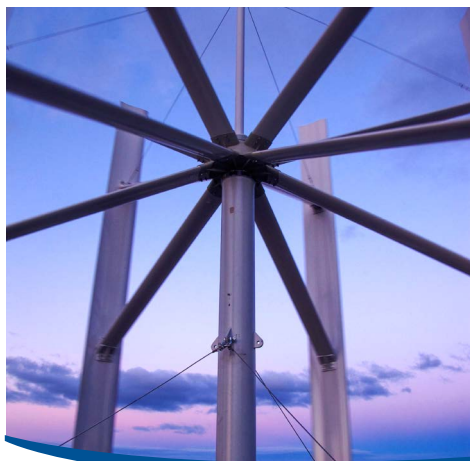


Energy Working Group



I. Introduction – comment from the Chair

The Energy Working Group (EWG) was established by the Minister for Energy, Mr Matthew Groom, MP in early May 2014. The EWG is pleased to present this report as part of its advisory role in the development of a new Energy Strategy for Tasmania.

The EWG is a customer focussed panel. It includes representatives from the large energy intensive industries, a representative with experience in the commercial and industrial and small customer segments, a representative from the State's agricultural sector and expertise representing the point of view of low-income and vulnerable customers.

The EWG does not claim expertise in the supply side of the energy industry but has involved itself in discussions with the major components of the State electricity industry and the wholesale and retail parts of the State's gas industry. There has also been an opportunity for all external parties to contribute to the development of the Government's energy strategy through the release of an Issues Paper and call for submissions.

The EWG also recognises that in recent times, the Parliament (under the *Electricity Supply Industry Expert Panel Act 2010*), created an Electricity Expert Panel to undertake a comprehensive analysis of the electricity industry in Tasmania. Persons wanting an expert view informed by those panel members and a major amount of commissioned analysis should refer to www.electricity.dpac.tas.gov.au.

The Tasmanian Government is committed to making energy a competitive advantage for Tasmania and delivering competitive power prices.

The Government also recognises the opportunity to effectively utilise the State's energy assets as an economic driver to attract new investment, retain existing industry and secure employment. The EWG hopes that its input into the development of the Strategy will allow the Government to develop actions and initiatives to fulfil these aims.

A lot of the work of the EWG has focussed on the immediate issues facing customers in the Tasmanian energy markets, particularly electricity. This is not surprising given the electricity intensive nature of Tasmania's industrial base, the dominance of electricity in household energy budgets and the fact that the Government is the owner of all three major elements of the electricity supply industry.

This focus on electricity does not diminish the importance of other energy sources and markets. Nor does a focus on immediate issues diminish the need for or the role of long term planning and strategy development.

In particular, the EWG recognises the importance of transport-related energy to households and industry competitiveness.

The relative lack of input and analysis of these issues reflects the expertise available to the EWG and the reality that the State Government has and will continue to have very little ability to impact on pricing or other supply outcomes in this sector. The EWG notes that four submissions to the Issues Paper commented on the absence of discussion on transport and two more offered suggestions on transport alternatives (ie electric vehicles).

The Terms of Reference for the Energy Working Group is attached at Appendix I. I can report that we have discussed and provided advice to the Minister and the Department on the objectives that the Energy Strategy should seek to achieve in addition to providing advice on the scope. The EWG has provided comment on the draft Issues Paper prior to its release and will provide further advice on the Draft Strategy.

This Report largely fulfils our obligation under the Terms of Reference to discuss the merits of potential strategies and what actions might be taken to implement them. Further advice will be provided on the Draft Strategy as required.

The EWG would like to thank the Department of State Growth for the secretariat support provided to the Committee over the last six months.

Rhys Edwards

Chair, Energy Working Group

November, 2014



Working Group Members

- Rhys Edwards (Chair)
- Ray Mostogl (Tasmanian Minerals and Energy Council)
- Marc White (expert in medium and small business and residential energy users)
- Greg Zooeff (Nyrstar and the Big Picture Group)
- Tony Reidy (Tasmanian Council of Social Service)
- Jan Davis (Tasmanian Farmers and Graziers Association)

2. Executive summary

A starting point for the deliberations of the Energy Working Group has been the hypothesis that lower electricity prices can produce net economic benefits for customers (including different customer segments) and the general economy. This is consistent with the Minister's desire for the Energy Strategy to position energy as a comparative advantage for Tasmania and to contribute to driving economic growth in the State.

The EWG has sought to test this hypothesis through quantitative and qualitative information from a range of sources.

Economic modelling conducted on behalf of the EWG by Sapere, indicated that lowering electricity prices could help stimulate economic growth in Tasmania, though this is highly dependent on the assumptions used in the modelling and whether savings arising from lower prices are retained in Tasmania. Taken together with the modelling undertaken in Queensland for its energy strategy, there is evidence which supports the pursuit of lower electricity prices through a more efficient electricity sector.

The EWG has also sought to consider what levers the State might have to assist in reducing electricity prices.

The EWG considered a wide range of information from various sources, reached a number of conclusions about that information, and has made a number of observations and recommendations for potential strategies. These potential strategies follow from a number of key themes, as reflected in the structure of this Report. There is considerable interrelationship between the themes, and some potential overlap. This is because energy supply, its role in the economic welfare of our community, and the role of the customer, are all interrelated.

The Working Group has, however, endeavoured to structure its report, and presentation of the potential strategies, following identified themes. The potential strategies recommended by the Working Group are summarised below.

Electricity pricing

- In developing the Energy Strategy, the EWG strongly supports Government using explicit targets for its businesses to achieve. These may be specific or relative price targets, or may be cost reduction targets for the supply industry (and should be appropriately benchmarked).

- The EWG encourages the Government to pursue opportunities for network tariff reform including through working with the other members of the COAG Energy Council.
- In order to take advantage of innovative retail tariffs, the EWG would encourage a market-driven roll out of advanced metering technologies to provide customers with choice regarding 'time of use' tariffs and other demand-side strategies to achieve better outcomes for customers.

Efficient energy sector

- Whilst to date no new retailers have entered the Tasmanian residential market, the EWG believes that the Tasmanian Government should continue to monitor the market and be willing to consider appropriate further action to reduce barriers to entry, where possible ensuring that the interests of consumers are protected in the process. This work should include the impact that the structure of the generation sector has on the appetite for new retail entrants.
- Government should engage with potential retailers to understand real or perceived barriers to entry, including if these have changed since the Expert Panel report was finalised and since the sale process for Aurora Energy's customer book was discontinued.
- The Government should continue to monitor the opportunity for retail divestment, and consider strategies that might achieve the best outcome for Tasmanians. This could include the merits of selling tranches of Aurora Energy's customer base and possibly combining these with Momentum Energy's customer base.
- Government should consider options that would provide price relief to consumers in response to the significant price increases experienced in the previous regulatory regime that were based on investments that were ultimately not required (as demonstrated by lower than expected utilisation). The Government should consider the relative value/ risks of 'writing down' the value of the asset given the prevailing decline in energy consumption, 'over-invested' and partially stranded asset base and below average network utilisation levels.
- Government should ensure future network investments do not result in unsustainable price increases for customers, for example by:
 - » working with other governments to continue to improve the national regulatory regime;
 - » ensuring investment proposals are justified (including reviewing the merits of independent network planning such as through AEMO); and
 - » setting cost and capital efficiency expectations for TasNetworks.

- Government should consider long term network business challenges and the ownership arrangements or alternative capital structures that will facilitate the lowest network price outcomes for Tasmanian customers, as well as managing risks to the value of the business to the Tasmanian community.
- Government as shareholder should be more active in ensuring the supply chain is as efficient as possible and delivering price and value outcomes for Tasmanians, including through:
 - » having explicit challenging cost and capital efficiency targets embodied in corporate plans;
 - » use of tools like Value Driver Tree (VDT) analysis and other lean practices to give shareholders a level of understanding and visibility of business lines and activity, that support business investments and activities;
 - » considering carefully the decisions around new capital expenditure particularly in relation to diversification and growth strategies;
 - » considering implementation of those recommendations yet be acted upon which the Expert Panel made in Chapter 6 of its report on Governance Reforms; and
 - » having arrangements with industry experts/ consumer representatives to assist Government to ensure consumer concerns and industry issues are appropriately considered when evaluating business performance and setting objectives for the business.
- Government should have a retention strategy for existing major businesses. Again, this could be an explicit role ideally suited to the position of the Coordinator-General. This could include consideration of a set of criteria to assess the relative merit of attraction and retention of various businesses.
- The Government's ambition in growing the population has a direct link with ensuring greater economies of scale to support a thriving retail market. The EWG notes the commitment by the Government to develop a population strategy.

