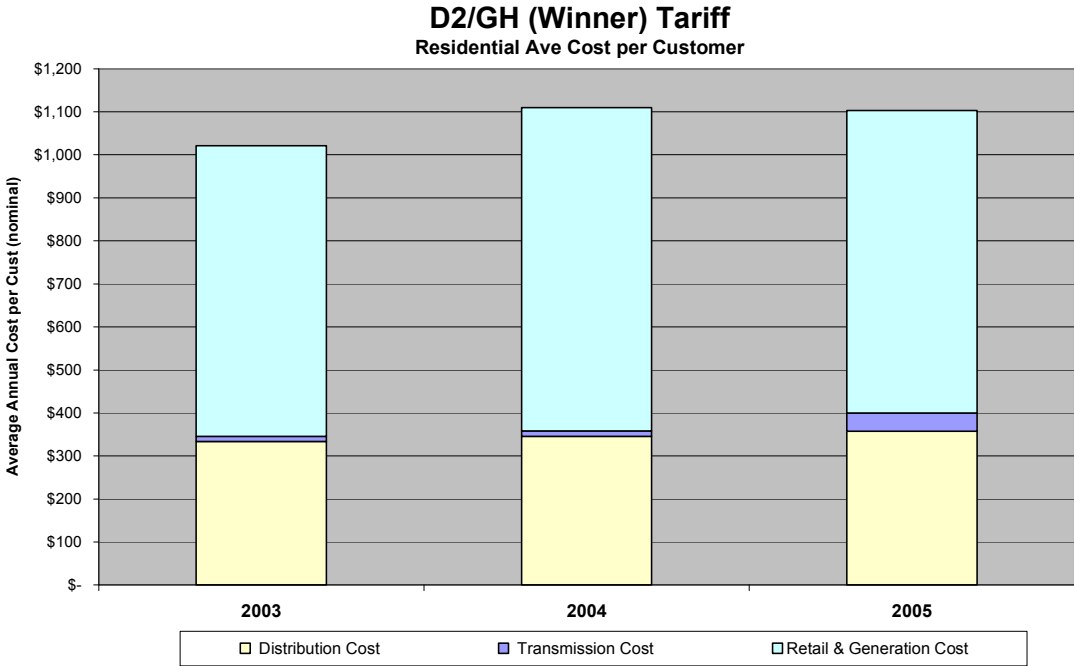
Figure 5: Annual Grid Equalisation Adjustments

Period	Adjustment
1 July 2001 – 30 June 2005	\$15,208,800
1 July 2005 – 30 June 2010	\$11,406,600
1 July 2010 – 30 June 2015	\$7,604,400
1 July 2015 – 30 June 2020	\$3,802,200
Thereafter	Nil

2.2.1.4 Retail Tariffs

This Tariff Strategy Report focuses primarily on tariffs associated with electricity distribution and transmission. Stakeholders should note, however, that these tariffs are only one component of the final electricity bill that end-users will receive. Other charges include wholesale energy costs and charges levied by retailers. Figure 6 shows that on average, transmission and distribution costs for a residential two rate (D2) customer are less than 40% of the final retail bill. Powercor Australia’s tariff strategy is limited in its influence over retail electricity costs as it can only influence the distribution and transmission portions of the final bill.

Figure 6: Small Two Rate Tariff 2003-5



2.2.2 Anticipated Tariff Directions and Movements

It is anticipated that, consistent with price controls and rebalancing constraints set out by the Commission, most of Powercor Australia’s tariffs will undergo uniform adjustments in the current pricing period. Refer to section 4.1 for further detail on anticipated directions and tariff movements.

2.2.3 Outcomes

Powercor Australia’s current tariffs are designed to reflect service costs and thus provide efficient signals to customers. Powercor Australia is constantly reviewing tariffs to improve their efficiency and in the current

regulatory period intends to devote particular attention to improving time of use price signals. Where necessary, changes to tariffs will be implemented in accordance with price controls and rebalancing constraints.

Price signals will encourage customers to change their consumption behaviour and acquire more energy efficient appliances. The proposed changes will provide customers with the opportunity to reduce their energy costs, while assisting Powercor Australia to manage peak load. Data made available through the bulk rollout of interval meters will assist Powercor Australia to incorporate further cost reflectivity, efficiency and price signals into its tariffs.

It is anticipated that the structure of Powercor Australia's distribution tariffs will remain largely unchanged within the 2006-2010 regulatory period. The only structural changes anticipated are the introduction of Embedded Network Tariffs and Reactive Demand Charges. Structural changes that may arise from the review of interval meter data are likely to be considered in the 2011-2015 regulatory period

2.3 Proposed Structure 2006-10

This section outlines current tariff structures and proposed structural changes for the forthcoming regulatory period. Powercor Australia's current network tariffs are designed to be cost reflective and thus provide efficient price signals. Powercor Australia is constantly monitoring its tariff efficiency to ensure cost reflectivity and adherence to price controls and rebalancing constraints.

