

Introduction

Aurora Energy welcomes the opportunity to make a submission on the Energy Strategy Issues Paper released by the Department of State Growth on 12 August 2014.

The Energy Strategy is being developed on the back of significant structural and regulatory changes to the Tasmanian electricity supply industry, the benefits of which are beginning to be realised by Tasmanian customers in the form of price reductions. As a result of these reforms, Aurora Energy commenced operations as a stand-alone energy retail business from 1 July 2014 with a sole focus on providing retail services to electricity and gas customers in Tasmania. Also on this date, full retail competition (FRC) commenced for all electricity customers meaning that retailers can now compete for all Tasmanian energy customers.

In preparation for 1 July 2014, Aurora Energy has undertaken a significant transformation program to ensure that it will operate as a cost-effective energy retail business in a competitive energy market. Aurora Energy's new vision '*Aurora Energy is valued by its customers and provides sustainable returns to the Tasmanian Community*' captures the critical characteristics and elements of success and provides a principle objective for the business. The vision implicitly reflects a targeted state whereby Aurora Energy is efficient, customer orientated, cost-effective, and recognises the value Aurora Energy can provide as a Tasmanian entity to its shareholders and customers.

Aurora Energy has provided retail services to Tasmanian customers for over 16 years and was an active participant in the recent reform program. As a result, Aurora Energy is well placed to advise the Government on issues relating to the Tasmanian energy market and looks forward to continuing to work with the Government as it develops its Energy Strategy.

Response to Questions Raised in Issues Paper

Question 2 - Given both the State and Commonwealth Government are committed to reducing red and green tape, and that the electricity market is highly regulated and complex, what opportunities are there to reduce or remove regulation?

As a general comment on the regulatory frameworks under which the Tasmanian energy industry operates, non-price regulation for electricity now sits at the national level with the Australian Energy Regulator (AER) following Tasmania's adoption of the National Energy Customer Framework (NECF) on 1 July 2012. The AER is also responsible for price regulation for Tasmania's distribution and transmission networks.

At a State-level, the Tasmanian Economic Regulator (TER) is responsible for setting maximum prices for Aurora Energy's standing offer contracts, administering the framework under which Hydro Tasmania is required to offer regulated contract products in Tasmania and regulating natural gas retailers and distributors.

In relation to potential opportunities to reduce regulation in Tasmania, Aurora Energy believes the following two opportunities could be considered by the State Government:

- simplifying non-price regulation; and
- moving from price regulation to price monitoring for electricity.

Simplifying non-price regulation

There are likely to be some inefficiencies or direct costs for market participants associated with having two separate regulators, however this is difficult to quantify.

The NECF currently applies in Tasmania, the ACT, South Australia and NSW. The objective of adopting a single national framework was to facilitate an increase in retail competition by reducing regulatory complexity and lowering barriers for energy retailers to enter into the market across participating states and territories. The NECF also establishes stronger protections for customers, including guaranteed access to supply, a requirement for retailers to have customer hardship programs that are approved by the AER and mandatory minimum terms and conditions for residential and small business customers.

Aurora Energy supports the overall objective of the NECF, particularly as it relates to increased customer protection. However, there are some aspects of the NECF that are overly prescriptive, resulting in increased costs for retailers with no direct benefit for customers (for example, the specification of customer bills). Further identifying and 'opting out' of aspects of the NECF that do not provide benefits to customers would reduce the overall regulatory burden for electricity in Tasmania.

Move from price regulation to price monitoring for electricity

The majority of jurisdictions in the National Electricity Market (NEM) have either deregulated electricity prices or commenced the process to deregulate. In these jurisdictions, some form of price monitoring has been put in place to provide a safety net for customers.

Whilst price deregulation is ultimately a decision for the Government, effective competition may be more likely to develop in a deregulated market and there may also be greater capacity for innovation by retailers in the way they structure retail products. However, Aurora Energy observes the experience in other jurisdictions in the NEM whereby effective competition was required prior to prices being deregulated, as deregulating prices could ultimately lead to higher prices for customers.