Diversity of supply

- The Government should evaluate the energy security role of the Tamar Valley Power Station (TVPS) and consider its energy security value, to ensure the State has prudent arrangements. Subject to this, Government should consider the commercial viability of the TVPS and the impact of retained ownership on taxpayers.
- The Government should support an increase in the amount of gas exploration undertaken in the State. Tasmania does have gas resources and the potential of commercialising gas and also attracting large gas consuming industries to the State is a possible investment growth option which could create investment and significant employment. The legislative and regulatory processes around exploration must be streamlined to enable easier access to exploration. This could be a function for the Coordinator-General working closely with Mineral Resources Tasmania.
- The Government should continue to monitor developments in the Tasmanian gas industry and relevant developments impacting upon gas commodity prices

Economic development

- Government and its electricity businesses should consider options to market a block of industrial priced (delivered) energy at long-term attractive commercial rates to stimulate investment in large energy consuming facilities which create significant employment. This could improve the prospects for more load (which in turn improves outcomes for the generation and network businesses, with more revenue to be apportioned over fixed costs). It could also act as a risk mitigant by diversification of the Major Industrial base. This 'block' of energy could also be used by existing Major Industrials in potential capacity expansions in the future. The Coordinator-General would appear ideally placed to work with the energy businesses to market a price-certain block of delivered power.
- The Government should develop a targeted approach to attract certain industries rather than hoping that industries will come. It must be noted that electricity alone is not the answer as most large industries are export oriented and as such transport solutions must also be part of this investment attraction strategy.

Energy productivity/efficiency

- Government should consider funding energy efficiency programs targeted at vulnerable customers, to assist them in ways to reduce energy costs. This consideration should take into account national programs and non-government activity in this area, as well as evaluation of the outcomes from previous programs, to ensure maximum benefit.
- Appropriate Government facilitation of energy productivity in the business sector could be improved, preferably through facilitating and enabling private sector financing options for businesses to access capital for the purpose of energy productivity/efficiency upgrades. Environment Upgrade Agreements are an example worthy of consideration.

Vulnerable customers

- Government should review its concession policy to ensure it is well targeted and equitable. For example, Government should consider and investigate the provision of electricity concessions on a percentage basis and other models rather than solely as a flat rate. This review should be conducted in the context of any tariff reform proposal to ensure that vulnerable customers are able to take advantage of demand-side strategies that may assist in reducing energy bills.
- Government should also consider measures to enhance customer knowledge and engagement on energy related matters, including consumer protections, rights and responsibilities, and low cost energy efficiency measures. This would assist customers in making sound choices about how to meet their energy needs more cost effectively and would be of benefit to all small customers, not just vulnerable customers.
- Consideration should also be given to addressing anomalies in the current concession regime where customers with concession cards are not able to access the electricity concession because of the manner in which they pay for their electricity. This includes temporary residents of emergency and crisis accommodation, as well as permanent residents in embedded networks, such as caravan parks.
- Government should consider and fund energy efficiency programs for low-income households and vulnerable customers, as discussed in the Energy productivity/efficiency section.
- Government should review current protections for gas customers in light of the consumer protection provisions of the National Energy Customer Framework (NECF) and consider the costs and benefits of regulatory and non-regulatory options to address any identified gaps with particular reference to vulnerable customers.

Long term issues

- The Government should undertake a scenario modelling exercise of potential different energy futures which could feed in to future iterations of the Energy Strategy. Alternatively, the Government could take existing scenario work such as the CSIRO Future Grid work and undertake more detailed analysis of what these scenarios mean from the Tasmanian perspective.

3. Background

Tasmania's energy supply system has been dominated by electricity supplied through hydro generation, with four major electricity intensive industrial facilities dominating electricity usage accounting for approximately 60 per cent of the State's electricity load.

Diversification of supply has, however, been driven by the introduction of natural gas, along with the building of wind farms and interconnection to the National Energy Market (NEM) via Basslink, and the recent rapid uptake of household solar panels (micro solar photovoltaics (PV)).



Tasmania's reasonably new natural gas market is relatively small but is a fully contestable predominantly private market, subject to minimum regulation.

Other characteristics include:

- A relatively small market – with around 270 000 electricity connections and 12 000 gas distribution connections.
- Retail contestability, whilst being present in the Tasmanian market with Full Retail Contestability (FRC) for all electricity consumers commencing on 1 July 2014, is yet to see entry of new retailers in the Tasmanian small customer market and only limited competition in the large customer market.
- Until very recently, there has been a period of dramatic increases in electricity prices, particularly as a result of significant rises in capital expenditure on the network systems and environmental charges (such as the Renewable Energy Target and carbon tax). In Tasmania, transmission costs make up a higher proportion of overall network costs relative to the national average.
- Electricity consumption within the Tasmanian residential and commercial sectors is higher than the Australian average, resulting in Tasmanian electricity bills remaining relatively high by comparison to consumers interstate (due mainly to a cooler climate). Household expenditure on energy used within the home as a proportion of gross household income though has remained steady.
- There has been a reduction in consumption in response to the global financial crisis, higher electricity prices, increased levels of micro embedded generation, and fuel switching. As a consequence of this Tasmania now has enough installed generation and network capacity (notwithstanding localised requirements) to meet expected forecast demand growth for the foreseeable future to at least 2035 (Source: National Electricity Forecasting Report 2014 AEMO).
- The market participants in electricity generation (Hydro Tasmania), the regulated, natural monopoly networks business (TasNetworks) and the energy retailer (Aurora Energy), are all Government-owned. Only one private sector retailer (ERM Power) is actively operating in the State, servicing medium to large business customers.

4. Electricity pricing

Observations

The Tasmanian Government has come in to office with a commitment to deliver competitive power prices through introduction of effective competition and through prudent management of the State's energy businesses.

The EWG's work and focus has been on considering the hypothesis that lower electricity prices can produce net economic benefits for customers (including different customer segments) and the general economy. This focus is consistent with the Minister's desire for the Energy Strategy to position energy as a comparative advantage for Tasmania and to contribute to driving economic growth in the State.

The EWG has sought to test this hypothesis through quantitative and qualitative information from a range of sources. The EWG has also sought to consider what levers the State might have to assist in reducing electricity prices.

Customer expenditure is both a reflection of price levels and consumption thus a focus on downward pressure on prices is desirable as well as mechanisms for managing consumption by being able to respond to price signals.

In order to drive a sustainable lower level of pricing, a focus on the efficiency of the supply chain is important. Lowering prices can also be achieved with improved utilisation of the network through attracting new load. Load growth has a dual benefit of potentially lowering prices but also stimulating economic activity in the State. This is discussed further in Section 6.

Transmission network prices

Over the past decade electricity prices for all consumers have increased significantly above CPI. These increases have largely been driven by increasing transmission network prices, which have increased in Tasmania by approximately 125 per cent (according to TasNetworks' estimates) and potentially even higher for some major industrial customers when exchange rate impacts are taken in to account. This compares to CPI growth of approximately 20 per cent over the period 2007 to 2014.

Large customers connected directly to the transmission network are typically exposed to world market conditions, which have also been challenging, leading to increased concern over electricity pricing impacting the competitiveness of these businesses.

Though transmission costs look to have declined in 2014-15 and will remain flat or decline in real terms over the current reset period, there is concern that past expenditure is placing an unreasonable burden on all customers, but particularly on our energy intensive trade exposed industries. This puts pressure on the Government's intention to use energy as a driver of economic growth and its ability to retain key industrial activity.

Distribution network prices

As with Transmission charges, distribution costs and charges have increased dramatically over a similar period. The increase from 2007-2014 has been relatively less than the transmission system at 55 per cent in nominal terms and is projected to decrease in real terms for the remainder of the reset period (until 2017).