2.3.1 Block Tariffs

In 2001, Powercor Australia introduced an inclined block tariff structure for small and medium sized residential customers. This involved establishing a series of price bands (or "blocks") within certain tariff categories. Customers pay lower prices for low levels of electricity consumption, with prices rising progressively over a series of price blocks as consumption increases. Tariffs are designed so that customers consuming electricity only for basic household functions will fall into the lowest price block.

Block tariffs function as a demand management tool by providing a disincentive for customers to increase consumption. By incorporating a series of price steps, the tariff design provides a graduated incentive to target individual customers with varying price sensitivity.

Powercor Australia will continue to use an inclined block tariff structure on tariffs where this mechanism is effective.

2.3.2 Time of Use Tariffs

Time of use pricing is designed to create an incentive for customers to use the network in an optimal manner. Peak and off-peak pricing is the key mechanism for time of use pricing. Peak and off peak charges encourage customers to shift consumption from periods of high demand to periods of low demand. By balancing network utilisation Powercor Australia is able to deliver lower distribution prices because networks may be designed and maintained to support lower maximum demand requirements.

Powercor Australia's peak and off peak prices are designed to take account of differing usage patterns across different classes of customers. It is anticipated that changes to time of use tariffs over the regulatory period are more likely to impact residential customers as interval meter data is expected to improve profiling of residential usage. Time of use signals are more effectively applied to residential tariffs as consumption is subject to greater volatility.

The gradual introduction of meters with the capacity to take half-hourly readings will provide an improved profile of how Powercor Australia's services are utilised, particularly in the small business and residential sector. It is anticipated that Powercor Australia will reform time of use tariffs during the 2006-10 period to allow for sharper pricing signals during peak periods. The exact format of any tariff changes will be determined after an initial period of data collection and analysis to evaluate how customer groups contribute to network peaks.

Powercor Australia is reducing off-peak rates more than peak rates in 2006 to send sharper price signals during times of network peak demand.

2.3.3 Location Based Tariffs

Some of the costs incurred in operating a distribution network are influenced by location. Cost drivers include customer density, line length from a zone sub station, vegetation control, storm activity, corrosion and bush fires.

Powercor Australia has reviewed location based tariffs and found that large customers contribute significantly to location based costs. Powercor Australia will continue to provide location based signals to large customers to ensure that electricity costs will be factored into business development decisions.

Powercor Australia does not currently plan to introduce location based tariffs for residential or medium size customers as this would significantly impact upon the power bills of rural customers. Location based tariffs for small to medium sized customers would also prove administratively difficult to manage and result in a increase in tariff complexity. The merits of introducing location based tariffs for medium or residential users will continue to be assessed.

2.3.4 Interval Meter Tariffs

Powercor Australia introduced new interval meter tariffs on 1 January 2005 to coincide with the introduction of interval meters into the Victorian market. An interval meter records data on how much electricity was consumed every half hour. Interval meters were introduced to replace accumulation meters, which record only the aggregate amount of peak or off peak consumption within the billing period.

Powercor Australia will offer the following interval meter tariffs in 2006; residential interval (D3), hot water interval (D3.HW), Climate Saver Interval (D3.CS) and non-residential interval (ND5). These tariffs will allow interval meter distribution tariffs to be amended over time to incorporate improved cost reflectivity without causing sudden price shocks. Powercor Australia customers will be assigned to the appropriate interval meter tariff when they receive an interval meter.

2.3.5 Summer and Winter Tariffs

A proportion of Powercor Australia's costs are driven by seasonal peaks in demand on the network. Powercor Australia anticipates that during the 2006-10 period there may be an introduction of seasonal tariffs to send sharper price signals to customers when demand on the distribution network is highest. The exact nature of the seasonal tariffs will be determined after gathering and analysing data on seasonal network peaks across customer groups. Data collection will be facilitated by the rollout of interval meters.

Powercor Australia currently operates a climate saver tariff that captures some degree of cost reflectivity by providing prices signals to residential customers on a seasonal basis.

2.3.6 Embedded Network Tariffs

The Victorian regulatory environment exempts certain parties from the need to obtain a distribution or retail licence to operate embedded networks within the Powercor Australia area. Powercor Australia has downstream obligations to the end users of an embedded network and thus incurs additional processing and administrative costs to serve the operator of the embedded network. Powercor Australia will propose Embedded Network Tariffs to encourage greater cost reflectivity in this area and prevent other electricity customers from having to bear the costs of serving embedded network customers. Powercor Australia intends to introduce new embedded network tariffs from 1 January 2007.

The operators of embedded networks will be assigned these tariffs when they become embedded network customers. Separate tariffs are to be proposed for embedded networks operating primarily in residential and commercial areas.

2.3.7 Excessive Reactive Demand Charge

Powercor Australia proposes to introduce an Excessive Reactive Demand Charge from 1 January 2007 to provide customers with an incentive to comply with power factor requirements under the *Electricity Distribution Code*. This charge will apply to all customers on distribution tariffs incorporating a demand charge.