Question 3 - Is retail competition important because of price, choice or for other reasons?

The benefits from effective competition will include both price and non-price benefits.

Aurora Energy considers that non-price benefits are likely to be more significant for customers in Tasmania than reductions in prices. Potential non-price benefits include the opportunity for customers to shop around and negotiate with energy retailers to secure the best possible contract for their circumstances, improved customer service and a greater level of innovation by retailers in developing market products (which can be limited by ongoing price regulation).

The potential for significant price benefits may be limited in Tasmania, as there is very little ability to compete on regulated wholesale and network costs. Whilst retailers could compete on retail costs, these costs only contribute around 13 per cent to electricity prices and retailers will be required to recover some proportion of this component to fund their operating costs and make a reasonable commercial return. In order to offer more competitive pricing, retailers will either need to accept a lower return from customers, or potentially accept a higher level of risk in purchasing electricity in the wholesale market.

It is important to note that competition is unlikely to provide any price relief for Tasmania's vulnerable customer group. The payment behaviours of this customer segment are unlikely to attract the interest of new entrant retailers, and therefore it is unlikely that they will be offered a price below the current standard offering.

Question 4 - What enhancements or additional information could increase the reporting transparency of the Government's electricity businesses and contribute to improved efficiency?

The Government's electricity businesses are already subject to a robust corporate governance framework that includes extensive reporting requirements and is based upon the ASX Corporate Governance Principles. For example, Aurora Energy is required to prepare annual Corporate Plans, provide quarterly performance reports to its Shareholders and prepare and publish an Annual Report.

Aurora Energy is required by the Electricity Companies Act 1997, its Constitution and its Shareholder Letter of Expectations to operate in accordance with sound commercial practice and maximise its sustainable return to the Government. The Aurora Energy Board is responsible for meeting these obligations on behalf of the Government as shareholders.

There will always be the potential for the State-owned electricity businesses to be required to both operate in a commercial manner and deliver the Government's broader social or policy objectives. In this regard, Aurora Energy considers that the overall efficiency of the businesses will be maximised if clear strategic objectives for the businesses are set and any non-commercial activities delivered transparently.

In their review delivered in 2012, the Electricity Supply Industry Expert Panel found that the key arrangements that formally underpin Tasmania's governance framework for State-owned electricity businesses are consistent with good practice principles. However, the Expert Panel made a number of recommendations to further build upon the governance framework and provide a more transparent picture of the performance and direction of the State-owned electricity businesses.

As these recommendations were not considered as part of the recent reform program, there may be some benefit in revisiting the Expert Panel's recommendations in this area as part of the Energy Strategy.

Question 6 – Would you consider accepting slightly lower levels of reliability if this resulted in materially lower prices?

Aurora Energy appreciates the intent that underpins this question, being that network prices have increased significantly in recent years to reflect the investment that has been made in networks to ensure peak demand can be met. Aurora Energy also appreciates the vastly different consumption patterns and circumstances of its customers across Tasmania. For example, some customers rely significantly on electricity for their ongoing business operations, whilst others depend on life-support equipment that is powered by electricity.

As such, whether customers prefer reliability or lower prices is likely to depend on a range of factors, including what is happening in their individual premise at the time when this trade-off becomes 'real'. As a general principle, Aurora Energy considers that network businesses should be incentivised (not penalised) through the price-setting process to meet minimum reliability standards in the most cost-efficient manner possible, rather than the trade-off between price and reliability being made by customers.

Question 7 - Would a review of tariff structures be desirable, in terms of minimising total network costs and allocating costs fairly?

The rationale that underpins the current setting of network prices is to spread network costs evenly across all customers. Given tariffs are generally set to recover the capital and operational costs of the supply industry over a period of time, there are likely to be both winners and losers from moving to more cost-reflective pricing. The degree to which a customer can benefit from tariff reform is likely to depend on their ability to change consumption patterns in response to the new price signals. This may not be possible for the most vulnerable customers, which would be inconsistent with the objective of allocating costs fairly.