The significant increase has been driven by large investments in infrastructure during this period despite demand falling post 2008. The main driver has been the replacement of ageing infrastructure as well as augmentation for what demand growth has occurred. Over the period operating costs also rose significantly in real terms. Adding to the impact on customers was significant increases in the three years prior to this period.

These increases in distribution charges in combination with substantial increases in transmission charges have seen customer price increase dramatically over the period. In a residential customer's bill, distribution charges are now the most significant component of the bill (over 30 per cent).

Cost reflective tariffs

The ability for customers to optimise the use of energy relies not only on a competitive level of pricing but also the ability to respond to price signals in order to manage energy consumption.

The current flat charge and a flat usage tariff (ie. cents/kWh) system in Tasmania does not provide the signals to customers to reduce demand when demand is highest. The development of tariff structures that provide better signals to the customer as to when electricity supply is more expensive would help lower demand during these times and reduce the long term cost of electricity.

While the current usage charge assists in conservation of energy, it does not allow a differentiation between peak demand and energy consumption. Of concern is that peak demand drives the majority of network investment and hence cost for supply of less than one per cent of the time.

Providing an appropriate price signal, and hence incentive, should allow demand shifting to reduce peak demand and delay future network investment and ultimately lower power bills in the longer term.

The issue has been further exacerbated by arguments of cross subsidies with existing tariff structures for households with either large air conditioners (or heat pumps in Tasmania) and PV installations. AEMC in its modelling for the draft rule change (discussed below), estimated that on average, nationally, households with air conditioners are subsidised to the tune of \$700 per annum while those with PV systems do not pay approximately \$120 per annum for the use of network services.

The impact of peak demand and the ability to shift or reduce demand has not been examined in detail by the EWG and warrants further examination by the Government.

The AEMC is reviewing tariff structures and in September 2014 issued a draft rule determination on cost reflective tariffs for distribution network businesses. This rule change advocates using long run marginal cost for network investment to price distribution charges as well outlining principles of customer engagement and cost recovery the network businesses should apply.

The draft rule is not prescriptive and leaves room to design cost structures to ensure the best outcome for the network businesses and customers. It also does not prescribe that retailers need to adopt the tariff structure but encourages the distribution business and retailer to engage in this discussion so clear signals can flow through to the customer.

The EWG acknowledges that cost reflective tariffs will have impacts on all customers, particularly vulnerable customers, and this needs to be carefully considered.

The EWG is encouraged by the recent analysis by AGL of its 160 000 customers in the Victorian region, which indicated that over 80 per cent of vulnerable customers could be better off under a cost reflective tariff (in this case 'time of use' tariffs). This still means 20 per cent are worse off and concession arrangements may assist in alleviating any impact to such customers.

The EWG notes that the AEMC also recommended the review of concession arrangements as part of the tariff reform process.



Impacts of price reductions

In the development of the Queensland 30 year strategy, modelling for the Queensland Government estimated that a one per cent decline per annum in electricity prices (real terms) would result in an increase of \$1.8 billion in GSP over a 30 year period. This was particularly so when the one per cent decline was a result of productivity gains across the electricity supply chain.

As the Tasmanian economy is markedly different to the Queensland economy, the EWG felt that there would be benefit in modelling the impact of electricity price reductions on the ability to improve economic activity in the Tasmanian economy.

Sapere Research Group (Sapere) were engaged to undertake a partial modelling exercise to estimate the benefits to vulnerable and average residential users as well as small, medium to large, and major electricity businesses of real 'step change' savings in electricity prices of 10 per cent, 20 per cent and 30 per cent achieved over four years.

Sapere were not asked to look at how these savings would, or could, be achieved, nor were they asked to look at the costs involved in these savings. The modelling specifically asked the question: if these savings could be achieved, would they be a 'game changer' for Tasmania and more specifically the different consumer groups being looked at?

The model assumed price reductions are achieved through real savings, so dividend returns to Government were assumed to remain neutral and more broadly, it was assumed that the Government did not raise taxes or reduce services to subsidise electricity price decreases other than through indirect benefits. It is also assumed there would be no change in service quality (eg reliability), due to reduced future capital expenditure.

A summary of findings from the Sapere research is included in this section.

The partial analysis undertaken by Sapere provides some useful indicative data. More sophisticated modelling techniques such as general-equilibrium analysis would provide a more robust set of results. The Government should look at the ability to build capability within the public service for undertaking these sorts of modelling exercises.

A summary of Sapere Research Group findings:

“The modelling results for a base case suggest that, by 2017-18, a 10 per cent decrease in electricity price scenario would lead to \$112 million annual aggregate saving for energy consumers in Tasmania. After taking into account the fact some of this saving would flow to the rest of the world, this would be equivalent to around 0.2 per cent of assumed Gross State Product (GSP) for that year. Under a 30 per cent decrease in electricity price scenario, the annual aggregate saving for consumers in 2017-18 would be around \$337 million, or 0.7 per cent of GSP.

While the total benefit under the 30 per cent scenario seems significant, this should be treated very cautiously. In the first place, it does not include any of the transition costs required to achieve these savings. Similarly, it does not take into account that a portion of savings would be offset by corresponding reduced revenue/expenditure by State-owned energy companies (directly or indirectly through the Tasmanian Government as shareholder). [Notwithstanding these caveats, it is the experience of some EWG members that transformational reform can be achieved with low or no capital expenditure and still achieve substantial savings.]

The GSP estimates in particular are likely to overstate the real effect of these changes and the potential benefits to the Tasmanian economy. It is also important to take into account that a significant share of benefits under each scenario is likely to be transferred outside Tasmania.

The modelling indicates that by 2017-18 residential users would be saving around \$190 per year under a 10 per cent scenario, and up to \$570 per year under a 30 per cent scenario. For average households, this represents a modest reduction in the electricity share of typical household expenditure – from 4.5 per cent to 4.1 per cent. This could also be modest relative to other changes in prices for other household expenditure and incomes by 2017-18. Similarly, for vulnerable customers, the reduction is also modest (from 5.5 per cent to 5.0 per cent) and could be overtaken by other changes in prices or income. To put these numbers in context, the 20 per cent scenario would simply return Tasmanian households to the position they were in at the time of the most recent ABS household expenditure survey in 2009-10.

The extent benefits to electricity consumers flow to the Tasmanian economy is highly uncertain and depends on a range of variables. It also depends on the accuracy of the

baseline case regarding the current allocation of electricity supply costs between the five major customer groups, as well as future trends in electricity consumption and prices.

The central modelling challenge is representing decisions by various customer groups in response to reduced electricity prices under the three scenarios. Initially, this issue has been addressed by defining a range of “buckets” for the allocation of lower electricity purchase costs by the five types of end user.

Model inputs were set on the assumption the majority of benefits flowing to vulnerable, average residential and small business users flow to the broader Tasmanian economy. There would be some “leakage” to the Rest of the World from these groups, but it is assumed this is relatively modest.

Responses by major industrial users were assumed to have a significant impact on the indicative results for the Tasmanian economy; more so than applying a higher demand forecast. This reflects the proposed allocation of price reduction benefits, based on the current allocation of aggregate electricity supply costs between customer groups. Accordingly, a range of model cases were developed to illustrate the sensitivity of results to different allocation decisions by major industrial users.

Under a case where it was assumed major industrial users distribute the majority of benefits they receive outside Tasmania, benefits to Tasmania would be slightly less than half total benefits. Under a case where it was assumed major industrial users distribute the majority of benefits they receive within Tasmania, benefits to Tasmania would be more than 70 per cent of total benefits.

Modelling outputs could be improved by testing and refining key inputs, especially assumptions around the allocation of price reduction benefits between different types of expenditure (and saving), and between Tasmania and the rest of the world. This is most challenging for major industrial users and medium to large business users.”

Sapere Research Group, 2014

Conclusions

The EWG sees an objective of any future strategy is to achieve a declining real price path for all consumers in Tasmania to assist in future economic development for Tasmania, and to alleviate financial stress for vulnerable Tasmanian households.

In short, the lowering of electricity prices will help stimulate growth in the Tasmanian economy and lead to positive outcomes for Tasmania.