The successful implementation of the Excessive Reactive Demand Charge will ensure that customers who cause a deterioration of Powercor Australia's network power factor will be required to meet the costs of rectifying the loss. This mechanism will prevent this cost from having to be met by the majority of customers who remain within power factor limits.

2.3.8 Land Tax

The Victorian Government on 1 July 2004 abolished the smelter levy charged on retailers under the *National Electricity Code* and replaced it with a land tax on transmission easements. This resulted in a marked increase in the transmission charges levied on Powercor Australia by SP AusNet and Vencorp. As price controls only provide for adjustment to tariffs on an annual basis, the land tax recovery of \$28.9M in 2005 was for the 18 month period from 1 July 2004 to 31 December 2005. In 2006, customers will see a reduction in transmission charges as a result of distribution business needing to recover 12 months of land tax of \$19.9M. Further shocks are not anticipated beyond 2006

2.4 Excluded Service Charges and Prescribed Metering Service Tariffs

2.4.1 Excluded Service Charges

Excluded service charges apply to certain activities not covered by network tariff price controls. Excluded service charges are regulated by the Commission.

Powercor Australia's current schedule of excluded service charges can be found at:

http://www.powercor.com.au/infocentre/fs_electricity.html

This schedule contains a complete list of Powercor Australia's excluded services, a description of these services and related prices. Charges may be reviewed from time to time to take account of new services, changes to existing services or reviews of excluded service prices. The only anticipated structural change to excluded services in the current regulatory period is the proposed introduction of a Reactive Demand Charge

2.4.2 Prescribed Metering Service Tariffs

Prescribed metering service tariffs apply for the provision of interval meters and meter data services for customers consuming less than 160 MWh/pa and where the meter is not remotely read. This service consists of two components; meter provision charges and charges for meter data services.

2.4.2.1 Meter Provision

From 1 January 2006, the capital and operating costs associated with providing meters will be funded by new meter provision charges. There are four categories of meter provision charge, reflecting differing costs associated with providing different types of meters. The meter types available are:

- Single Phase Peak
- Single Phase Off-Peak
- Multi Phase Direct Connected
- Three Phase CT

Powercor Australia will levy meter provision charges on a per NMI basis. The 2006 charges consist of a set charge per NMI per annum, such that customers will pay the same charge regardless of whether they have an interval or accumulation meter. Metering charges are subject to a CPI + 20% price path from 2007 onwards and it is assumed that these charges will increase significantly over the 2007-10 period.

Since the *Determination*, the Victorian Government introduced its Advanced Interval Meter Roll Out (AIMRO) program. Under the AIMRO the meters of all customers consuming less than 160 MWh p.a. will be replaced with automated interval meters. The exact timing of the program is still to be confirmed but it is anticipated it will commence around 2008-09 and take four years to complete. As a consequence it is expected that meter provision charges will be required to increase to fund the roll out of automated interval meters.

2.4.2.2 *Meter Data Services*

From 1 January 2006, the capital and operating costs associated with providing meter data services will be funded by new meter data service charges. There are three categories of meter data service charge, reflecting differing costs associated with different read frequencies. The options for meter read frequency are:

- Quarterly read meter
- Monthly read meter
- Unmetered supply

Powercor Australia will levy quarterly and monthly read charges on a per NMI basis. Unmetered supply charges will be levied each month on a per light basis. The 2006 charges consist of a set charge per NMI (or light) per annum, such that customers will pay the same charge regardless of whether they have an interval or accumulation meter. Metering charges are subject to a CPI + 20% price path from 2007 onwards.

Since the *Determination*, the Victorian Government introduced its AIMRO program. Under the AIMRO the meters of all customers consuming less than 160 MWh p.a. will be replaced with automated interval meters. The exact timing of the program is still to be confirmed but it is anticipated it will commence around 2008-09 and take four years to complete. As a consequence it is expected that meter data service charges will be required to increase to fund the processing of automated interval meter reads.

3. TARIFF POLICY FRAMEWORK

3.1 Pricing Principles and Outcomes

3.1.1 Distribution Tariffs

The Commission has determined the following three pricing principles for distribution tariffs:

- Each distribution tariff should be above the avoidable cost of servicing distribution customers assigned to that distribution tariff;
- Each distribution tariff should be below the cost of providing the service on a stand alone basis to distribution customers assigned to that distribution tariff; and
- Each distribution tariff should signal the impact of additional usage on future investment costs.

3.1.2 Transmission Tariffs

The Commission has determined the following three pricing principles for transmission tariffs:

- Each transmission tariff should be above the avoidable cost of servicing distribution customers assigned to that transmission tariff;
- Each transmission tariff should be below the cost of providing the service on a stand alone basis to distribution customers assigned to that transmission tariff; and
- Each transmission tariff should signal the impact of additional usage on future investment costs.