Whilst there may be challenges associated with tariff reform, Aurora Energy supports a review of tariff structures being undertaken in Tasmania and is keen to be an active participant in any review. As a general principle, Aurora Energy considers that any review should be conducted with a focus on end-outcomes for customers and that network and retail tariffs should be considered collectively to ensure that any benefits from tariff reform find their way through to customers.

It may also be prudent as part of the review to consider how the electricity concession framework could be adjusted to better target assistance for vulnerable customers in light of potential new tariff structures.

Question 12 – Is there a further facilitation role for Government in gas roll-out, or should Government focus its efforts on examining the costs and benefits of improving minimum protections for gas customers?

Aurora Energy agrees that questions remain surrounding future development opportunities for natural gas in Tasmania, including the Government's future role in the natural gas supply industry.

As noted in the Issues Paper, there is upward pressure on natural gas prices driven by increases in commodity prices and transmission costs. Given the nature of the supply arrangements in Tasmania, the forecast increase in gas prices across Australia and the small Tasmanian customer base, it is likely there is going to be further upward pressure on prices in the short to medium term.

The Issues Paper cites the potential to improve minimum protections for gas customers but notes that the benefits of any proposed regulatory changes would have to clearly outweigh the cost of the regulation. Aurora Energy considers that any additional regulation for gas customers is likely to have a significant cost, particularly given the small number of gas customers in Tasmania.

Notwithstanding this cost, there is anecdotal evidence of financially vulnerable gas customers present in Tasmania who may benefit from improved minimum protection. Whether the overall benefits of increased regulation would outweigh the costs is as yet unclear.

On balance, Aurora Energy recommends that the Energy Strategy commit to a review of the natural gas industry in Tasmania that takes into account the factors identified above, including the likely increase in gas prices over the short to medium term.

Question 13 - What are considered to be the key opportunities, and the key issues, associated with possible energy futures?

In recent years there has been significant investment to make structural and regulatory changes to the Tasmanian electricity supply industry. Whilst the benefits of these reforms are beginning to be realised by Tasmanian customers, it is unlikely that the full benefits of the reforms and the associated investment in these have been realised given that some of the major changes have only recently taken effect.

In this respect, the immediate opportunity for the industry would be to allow sufficient time for the reforms to bed down and the full benefits to be realised. In the meantime, some measures identified in the Issues Paper could be further considered, for example a review of tariff structures and gas. Aurora Energy suggests that any measures considered by the Government be subject to small-scale trials to ensure that the impact of the measure is fully understood prior to full-scale deployment.

The Government should also continue to pursue a cost-efficiency program through its electricity businesses to drive further operational efficiencies and place additional downward pressure on prices. An efficiency program can be delivered within the existing regulatory framework and market structure without further significant capital investment. Such a program would also not prevent future changes being made to the industry if it becomes clear that the Government's objectives for the industry will not be met under the current policy settings.

Question 14 - What could be some outcomes for the Tasmanian Energy Strategy, and what actions can government, or energy providers and consumers take to achieve them? How could success/performance be measured?

Aurora Energy supports the outcomes-based approach to developing the Energy Strategy that is proposed in the Issues Paper. Using clearly defined outcomes to develop strategies and actions will ensure that any measures adopted by the Government strike an appropriate balance between a broad range of competing interests and objectives and build upon the reforms that have been implemented to date.

Aurora Energy also supports the draft outcomes proposed in the Issues Paper and suggests that an additional outcome be included to ensure that strategies and actions developed under the Energy Strategy take into account broader market and policy developments occurring in the National Electricity Market. This new outcome could be that *“The Tasmanian energy industry is robust to policy and market developments occurring in the National Electricity Market”*.

To enable the success or performance of the Energy Strategy to be measured, the Energy Strategy could include tangible targets against which performance could be reported on an annual basis, such as performance against the Government’s desired price path outcomes.