While the ideal would be to have the cheapest electricity prices in Australia, this is challenging because we have:

- a predominantly hydro system which is more expensive than coal fired generation particularly in a market without carbon pricing;
- installed wind energy which presumably does not lower the average cost of the existing installed generation;
- a small scale network system and dispersed population, paying postage stamp priced tariffs (which theoretically means it is difficult to be cheaper than larger populated jurisdictions with more concentrated settlement patterns); and
- a small customer base and, therefore, a retail sector with a high cost to serve given the scale efficiencies in billing, customer service and other retail activities.

Given this, the focus should be on ensuring all parts of the electricity supply chain are as efficient as possible and that prices are low as they can be. Taken together, the outcomes of the Queensland modelling and the Sapere modelling support the pursuit of maximum efficiency in the supply chain.

Delivering sustainably lower prices through supply chain efficiencies is discussed in greater detail in the following Efficient sector section of this report.

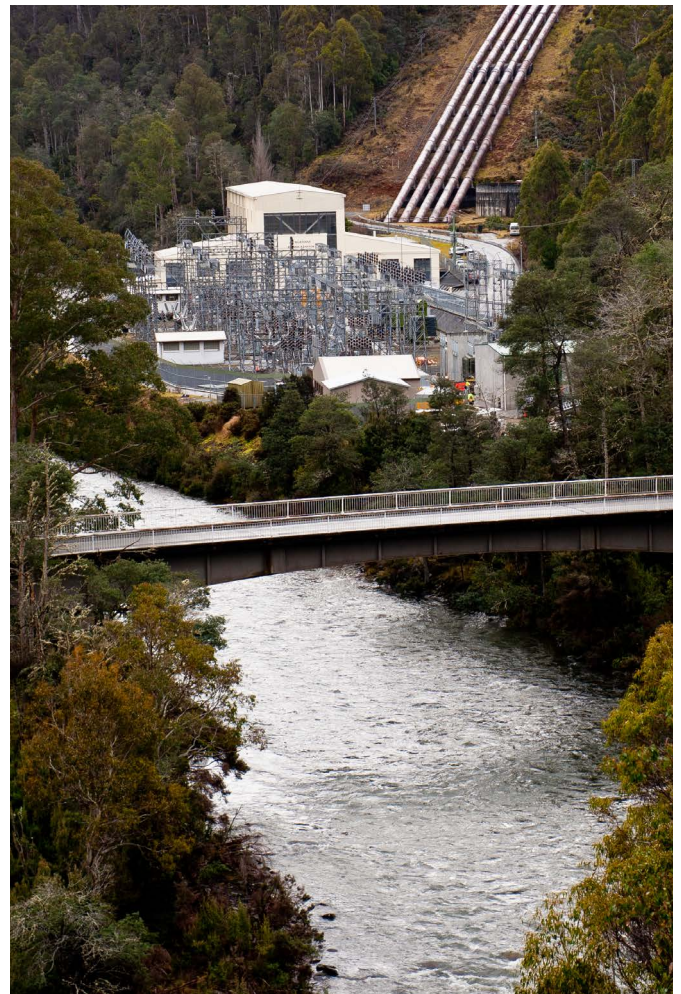
The EWG concludes that a move to more cost reflective tariffs should be encouraged with Government facilitating discussion between Aurora Energy and TasNetworks on any future tariff changes to help ensure price reflective signals are passed through to the customers in their tariffs.

EWG would encourage the Government to review the concession arrangements in any process of tariff reform to ensure vulnerable customers are not adversely impacted.

Metering solutions may also be a key enabler of tariff changes, including managing impacts on vulnerable customers. For example, pay as you go (PAYG) meters are valued by some customers, including vulnerable customers, and advanced meters could replace the existing PAYG meters while essentially maintain the pre-paid functionality.

Potential strategies

- In developing the Energy Strategy, the EWG strongly supports Government using explicit targets for its businesses to achieve. These may be specific or relative price targets, or may be cost reduction targets for the supply industry (and should be appropriately benchmarked).
- The EWG encourages the Government to pursue opportunities for network tariff reform including working with other members of the COAG Energy Council.
- In order to take advantage of innovative retail tariffs, the EWG would encourage a market driven roll out of advanced metering technologies to provide customers with choice regarding time of use tariffs and other demand-side strategies to achieve better outcomes for customers.



5. Efficient sector

Observations

The Tasmanian electricity sector has undergone significant recent change across the retailing, network and generation components of the supply chain.

The EWG had meetings and workshops with each of the Government businesses, and heard that each was at different stages of a reform journey. This includes being at different stages of identifying and implementing efficiencies.

With respect to the retail sector, the EWG notes:

- the deregulation of the various customer tranches to allow competition and competitive pricing to flow into the market, cumulating in full retail contestability (FRC) of residential customers from 1 July 2014;
- the disaggregation of the distribution and retail businesses of Aurora Energy, such that Aurora Energy became a retailer only on 1 July 2014; and
- the proposed action recommended by the Expert Panel and supported by the previous Tasmanian Government for the sale of Aurora Energy's retail customer book, which was discontinued in October 2013.

The EWG notes that Aurora Energy has made significant changes in preparing to be a retailer only in a full retail contestability environment, including efforts to create a 'lean' company. In terms of impact on final customer prices, it is noted that the retail component is only a relatively minor part of the overall energy price structure.

With respect to the prospect of new retailers entering the Tasmanian market, the EWG notes that there continues to be a number of barriers that are likely to inhibit entry. These have been commented on publicly previously, and include:

- Hydro Tasmania's wholesale market dominance;
- The sovereign risk associated with doing business in a market that is regulated at both wholesale and retail levels, and where the Government maintains ownership of the key market participants;
- the small size of the Tasmanian customer base;
- a relatively high credit risk customer retail 'book' due in part to a high welfare dependency; and
- the relatively high cost to serve.

However, the EWG has heard from one retailer currently operating in Tasmania in a niche market segment, which indicated that it is comfortable with the existing contracting market in which it operates.

With regard to the network, the EWG notes the merger of Tasmania's transmission and distribution networks under one business, TasNetworks, which commenced operating on 1 July 2014.

The EWG heard that TasNetworks has a three phase plan associated with its creation, with the first two phases focussing on the lead up to the 1 July 2014 start up and the immediate period afterward. The third phase, 'transform practices', is set to commence soon and this is the phase where significant further efficiency opportunities are likely to be identified and implemented.

While this is encouraging, and together with more recent changes to the regulatory regime, should put future transmission price changes on a more sustainable basis, it is the ongoing price impacts from the most recent regulatory period which is a major concern impacting both large customers directly connected to the transmission assets, as well as smaller customers connected to the distribution assets.

The EWG also notes that there are many challenges facing traditional network businesses (internationally and nationally), such as migration away from the network by consumers, and TasNetworks is no exception. From a longer term perspective, these challenges raise interesting questions for the Government as owner of the business, in terms of risk to the value of the business.

The EWG noted research (including by Ernst and Young), that indicated private sector network businesses in Victoria and South Australia had reduced their real operating costs over the period examined and were able to keep expenditure within the regulatory allowances, which had generally led to lower customer prices, compared with Government owned network businesses.

Other work examined, including by the Productivity Commission's Electricity Network Framework Review and Bruce Mountain showed differences in outcomes as a result of private versus public ownership.

The generation sector in Tasmania is still dominated by Hydro Tasmania. This position has consolidated further since the transfer of the Aurora Energy Tamar Valley (AETV) power station to Hydro Tasmania in 2013, which was the only large competitive supply of electricity in the Tasmanian sector prior to this transfer.

Other key developments have included:

- requiring Hydro Tasmania to offer some safety net contracts on a weekly basis at a regulated price;

¹ Independent regulation of government-owned monopolies: an oxymoron? The case of electricity distribution in Australia. Presentation to the London school of Economics, March 2014.

- business decisions which have proven to be highly sensitive to regulatory changes, such as the repeal of the carbon tax and uncertainty surrounding the Renewable Energy Target;
- recent falling storage levels, coupled with flat forecast demand, potential large amounts of renewable generation capacity entering the market pre 2020 and inflows expected to remain around average; and
- the vertical diversification of Hydro Tasmania, which has gone from a 'pure play' generator to now encompass, consulting and electricity retailing.

Hydro Tasmania (inclusive of all the entities 100 per cent owned or controlled by Hydro Tasmania) has delivered significant returns and profits in the past few years, but this was highly dependent on favourable regulatory policies (particularly the carbon tax). With a change to some of these policies, Hydro Tasmania's financial outlook is challenging.