3.1.3 Pricing Objectives

Preparation of network tariffs requires a robust set of objectives that can be used to evaluate the suitability of network tariffs. The objectives employed by Powercor Australia in setting both distribution and transmission tariffs can be summarised as follows:

- **Economic Signals:** Ensure there is appropriate signalling to customers of their impact on the distribution and transmission system;
- **Stability:** Distribution and transmission tariffs should be stable and predictable through time;
- **Simplicity:** Distribution and transmission tariffs should be readily understood by customers and easy to apply;
- **Equity:** Distribution and transmission tariffs should avoid undue discrimination between customer classes; and
- **Regulatory Compliance:** Distribution and transmission tariffs must comply with the pricing principles and price controls set out by the Commission.

Distribution and transmission tariffs can be designed to include a number of tariff components. Typically a distribution or transmission tariff will consist of 3 or more components. How tariff components are included will have a significant impact on the economic signals provided by the tariff to the customer.

3.1.4 Compliance with the Pricing Principles

Powercor Australia engaged Harding Katz to examine Powercor Australia's distribution tariffs and they found that all are within the efficient cost window according to the Commission's criteria. Powercor Australia will continue to monitor its existing tariffs and all proposed new tariffs to ensure they remain efficient.

Under clauses 2.3.16 and 3.3.6 of the *Determination* distributors are required to, in the setting of distribution and transmission tariffs, have regard to the principle that each tariff should signal the impact of additional usage on future investment costs.

Powercor Australia notes that the present state of metering technology is a practical limitation to the extent of pricing signals that can be provided to customers. Powercor Australia introduced interval meter tariffs in 2005 and has adjusted these slightly for 2006 with the introduction of ND5 to allow for appropriate segmentation between residential and non-residential use. Powercor Australia will continue to develop its interval meter tariffs to provide appropriate pricing signals to customers.

4. NETWORK TARIFF METHODOLOGY

4.1 2006 Tariffs and Future Developments

This section outlines Powercor Australia's proposed Network Tariffs for 2006, tariff components and likely development over the 2006-10 regulatory period. Tariff developments are intended to further refine the cost reflectivity of Powercor Australia's tariffs and enhance the efficiency of price incentives for consumption.

Data from the rollout of interval meters will provide Powercor Australia with a more accurate profile of customer demand. To date this profiling has been limited due to an insufficient number of installed interval meters and insufficient data on usage patterns over time. Data made available from interval meters is expected to lead to more accurate predictions of future investment requirements. When more data is available for modelling Powercor will reassess tariffs accordingly.

4.1.1 D1 – Residential Single Rate

Formerly Small Single Rate

Description: This is the basic network tariff for general domestic usage such as lights and power.

2006 Structure: This tariff has a fixed standing charge and an energy charge that applies 24 hours per day, 7 days per week. There is an inclining block structure but no off-peak charge associated with this tariff.

Going Forward: The Victorian Government's AIMRO program will mean that all new and replacement meters will be automated interval meters from sometime in 2008-09. After this time, no new customers will be connected to this tariff. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.2 D1.CS – Climate Saver

Description: This network tariff applies to residential customers who are using eligible energy efficient reverse cycle heaters/air conditioners. D1.CS is only available to customers who have an existing D1.CS configuration.

2006 Structure: This is a seasonal tariff with no standing charge. The peak charge applies to the hotter months (November to March) when the network is heavily used. The off-peak charge applies to colder months (April to October) when the network is less utilised. This structure enables Powercor Australia to offer very competitive rates during winter for heating. There is also an inclining block structure.

Going Forward: No new customers will be connected to this tariff interval meters are introduced. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.3 D3.CS – Climate Saver Interval

Description: This network tariff applies to residential and non-residential interval meter customers who are using eligible energy efficient reverse cycle heaters/air conditioners. The D3.CS network tariff is only available to customers where interval capable metering is installed.

2006 Structure: This is a seasonal tariff with no standing charge. The peak charge applies to the hotter months (November to March) when the network is heavily used. The off-peak charge applies to colder months (April to October) when the network is less utilised. This structure enables Powercor Australia to offer very competitive rates during winter for heating. There is also an inclining block structure.

Going Forward: The interval metering associated with this tariff will enable structural reform over the 2006-10 period. After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods to send sharper price signals during times when demand on the distribution network is highest.

4.1.4 D2 – Residential Two Rate 5d

Formerly Small Two Rate

Description: This network tariff applies to residential customers who have a meter capable of measuring peak and off peak energy usage. This network tariff is also for general domestic usage such as lights and power. D2 is only available to customers who have an existing D2 configuration.

2006 Structure: The tariff includes a fixed standing charge, peak and off-peak energy charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Friday. Off-peak periods, such as the weekend and overnight, have a very low rate relative to the peak charge.

Going Forward: The Victorian Government's AIMRO program will mean that "off-peak" new and replacement meters will be automated interval meters from sometime in 2008-09. After this, no new customers will be connected to this tariff. Customer numbers on this tariff will reduce over the 2006-10 period due to the Victorian Government's AIMRO program. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.5 D2.DK – Docklands Two Rate 5d

Formerly Small two rate Bulk

Description: This network tariff applies to customers located in the Docklands region, who have a meter capable of measuring peak and off peak energy usage. This network tariff is for general usage such as lights and power.