The EWG notes that Hydro Tasmania is not required to return a dividend to Government until 2017-18, when it is estimated to return \$75 million. The EWG understands that achieving this will require some fundamental changes for Hydro Tasmania, including pursuing and achieving significant efficiencies in cost, capital allocation and revenue.

The workshops held between the EWG and the electricity businesses focussed on explaining the use of specific processes such as a Value Driver Tree (VDT) analysis in order to identify significant new opportunities to drive material productivity improvements. Other tools such as lean tools like Value Stream Mapping (VSM) were also discussed.

These discussions were well received by the energy businesses, and each said they would consider using the VDT. However the EWG notes that the Government energy businesses are unlikely to face the motive of 'survival' which have galvanised local major industries to undertake such initiatives (see break out box for an example of the experience of the Big Picture major industrials).

The VDT takes the understanding of what drives value / cost beyond the financial balance sheet to a more detailed point where specific constraints, business levers and activities can be seen and subsequently modelled.

A VDT can highlight where the constraints exist in a business, it can be used to model the financial implication of making a change at an activity level and it can be used to differentiate core and non-core activities.

In essence a VDT removes the complexity in understanding how to improve a business.

The challenge of the Big Picture major industrials

Significant power price increases against backdrop of Global Financial Crisis (GFC) global economic shock and high exchange rate Tasmania's Big Picture industries have faced power price increases of more than 200 per cent over the past five years placing significant pressure on their operations.

Collectively contributing in excess of \$2 billion to the Tasmanian economy and accounting for more than 10 000 direct and indirect jobs the Big Picture industries have faced threat of closure as a result of challenging macro-economic conditions exacerbated by spiralling transmission charges and a reduction in competitive freight options.

The GFC and subsequent shockwaves saw Tasmania's major industrials experience revenue losses of up to 40 per cent due to a collapse in global commodity prices and the significant appreciation in exchange rate markets.

The global response was to shut down and / or idle production facilities, starting with those operations making the biggest losses.

Given the Australian - USA exchange rate increased from \$0.68 during the GFC up to \$1.10 four years later, Australian-based commodity producers were not well positioned to deal with this crisis. For many, the 2014 revenue is only just beginning to recover to a position equivalent to that experienced in late 2009, during the GFC.

Faced with threat of closure, these businesses worked with supportive employees and suppliers to 'dig in', accepting that they had to make some very difficult choices in order to retain their operations in Tasmania.

These choices included pay freezes, workforce restructuring, employee reductions (which in some cases saw reductions of up to 20 per cent), asset rationalisation, and significant cost and capital productivity gains with existing assets and even output reduction.

Occurring against a backdrop of no material investment in assets, these businesses were all in survival mode. Transformation was not an option but a necessary business response to realign cost structures and efficiencies to volatile market and macro-economic conditions in order to support a sustainable future.

Conclusions

Competition in the retail sector is a worthy goal and, if effective competition can be established in Tasmania, will provide benefits to Tasmanian energy consumers. However, the barriers discussed earlier will make new retail participant entry challenging potentially without further reforms, at least for the short term.

The EWG notes that if there is successful competition before the Tasmanian Government has sold Aurora Energy, the value of the Aurora Energy retail book is likely to decrease.

Noting the sovereign risk issue associated with regulation of the wholesale and retail markets being at the State level, at the same time the Government owns market participants, the Government should also be mindful of the impact of changes to the regulatory environment (such as the recently announced changes to the Office of the Tasmanian Economic Regulator (OTTER)). As recommended by the Expert Panel in its Governance discussions, it is important that there is confidence in the independence of regulatory processes.

There are limited options to potentially redress the recent significant increase in network costs, as past investment decisions divided by consumption are the two key drivers of network price outcomes. Future investments have only minor impacts on network prices particularly if consumption/demand continues to decline. Asset write downs for underutilised assets and/or under recovery of revenue allowances appear to be possible options, though this would be at the expense of Government returns.

The EWG is of the view that the focus of the Government should be to provide the right incentives to the network businesses to consider the potential for regulatory cost relief for customers. This should be done such that the any cost reduction will deliver the best economic outcomes for Tasmania.

With respect to future network costs, the regulatory regime that the Australian Energy Regulator is responsible for must continually be reviewed and monitored so that it provides more favourable conditions for customers in the future and ensures past outcomes are not repeated. The regulatory regime should not allow for a situation like the most recent revenue period, where prices increased dramatically on the back of investment proposals that proved 'unjustified' in the context of actual demand.

Of particular concern is the outlook for demand and hence the way in which the investment on the existing assets is captured in the future. The EWG notes that an ongoing issue will continue to be demand forecasting to ensure that efficient network upgrades are made in the future to ensure lowest possible network costs for customers.

The EWG notes the role that AEMO plays in the Victorian jurisdiction as transmission network planner and considers that there is merit in the Government exploring in more detail having AEMO become an independent jurisdictional network planner for Tasmania. This change would provide a more arm's length basis for network planning with the potential for lower planning costs and lower future network investment.

The EWG considers that transformative change is required in the Government electricity businesses to ensure they can be sustainable in the face of significant current and future challenges. The Government should ensure its energy businesses are maximising value for the shareholder in terms of the activities they pursue.

The EWG supports observations made by the Expert Panel over two years ago that Shareholder Ministers could have been more active in driving accountability for efficiency and effectiveness over the past decade. Developing and maintaining a focus on maximising efficiency and continual improvement in reducing costs is as important now as it was when the Expert Panel delivered its report.

The Panel also highlighted the importance of the decision making framework around capital expenditure particularly where it relates to core assets versus diversification and growth strategies. Reconciling these tensions is aided manifestly by having a clear understanding of the purpose of State-owned businesses and what the Government is seeking to achieve through its ownership of them.

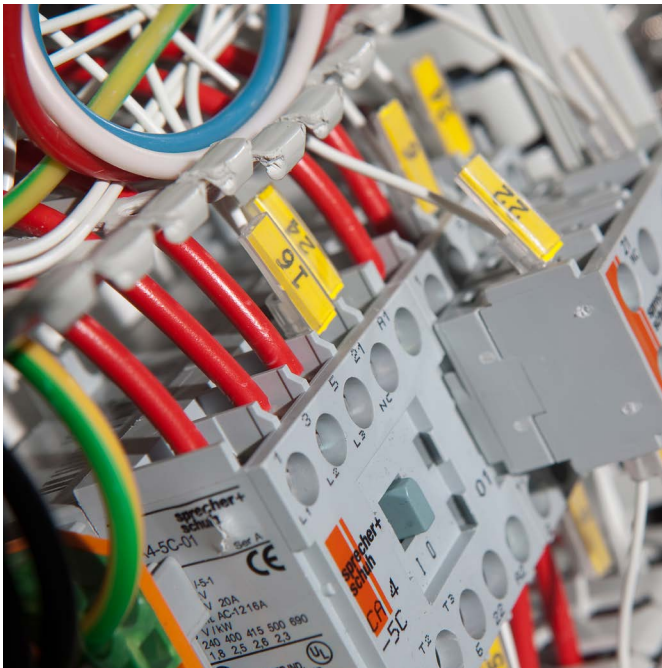
Improved governance arrangements would focus on making sure clear objectives are set for each business and the businesses are held to account for delivering on those objectives.

Government businesses appear to have enjoyed benefits and protections of Government ownership that large private sector businesses have not. For example, poor financial performance results in lower returns to Government or even financial support (such as through debt guarantees or equity injections), compared with private sector businesses that generally do not have such options.

Governance arrangements should create some tension between the Government, as shareholder, and the businesses, to ensure there are appropriate mechanisms to ensure Government fulfils its role in holding the businesses to account.

The EWG notes the role that public reporting and Parliamentary scrutiny plays in this regard. Governance arrangements may also be enhanced by the Government accessing expert advice (ie. to deal with the more complicated aspects of the industry) and consumer input when evaluating business performance.

This ultimately impacts on electricity customers (where inefficiencies lead to high prices) and the Tasmanian community (where lower returns or 'subsidised' support comes at the opportunity cost of lower taxes and/or greater expenditure in 'core' Government services).