2006 Structure: The tariff includes a fixed standing charge, peak and off-peak energy charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Friday. Off-peak periods, such as the weekend and overnight, have a very low rate relative to the peak charge.

Going Forward: The Victorian Government's AIMRO program will mean that "off-peak" new and replacement meters will be automated interval meters from sometime in 2008-09.

4.1.6 D3 – Residential Interval

Formerly Small Customer Interval

Description: The D3 residential interval meter tariff applies to residential interval meter customers. This network tariff is for general domestic usage such as lights and power.

2006 Structure: The tariff includes a fixed standing charge, peak and off-peak energy charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Friday. Off-peak periods, such as the weekend and overnight, have a very low rate relative to the peak charge.

Going Forward: The Victorian Government's AIMRO program will mean that customer numbers on this tariff will increase over the 2006-10 period. The interval metering associated with this tariff will enable structural reform over the 2006-10 period. After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal tariffs to send sharper price signals during times when demand on the distribution network is highest.

4.1.7 DD1 – Dedicated Circuit

Description: This network tariff relates mainly to customers with off-peak hot water but also includes storage heating. DD1 is only available to customers who have an existing DD1 configuration.

2006 Structure: The network tariff includes a fixed standing charge and an off peak energy charge.

Going Forward: The Victorian Government's AIMRO program will mean that "off-peak" new and replacement meters will be automated interval meters from sometime in 2008-09. After this, no new customers will be connected to this tariff. Customer numbers on this tariff will reduce over the 2006-10 period due to the Victorian Government's AIMRO program. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.8 D3.HW – Hot Water Interval

Description: This network tariff relates to single phase residential interval meter customers with controlled off-peak hot water loads.

2006 Structure: The network tariff includes a fixed standing charge and an off peak energy charge.

Going Forward: The Victorian Government's AIMRO program will mean that customer numbers on this tariff may increase depending on the final decision with relation to single versus two element meters. The interval metering associated with this tariff will enable structural reform over the 2006-10 period. After an initial period of data gathering and analysis, Powercor Australia anticipates that there may be structural changes to this tariff.

4.1.9 ND1 – Non-Residential Single Rate

Formerly Medium Single Rate

Description: This is the basic network tariff for non-residential customers with little overnight or weekend usage.

2006 Structure: This tariff has a fixed standing charge and an energy charge that applies 24 hours per day, 7 days per week. There is an inclining block structure but no off-peak charge associated with this tariff.

Going Forward: The Victorian Government's AIMRO program will mean that all new and replacement meters will be automated interval meters from sometime in 2008-09. After this, no new customers will be connected to this tariff. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.10 ND2 – Non-Residential Two Rate 5d

Formerly Medium two rate, 5 day

Description: This network tariff is for non-residential customers with some overnight or weekend usage. Customers will benefit through lower charges during off-peak periods that extend both overnight and into the weekend. Examples include restaurants, farms and small businesses. ND2 is only available to non-residential customers who have an existing ND2 configuration.

2006 Structure: The network tariff includes a fixed standing charge, peak and off-peak charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Friday. The off-peak period includes overnight and into the weekend.

Going Forward: The Victorian Government's AIMRO program will mean that "off-peak" new and replacement meters will be interval meters from no later than 1 Jan 2006. After this, customers will be connected to the ND5 – Non-Residential Interval tariff. Customer numbers on this tariff will reduce over the 2006-10 period due to the Victorian Government's AIMRO program. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.11 ND3 – Non-Residential Two Rate-7d

Formerly Medium Two Rate, 7 day

Description: This network tariff is for non-residential customers with little overnight usage. ND3 is only available to customers who have an existing ND3 configuration.

2006 Structure: The network tariff includes a fixed standing charge, peak and off-peak energy charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Sunday. Customers are charged lower off-peak rates during the remaining period.

Going Forward: No new customers will be connected to this tariff. Customer numbers on this tariff will reduce over the 2006-10 period due to the Commission's IMRO program. Due to the metering associated with this tariff, it is expected that there will not be major structural changes over the 2006-10 period.

4.1.12 ND5 – Non-Residential Interval

Description: The ND5 non-residential interval meter tariff applies to non-residential interval meter customers.

2006 Structure: The tariff includes a fixed standing charge, peak and off-peak energy charge. The peak charge includes an inclining block structure and applies between 7am and 11pm, Monday to Friday. Off-peak periods, such as the weekend and overnight, have a very low rate relative to the peak charge.

Going Forward: The Victorian Government's AIMRO program will mean that customer numbers on this tariff will increase over the 2006-10 period. The interval metering associated with this tariff will enable structural reform over the 2006-10 period. After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal tariffs to send sharper price signals during times when demand on the distribution network is highest.

4.1.13 PL2 – Unmetered Supplies

Description: This tariff is designed for unmetered customers who require low voltage supply, such as public lighting.