Potential strategies

- Whilst to date no new retailers have entered the Tasmanian residential market, the EWG believes that the Tasmanian Government should continue to monitor the market and be willing to consider appropriate further action to reduce barriers to entry, where possible ensuring that the interests of consumers are protected in the process. This work should include the impact that the structure of the generation sector has on the appetite for new retail entrants.
 - Government should engage with potential retailers to understand real or perceived barriers to entry, including if these have changed since the Expert Panel report was finalised and since the sale process for Aurora Energy's customer book was discontinued.
 - The Government should continue to monitor the opportunity for retail divestment, and consider strategies that might achieve the best outcome for Tasmanians. This could include the merits of selling tranches of Aurora Energy's customer base and possibly combining these with Momentum Energy's customer base.
- Government should consider options that would provide price relief to consumers in response to the significant price increases experienced in the previous regulatory regime that were based on investments that were ultimately not required (as demonstrated by lower than expected utilisation). The Government should consider the relative value/ risks of 'writing down' the value of the asset given the prevailing decline in energy consumption, 'over-invested' and partially stranded asset base and below average network utilisation levels.
 - Government should ensure future network investments do not result in unsustainable price increases for customers, for example by:
 - » working with other governments to continue to improve the national regulatory regime;
 - » ensuring investment proposals are justified (including reviewing the merits of independent network planning such as through AEMO); and
 - » setting cost and capital efficiency expectations for TasNetworks.
 - Government should consider long term network business challenges and the ownership arrangements or alternative capital structures that will facilitate the lowest network price outcomes for Tasmanian customers, as well as managing risks to the value of the business to the Tasmanian community.
 - Government as shareholder should be more active in ensuring the supply chain is as efficient as possible and delivering price and value outcomes for Tasmanians, including through:
 - » Having explicit challenging cost and capital efficiency targets embodied in corporate plans;
 - » Use of tools like Value Driver Tree (VDT) analysis and other lean practices to give shareholders a level of understanding and visibility of business lines and activity, that support business investments and activities;
 - » Consider carefully the decisions around new capital expenditure particularly in relation to diversification and growth strategies;
 - » Considering implementation of those recommendations yet be acted upon which the Expert Panel made in Chapter 6 of its report on Governance Reforms; and
 - » Having arrangements with industry experts/ consumer representatives to assist Government to ensure consumer concerns and industry issues are appropriately considered when evaluating business performance and setting objectives for the business.

6. Economic development

Observations

Energy driven development, particularly during the 20th century through the hydro industrialisation period, has been a significant contributor to Tasmania's economic development and modernisation. The benefits of that period are still evident today, with some key major industrial companies still operating in the State and which use approximately 60 per cent of the State's energy consumption.

However, the maturity and current structure of the economy (both nationally and in Tasmania), together with market changes (such as exposure to increased global competition) mean that large scale energy-related developments to drive broader economic growth in the Tasmanian economy are unlikely to be as sustainable as they once were.

This does not mean there are not any opportunities, rather, the business and economic case for Tasmania must be strong, and ensure that existing customers benefit. For example, the Government's commitment to examine the merits of a second Bass Strait interconnector and a further 10 per cent extra generation capacity from existing hydro assets are yet to be clearly understood, in terms of the net impact for Tasmanians.

Conclusions

Tasmania can be more proactive in attracting new load, but energy alone is not the sole determining factor that would be sufficient to attract new businesses to the State.

The EWG believes focus on retaining and growing existing business is just as important, if not more so, than attempting to attract new business. The EWG considers growth prospects for Tasmania are likely to be stronger through expanding businesses already located here, rather than through new entrants (though clearly the latter is important as well).

Any Government action to grow load needs to be well coordinated and the establishment of the Office of Coordinator-General is an ideal platform that can be used to this end. The role of the Coordinator-General is to attract and secure investment in major development projects in Tasmania and help streamline the Tasmanian business environment, promote competitiveness and assist with the assessment and approval of investment opportunities.

Growing load in Tasmania could be enhanced if longer term price-certainty could be provided to large energy intensive customers. This would also help reduce pricing for all other customers in Tasmania through lower network prices.

The EWG notes that it will be vital to ensure the Government-owned energy businesses are operating on a more efficient basis. Tasmania is a high price jurisdiction and faces other barriers such as small scale infrastructure and geographic isolation in trying to remain internationally competitive.

The EWG notes the Government's policy regarding the development of a second interconnector and the project to investigate a 10 per cent increase in Hydro production.

The EWG believes it is important for the Government to understand the conditions under which these projects would be financially and economically viable (noting that there has been past analysis into such a project by Marchmont Hill for the previous Government in 2011). Both these projects have 'option' value for the State but it is important that the benefit to Tasmanian electricity customers and taxpayers is clearly demonstrated.

The EWG believes that the market value of renewable energy may increase over the long term, both internationally and nationally. This trend is already occurring but, to date, has relied on favourable regulated arrangements, such as the RET which create regulatory risk when government policy changes.

Potential strategies

- Government and its electricity businesses should consider options to market a block of industrial priced (delivered) energy at long-term attractive commercial rates to stimulate investment in large energy consuming facilities which create significant employment. This could improve the prospects for more load (which in turn improves outcomes for the generation and network businesses, with more revenue to be apportioned over fixed costs). It could also act as a risk mitigant by diversification of the Major Industrial base. This block of energy could also be used by existing Major Industrials in potential capacity expansions in the future. The Coordinator-General would appear ideally placed to work with the energy businesses to market a price-certain block of delivered power.
- The Government should develop a targeted approach to attract certain industries rather than hoping that industries will come. It must be noted that electricity alone is not the answer as most large industries are export oriented and as such transport solutions must also be part of this investment attraction strategy.

- Government should have a retention strategy for existing major businesses. Again, this could be an explicit role ideally suited to the position of the Coordinator-General. This could include consideration of a set of criteria to assess the relative merit of attraction and retention of various businesses.
- The Government's ambition in growing the population has a direct link with ensuring greater economies of scale to support a thriving retail market. The EWG notes the commitment by the Government to develop a population strategy.



7. Diversity of supply

Observations

The gas industry in Tasmania is a relatively small but nonetheless important component of the State's energy supply. It is a fully contestable, predominantly private market subject to minimum regulation. There is no retail price regulation, and no obligation to offer supply.

Gas is provided into Tasmania from Victoria, distributed and retailed to customers by private companies and the State-owned Aurora Energy. There is a gas transmission pipeline from Bell Bay in the north of the State, that runs west to Port Latta, and south to Hobart with associated distribution networks running off this backbone. The main gas retailer in Tasmania is Tas Gas Retail, with Aurora Energy also having gas customers.

The EWG had presentations from key gas industry participants and understand there are some challenges facing the gas sector.

In particular, the outlook for gas commodity prices in the Eastern market is for significant increases, due to the coming on line of LNG export facilities in Queensland. Whether domestic prices in the southern part of the Eastern market reach export parity is a matter of debate, but nonetheless historic price levels are not predicted to continue.

At some point, it may no longer make sense for some users to continue using gas and there will be a demand side response which will see users either ceasing operations, substituting for another fuel or reconfiguring operations to reduce gas use.

In Tasmania, a similar range of demand side responses could be expected. A material increase in gas commodity prices is likely to threaten the viability of the operations of some users such as food processors, and it may result in other users reconfiguring operations.

A big demand side response will mean the already underutilised Tasmanian Gas Pipeline will be even further underutilised.

Increases in the gas commodity price will have less of an impact upon residential users than industrial users as the largest pricing component for residential users is for use of the distribution network. Many industrial customers connect directly to the transmission network and have a flatter load profile than residential customers so pay less for the haulage.

Conclusions

The EWG notes that there is upward pressure on gas prices, however, as the gas sector is unregulated there is little the Government can, or should do, to influence pricing. Doing so would risk creating longer term market distortions and result in overall inefficient allocation of investment in the State.

The EWG notes the Australian Government's position expressed through its Energy Green Paper, which similarly argues against market interventions and, instead, suggests the Australian Government help facilitate removal of impediments to development of new gas supplies as quickly as possible, and improve gas market transparency and liquidity (as well as gas pipeline access arrangements). Recent analysis by the Grattan Institute into the gas industry supports this position and focus for government.