2006 Structure: The tariff provides a time of use signal to promote efficient network use.

Going Forward: Powercor Australia anticipates that there will no structural changes over the 2006-10 period.

4.1.14 DL – Large Low Voltage Demand

Formerly Large Tariff

Description: This tariff is designed for commercial and industrial customers who require low voltage supply, such as industrial sites, hospitals and commercial buildings. This tariff is designed for customers with a minimum demand of 250kW or more.

2006 Structure: The tariff provides both a maximum demand price signal and a time of use price signal to promote efficient network use.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.1.15 DL.CXX – Large Low Voltage Demand CXX

Formerly Large Tariff CXX

Description: This tariff is designed for commercial and industrial customers who require low voltage supply, such as small industrial sites and commercial buildings. This tariff is designed for customers with a minimum demand of 120kW or more.

2006 Structure: The tariff provides both a maximum demand price signal and a time of use price signal to promote efficient network use.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.1.16 DL.A, DL.C, DL.S and DL.DK – Large Low Voltage (Location-Based)

Description: These tariffs are designed for commercial and industrial customers who require low voltage supply. These tariffs are designed for customers with a maximum demand of 250kW or more. Availability of these tariffs depends on the customer's location and connection characteristics.

2006 Structure: These tariffs provide both a maximum demand price signal and a time of use price signal to promote efficient network utilisation.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.1.17 DH – High Voltage Demand

Formerly High Voltage

Description: This tariff is designed for larger commercial and industrial customers who require high voltage supply such as large industrial sites, hospitals and commercial buildings. This tariff is designed for customers with a maximum demand of 1000kW or more.

2006 Structure: The tariff provides both a maximum demand price signal and a time of use price signal to promote efficient network use.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.1.18 DH.A, DH.C, DH.DK, DH.D1, DH.D2, DH.D3, DH.D4 and DH.D5 – HV Demand (Location-Based)

Description: These tariffs are designed for commercial and industrial customers who require high voltage supply. These tariffs are designed for customers with a maximum demand of 1000kW or more. Availability of these tariffs depends on the customer's location and connection characteristics.

2006 Structure: These tariffs provide both a maximum demand price signal and a time of use price signal to promote efficient network utilisation.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there may be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.1.19 DS.A, DS.G and DS.S – Subtransmission Demand

Description: These tariffs apply to very large connections operating at 66,000 volts.

2006 Structure: These tariffs provide both a maximum demand price signal and a time of use price signal to promote efficient network utilisation.

Going Forward: After an initial period of data gathering and analysis, Powercor Australia anticipates that there will be structural changes such as the introduction of more time of use periods and the introduction of seasonal pricing to send sharper price signals during times when demand on the distribution network is highest.

4.2 Tariff Assignment

Network tariffs are assigned based on the load, connection and metering characteristics of the customer.

Powercor Australia's customers will be transferred to interval tariffs at the time that their accumulation meter is replaced by one with an interval capability. As a result of this policy, the time frame for shifting tariff assignments will be aligned with the progress of the Victorian Government's AIMRO program. It is expected that existing residential and non-residential customers on non-interval tariffs D1, D1.CS, D2, DD1, ND1, ND2 and ND3 will transfer to the equivalent interval meter tariffs during this regulatory period or the next. Customers that receive an interval meter will receive a notice from the distributor detailing general information on interval meters and how customers pay for the interval meter.

4.3 Methodology of Standalone and Avoidable Costs

Powercor Australia engaged an independent consultant, Harding Katz, to undertake a detailed study to ensure all distribution tariffs were within the efficient cost window between avoidable and stand alone costs. The Harding Katz report defined the cost of serving customers as the cost attributable to an 'average' customer within the class of customers covered by each tariff. Cost per customer was established net of fixed costs, sunk costs and general overheads and formulated as the sum of average usage costs and an allocation of fixed costs per customer.