The EWG notes the Government's desire to see a more efficient energy supply chain and, in this context, notes that this goal would be inhibited if Hydro Tasmania were to continue to operate the Tamar Valley Power Station (TVPS) when it is uneconomic to do so. The EWG, however, considers that the energy security role of the TVPS should be evaluated before any decisions are made (noting the Department has advised the EWG that work has been done on this issue).

With respect to wind and solar developments, the EWG note that there has been no lack of private sector interest in these sectors when there has been regulatory certainty around legislated targets or carbon pricing. In this context, Government, or its energy entities, should not undertake further activity in these markets if the activity distorts or crowds out the private market.

Potential strategies

- The Government should evaluate the energy security role of the TVPS and consider its energy security value, to ensure the State has prudent arrangements. Subject to this, Government should consider the commercial viability of the TVPS and the impact of retained ownership on taxpayers.
- The Government should support an increase in the amount of gas exploration undertaken in the State. Tasmania does have gas resources and the potential of commercialising gas and also attracting large gas consuming industries to the State is a possible investment growth option which could create investment and significant employment. The legislative and regulatory processes around exploration must be streamlined to enable easier access to exploration. This could be a function for the Coordinator-General working closely with Mineral Resources Tasmania.
- The Government should continue to monitor developments in the Tasmanian gas industry and relevant developments impacting upon gas commodity prices.

² Note some of the current impediments are in the form of state moratoriums to exploration of coal seam gas resources.

³ Gas at the crossroads- Australia's hard choice, Grattan Institute, October 2014.



8. Energy productivity/efficiency

Observations

Improved energy productivity or efficiency can provide a range of benefits both at an individual, business and societal level, particularly in the context of rising energy prices.

More productive or efficient energy use also potentially provides additional indirect benefits via reduced demand on the network.

A member of the EWG provided example information for a business customer on the payback periods for the investment in a range of energy efficiency measures.

Measure	Cost	Payback period
Repairing hot water service leakages	\$250	2 years
Installing photo-sensors on lighting	\$300	3 years
Ceiling insulation	\$20 000	6 years
Installation of a 10kW solar panel system	\$13 000	8 years

There are three key elements to achieving a good standard of energy efficiency, and they apply equally to households or businesses. They are building energy efficiency, energy efficient appliances and/or processes, and behavioural change.

However, the uptake of energy efficiency measures is impacted by a number of non market barriers, including a lack of access to capital, information barriers and issues such as split incentives, the latter being reflected in the building sector where differing incentives are embedded in the owner/landlord/tenant relationship.

The EWG notes that there are a number of energy efficiency programs and policies that have been developed and continue to be implemented both nationally and in Tasmania, such as the minimum standards for energy efficiency in appliances, building energy efficiency requirements, information campaigns and specific programs to address energy efficiency in low-income households.

Three recent Tasmanian energy efficiency programs aimed at low-income households are Power Savings for Tenants; Stay Warm, Save Money; and Energy Champions. Evaluation of the

Power Savings for Tenants Program indicated that the average energy savings for households equated to around \$190 per year. Whilst the average savings for households participating in the Stay Warm, Save Money program have been assessed at approximately \$180 per annum. All of these programs are currently unfunded and therefore no longer operating.

In addition, the EWG has observed that the Australian Government has operated a number of programs such as the Low Income Energy Efficiency Program and the Renewable Energy Bonus Scheme - Solar Hot Water Program, (both no longer offered) along with programs such as the Energy Efficiency Opportunities program for large energy users.

Whilst the EWG noted there is little evidence in the Tasmanian business sector of the implementation and uptake of successful energy efficiency programs, there are opportunities available to this sector.

There is an increasing presence of the private sector partnering with government to provide particular funding mechanisms to address barriers associated with access to finance.

One example interstate is the emergence of Environmental Upgrade Agreements (EUAs), which provide a mechanism for commercial building owners to access funding to upgrade their commercial buildings to improve the efficiency of energy and water usage. EUAs assists in addressing market failure related to building owners being able to access affordable funding through providing a less risky repayment mechanism for financiers. Also EUAs overcome the issue of the cost of upgrades being tied to the owner rather than the building.

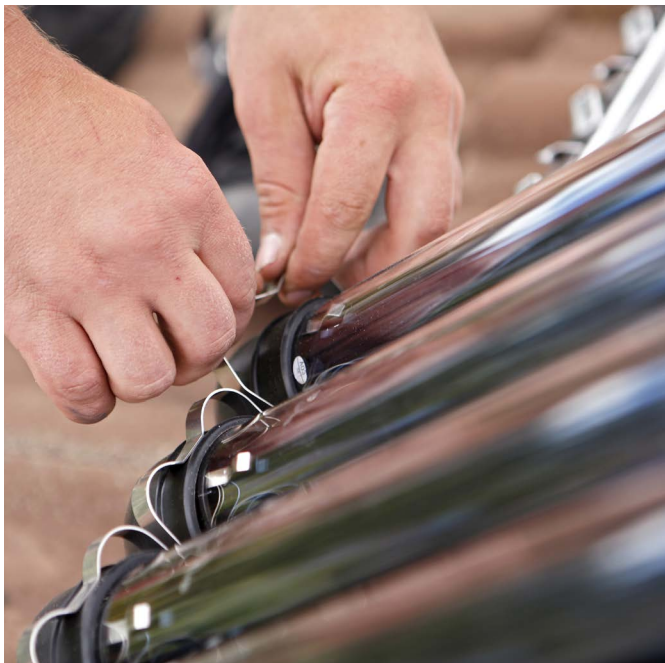
The EWG notes that there may be limitations to the uptake of EUAs in the Tasmanian context as projects are understood to need to be over \$250 000 to ensure financing/set up costs are not too prohibitive to make the project viable.

Conclusions

The key role for Government is to act as a facilitator or enabler where there is a market failure, particularly where those failures are a result to a lack of access to finance or due to information failures.

Policies to address the relevant market failure should be pursued specifically where the benefit of those policies is outweighed by the costs involved.

There have been, and continue to be, a range of Government (both national and State) energy efficiency and productivity programs, as well as growing private sector interests. Tasmanian policies and programs should complement existing efforts and focus on identified gaps.



9. Vulnerable customers

Observations

Tasmania has a higher proportion of vulnerable customers than other jurisdictions. While Tasmania's electricity concession system is generous in terms of quantum (it is the highest of any jurisdiction), Tasmanian bills are, on average, higher due to factors such as cold climate, low penetration of natural gas, and older (and inefficient) housing stock.

Tasmania was also one of the first jurisdictions to implement the National Energy Customer Framework (NECF) for electricity customers, which provides robust customer protection for residential and small business customers.

While the NECF was not applied to distribution and retailing of gas in Tasmania, the current Tasmanian Gas Retail Code and Tasmanian Gas Distribution Code provides a range of customer protection features that are similar with a number of the measures contained in the NECF. A significant variation, however, is that the Tasmanian regulatory framework does not impose on any retailer an obligation to offer supply. This means that a retailer may decline to offer a gas supply contract to a customer if the customer has a poor credit rating, or has amounts outstanding on energy accounts, either with the retailer or another retailer.

There have been recent instances where tenants in Housing Tasmania properties with gas hot water and heating have been unable to establish supply contracts with either of the gas retailers due to poor credit history. While Aurora Energy has an obligation to offer to supply electricity to such customers, there is no corresponding obligation to offer to supply gas.

The obligation to offer supply does not mean that a customer has no obligation to pay for the supply; nor does it mean that such a customer cannot be disconnected for non-payment. But in the absence of the obligation, there have been instances where customers, albeit a very small number, have not even been able to enter into a contract for supply at premises they occupy, where they have had no role in the decision to have energy supplied by gas (viewed as a product of choice) rather than electricity (viewed as an essential service).

Potential strategies

- Government should consider funding energy efficiency programs targeted at vulnerable customers, to assist them in ways to reduce energy costs. This consideration should take into account national programs and non-government activity in this area, as well as evaluation of the outcomes from previous programs, to ensure maximum benefit.
- Appropriate Government facilitation of energy productivity in the business sector could be improved, preferably through facilitating and enabling private sector financing options for businesses to access capital for the purpose of energy productivity/efficiency upgrades. EUAs are an example worthy of consideration.

The EWG noted the Tasmanian Council of Social Service (TasCOSS) submission to the Public Issues Paper, which included the following recommendations:

- Increase protection of small customers of natural gas in Tasmania by adopting the customer protection elements of the National Energy Customer Framework.
- Extend electricity concessions to eligible consumers who purchase their electricity from on-sellers (rather than directly from a retailer); these include some of the most vulnerable consumers in the State, for instance temporary residents of emergency and crisis accommodation and permanent residents of caravan parks and some retirement villages.
- Consider and investigate the provision of electricity concessions on a percentage basis.
- Reinstate Government funding for successful energy efficiency programs for low-income households in order to make a long-term improvement in energy affordability.
- Extend eligibility for assistance from the Electricity Hardship Fund to gas customers in need.
- Assist in creating and maintaining a system of long and short-term assistance measures (including those listed above and others) to ensure that no Tasmanian household is disconnected from energy supply solely for inability to pay.
- The Government, as part of both energy reforms and the new Energy Strategy, should fund and conduct a prominent public information campaign on energy issues. This should include information about consumers' rights, responsibilities and protections within a competitive retail energy market, as well as information about energy use and low cost energy efficiency measures.
- The Government should minimise its involvement in energy price regulation by allowing the Tasmanian Economic Regulator more discretion to set the wholesale pricing methodology within a market-based regulatory framework.
- Electricity price regulation for small customers must continue in Tasmania under an independent regulator at least until such time as it can be demonstrated that an effective competitive retail market exists in the State and delivers reasonable and sustainable prices under fair contracts to Tasmanian consumers.
- The regulated price should not include inducements to retailers to participate in the Tasmanian market.

Conclusions

The EWG believes that the Energy Strategy must consider the effects of policy changes on all customers and ensure that vulnerable customers are adequately protected through an appropriate safety net. The objective of achieving downward pressure on prices is very important to vulnerable and low-income customers, where energy costs represent a significant proportion of household expenditure.

The EWG is of the view that the current concession policy is not as equitable and well targeted as it could be. Further, the EWG is of the view that there should be a comprehensive evaluation of the existing consumer protection measures that are included under the Tasmanian Gas Retail Code and Tasmanian Gas Distribution Code to ensure that customer protection measures are maintained at appropriate levels, given the development of the market and the socio-economic profile of the customer base.

Potential strategies

- Government should review its concession policy to ensure it is well targeted and equitable. For example, Government should consider and investigate the provision of electricity concessions on a percentage basis and other models rather than solely as a flat rate. This review should be conducted in the context of any tariff reform proposal to ensure that vulnerable customers are able to take advantage of demand-side strategies that may assist in reducing energy bills.
- Government should also consider measures to enhance customer knowledge and engagement on energy related matters, including consumer protections, rights and responsibilities, and low cost energy efficiency measures. This would assist customers in making sound choices about how to meet their energy needs more cost effectively and would be of benefit to all small customers, not just vulnerable customers.
- Consideration should also be given to addressing anomalies in the current concession regime where customers with concession cards are not able to access the electricity concession because of the manner in which they pay for their electricity. This includes temporary residents of emergency and crisis accommodation, as well as permanent residents in embedded networks, such as caravan parks.
- Government should consider and fund energy efficiency programs for low-income households and vulnerable customers, as discussed in the Energy productivity/efficiency section.
- Government should review current protections for gas customers in light of the consumer protection provisions of the NECF and consider the costs and benefits of regulatory and non-regulatory options to address any identified gaps with particular reference to vulnerable customers.



10. Longer term issues

Observations

The change in demand and supply in the NEM has been unprecedented. Broadly, demand has plateaued or fallen across the NEM and forecasts of demand that would require extensive generation developments have been replaced by forecasts for no new generation.

Due to such changes, strategies or policies implemented at the beginning of the past five years have become less effective as the nature of the electricity market changes.

The past five years has shown issues with the regulatory environment in terms of network augmentation and pricing.

Coupled with emerging supply technologies like battery storage and electric vehicles and the potential for new retailers (ie. coupling electricity, gas, data, etc) there is a need to set a strategy that will encompass the continuing changing nature of the market.

Conclusions

The development of a 20 year strategy is generally very difficult and to ensure the strategy remains relevant will require it to be very high level and adaptable.

Having a focus for a short period of around five to 10 years would provide a more flexible strategy and could allow more defined and specific actions to be implemented.

If the Government is committed to a 20 year strategy, a mix of short, medium and long term actions would be appropriate, with more definitive and prescriptive actions associated with a short term horizon, and greater flexibility and less specification for a long term horizon (with medium term actions being appropriately articulated somewhere in between).

The role of Government in this context is to set the environment to allow strategy objectives to be achieved. This includes removing legislative barriers to new entry or new technologies with the ultimate aim of lowering prices to customers while not sacrificing the reliability customers are willing to pay for.

The Government should also set direction for its businesses that provide a clear focus and also monitor the businesses to ensure they are as efficient as possible.

Government in general should monitor for market failures and be ready to act to address these or adjust strategies where it is in the interest of consumers.

Potential strategies

- The Government should undertake a scenario modelling exercise of potential different energy futures which could feed in to future iterations of the Energy Strategy. Alternatively, the Government could take existing scenario work such as the CSIRO Future Grid work and undertake more detailed analysis of what these scenarios mean from the Tasmanian perspective.

APPENDIX I:

Terms of reference

ENERGY WORKING GROUP

Tasmanian Energy Strategy

I. Introduction

The Government is committed to making energy a competitive advantage for Tasmania, thereby driving economic growth in the State.

A core component of this commitment is the development of a "Whole of State" Energy Strategy for Tasmania. The key objective of the Strategy will be to identify ways in which energy can once again be utilised as an economic driver including by securing a stable and sustainable price path for power that can provide relief to consumers and help grow the economy and attract new investment.

The Department of State Growth will be responsible for drafting and delivering the final Strategy for the Minister's and Cabinet's consideration. The Department will consult and engage with the Working Group to seek its strategic input, so that a broad range of views can be considered in the development of the Strategy.

2. Working Group Purpose and Tasks

The Working Group will provide the Department of State Growth with advice, ideas and views on key aspects of energy supply and consumption in Tasmania, to assist and inform the development of the Energy Strategy.

The Working Group will conduct the following tasks:

- i. Discuss and advise Government, through the Chair to the Minister and through the Department of State Growth, on the objectives the Energy Strategy should seek to achieve;
- ii. Consider the scope of the Strategy, taking into account the new Government's policy focus;
- iii. Discuss the merits of potential strategies and what actions might be taken to implement them and advising Government, through the Chair to the Minister and through the Department of State Growth, of its views;
- iv. Provide comment and views on the draft Issues Paper to the Department of State Growth, before it is finalised for public release and comment; and
- v. Provide comment and views on the draft strategy to the Department of State Growth.

3. Milestones

The following are the key milestones associated with the tasks outlined in Section 2 of these Terms of Reference:

- Tasks (i), (ii) and (iii) are to be completed by end of June 2014.
- Task (iv) is to be completed by the end of July 2014.
- Task (v) is to be completed by end of October 2014.

The timing of individual milestones may be amended by agreement of the Minister.

4. Membership

The Working Group will consist of the following members:

- Rhys Edwards (Chair)
- Ray Mostogl
- Greg Zooeff
- Marc White
- Jan Davis
- Tony Reidy

5. Meeting frequency

The Working Group will hold its first meeting in May 2014. The Chair will determine the frequency of meetings beyond the first meeting, in consultation with Working Group members and the Department of State Growth.

6. Quorum

A meeting of the Working Group will be properly constituted with at least two thirds of members present. Members may attend meetings via telecommunication devices.

7. Media and Public Comments

All public and media communications regarding the Energy Strategy and the work of the Working Group will be provided by the Minister, unless otherwise agreed by the Minister.

The Minister's office will provide Working Group members with advance notice of any planned media statements or events.

8. Secretariat

The Department of State Growth will provide secretariat and support services for the Working Group, working closely with the Chair.

Photo credits

Images courtesy of Hydro Tasmania and
the Tasmanian Government

© State of Tasmania, 2014
ISBN 978-1-921527-40-1



Department of State Growth

GPO Box 536
Hobart TAS 7001 Australia

Phone: 1800 030 688

Fax: (03) 6233 5800

Email: info@stategrowth.tas.gov.au

Web: www.stategrowth.tas.gov.au