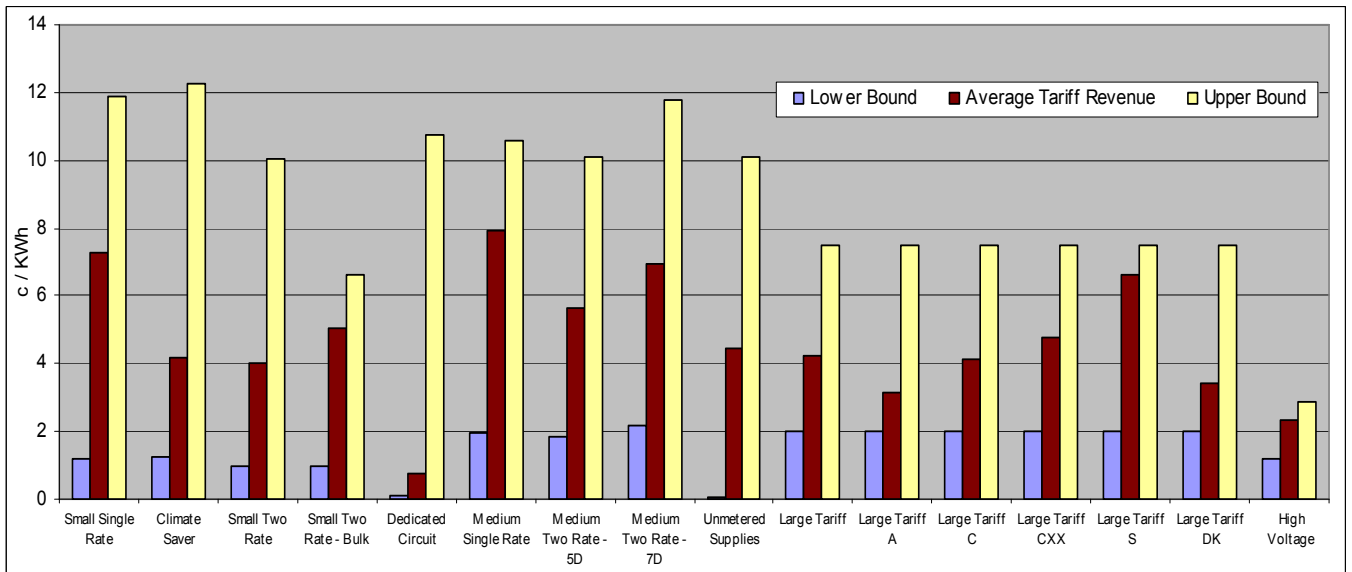
Stand alone costs was established by estimating the costs likely to be incurred by a notional efficient competitor to the network business. This approach was taken as economies of scale dictate that the stand-alone cost of providing for a single customer would set the upper bound so high as to provide no meaningful limit. The cost of providing for customers on a stand alone basis was then established as the networks and usage costs of providing for an 'average' customer within the class of customers covered by each tariff.

The Harding Katz model relied on the following assumptions in relation to cost data:

- The costs used in the model were future capital costs, not historical or "sunk" costs;
- The model incorporated actual costs faced by the distributor rather than relying upon a hypothetical situation;
- Direct network maintenance costs were incorporated; and
- The model considered indirect operational costs and overheads where appropriate.

Figure 7 illustrates the quantitative results from the Harding Katz report.

Figure 7: Tariffs Levels Related to Efficient Bounds



4.4 Fixed and Variable Charges

A large proportion of a distribution business’ costs are fixed. A consequence of a predominantly fixed cost business is that a customer’s consumption pattern may only impact on costs when the distribution assets servicing that customer fall due for renewal.

Levying a customer a variable charge where costs are fixed will result in large energy users subsidising small energy users. Hence where suitable metering is available Powercor Australia has sought to closely align the recovery of fixed costs through fixed charges i.e. through minimum demand charges.

For residential and non-residential customers a standing charge is applied as a proxy for the recovery of fixed costs. In the interests of not disadvantaging residential customers, Powercor Australia has placed a relatively low reliance on standing charges.

4.5 Future Investment Requirements

Powercor Australia produces a Distribution System Planning Report each year which details network capacity issues and future network investment requirements at a zone substation and subtransmission level. Network capacity constraints are a key driver of distribution costs. For more detailed network constraint information, please refer to Powercor Australia’s Distribution System Planning Report. The most recent report can be found at: http://www.powercor.com.au/infocentre/fs_electricity.html

Powercor Australia’s tariffs have been developed to provide cost-reflective signals through addressing coincident demand issues that place pressure on network capacity. Tariff devices targeting coincident demand include block tariffs and differentiation between customers on five day and seven day tariffs. Such tariffs are designed to have regard to the long run marginal costs of consumption. It is anticipated that structural tariff changes may be introduced in future where interval meter data reveals opportunities for Powercor Australia to improve the cost reflectivity of its tariffs.

4.6 Allocation of Transmission Costs

Powercor Australia is required, through the *Victorian Electricity Industry Tariff Order*, to collect transmission use of system fees (TUOS) on behalf of Vencorp and a connection charge on behalf of SP AusNet. The transmission charges applied to Powercor Australia are as follows:

- A TUOS Usage Charge (Summer Demand) based on the average of the ten highest peaks during weekdays (between 7am and 11pm) for each of Powercor Australia’s 11 terminal stations during the extended summer period from November to March;
- A TUOS General Charge This price is based on the total actual energy supplied to each terminal station for the billing period from the previous financial year;
- A Common Service Charge that includes costs for planning and operating the network and costs related to reactive plant; and
- A fixed connection charge levied by SP AusNet.

Powercor Australia also receives a fixed transmission benefit under the Grid Equalisation Scheme. The Scheme transfers transmission charges from rural and remote customers to urban customers, reducing the differential between urban and rural transmission tariffs.

Powercor Australia’s transmission tariffs are designed to recover the company’s transmission costs on a “user pays” basis. Customers are subject to transmission tariffs designed to recover the charges paid by Powercor Australia to Vencorp and SP AusNet. Transmission tariffs are designed to be cost reflective within the limits of price controls and rebalancing constraints. Due to seasonal fluctuations, TUOS charges have the potential to be volatile from year to year and Powercor Australia’s transmission tariffs may vary accordingly to recover costs.

4.6.1 Tariff Equalisation

Many of Powercor Australia’s customers and their representatives have indicated that they would prefer uniform network prices across the State or that price differentials between urban and rural customers should be kept to a minimum. The grid subsidy was established in 1995 to transition rural and remote customers to cost reflective prices. Annual grid subsidies received by Powercor Australia declined from \$19m to \$15m per financial year between 2001 and 2005 and declined further to \$1m for the 2006-2010 regulatory period (see Figure 5).

Powercor Australia notes that the Victorian Government has introduced a Network Tariff Rebate to help reduce the differential between urban and rural electricity costs. Extension of the established Victorian Equalisation Scheme is an issue outside the control of Powercor Australia; however the company supports plans to deliver uniform network tariffs across Victoria.

4.7 Allocation of Prescribed Metering Service Costs

Powercor Australia has adopted the following prescribed metering service tariff cost allocation pricing principles:

4.7.1 Cost of Service Provision

Prescribed metering charges are based on the estimated forward looking costs to provide these services. Within each prescribed metering category, charges have been designed to reflect associated costs and comply with the Commission’s modelling template.

4.7.2 Cost Allocation

In respect of the costs incurred by Powercor Australia in providing a prescribed metering service:

- (1) the costs do not include costs in respect of which Powercor Australia is remunerated under Powercor Australia’s distribution tariff or excluded service charge; and
- (2) those costs only include an appropriate allocation of any shared or common costs incurred by Powercor Australia in providing the prescribed metering services.

4.7.3 Cost Differentials

Powercor Australia will levy the same charge for customers regardless of whether an interval or an accumulation meter is installed. The different charges have been determined to provide appropriate signals to customers that impose clearly differing costs on the distribution business.

4.7.4 Simplicity

Powercor Australia has incorporated simplicity into the design of its prescribed metering charges by differentiating customers on factors that can be easily understood. Meter data service charges are determined based on how often a customer's meter is read, while meter provision charges are determined by the type of meter provided. All charges are calculated on a per NMI per annum basis.

5. CONSUMPTION SIGNALS

Powercor Australia will consider the following tariff structures over the 2006-10 regulatory period to provide price signals to distribution customers which encourage efficient consumption behaviour.

Figure 8: Proposed Tariff Structures 2006-10

TARIFF STRUCTURE	SIGNAL	OUTCOME
Location based tariffs	<ul style="list-style-type: none"> Powercor Australia will continue to provide location based signals to large customers. Powercor Australia will continue to assess the introduction of location based tariffs for residential and non-residential customers. 	<ul style="list-style-type: none"> Efficient usage of the network.
Interval meter tariffs	<ul style="list-style-type: none"> Allow for distribution tariffs for interval metered customers to be amended over time to create more efficient price signals for customers without causing sudden price shocks. Over time to sharpen the pricing signals to encourage customers to adopt efficient consumption patterns. 	<ul style="list-style-type: none"> Shift load and consumption during periods of network congestion. Introduction over time will ensure customers have time to respond and avoid price shocks. The exact format of the time of use periods will be determined after an initial period of data gathering and analysis of how specific tariff and customer groups contribute to network peaks at particular times.
Seasonal tariffs	<ul style="list-style-type: none"> Powercor Australia's costs are driven by seasonal peaks in demand on the network. 	<ul style="list-style-type: none"> Seasonal tariffs may send sharper price signals to customers during times when demand on the distribution network is highest.
Excessive Reactive Demand Charge	<ul style="list-style-type: none"> This new charge will apply to all customers on distribution tariffs that have a demand charge, and will provide customers with commercial incentives to remain within the power factor limits set out in the Electricity Distribution Code. 	<ul style="list-style-type: none"> Customers who cause poor network power factor are required to meet the costs of rectifying that power factor and not the majority of customers who remain within power factor limits.

6. CONSULTATION

Powercor Australia has undertaken the following consultative processes in the development of the Tariff Strategy Report:

- Regular updates and consultation regarding tariff issues and the draft tariff strategy report with the Powercor and CitiPower Customer Consultative Committee (PACCCC);
- A forum held for retailers to provide guidance and consult on tariff issues and the draft tariff strategy report;
- The Tariff Strategy Report being made available to all stakeholders through the Powercor Australia website; and
- The establishment of the Powercor Australia stakeholder register.

Any customers, retailers or other interested parties who would like to be included on the stakeholder register are requested to email their details to register@powercor.com.au. Powercor Australia requests that stakeholders direct any comments on this report, Powercor Australia's Tariff Strategy or its Annual Tariff Reports to this email address.

Powercor Australia intends to consult with the PACCCC and other key stakeholders each year on the Annual Tariff Report as part of its tariff development process. Further information regarding the future development of the report and the related Annual Tariff Reports will be provided to all parties on the stakeholder register.