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Energy Strategy Submissions
Department of State Growth
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Tasmanian Energy Strategy – Issues Paper

The Energy Supply Association of Australia (esaa) welcomes the opportunity to make a submission to the Department of State Growth on the Tasmanian Energy Strategy (the Strategy).

The esaa is the peak industry body for the stationary energy sector in Australia and represents the policy positions of the Chief Executives of 34 electricity and downstream natural gas businesses. These businesses own and operate some \$120 billion in assets, employ more than 51,000 people and contribute \$16.5 billion directly to the nation's Gross Domestic Product.

The electricity supply system in Australia is undergoing a period of transformation. Advances in technology are fundamentally changing the way electricity is made, moved and consumed. Consumers have also experienced sharp rises in electricity prices in recent years as the system keeps pace with reliability standards and a range of other cost pressures, including environmental policies.

The Government's Strategy is a timely attempt to address these challenges. One of the overarching objectives of the Strategy is seeking ways to manage future costs, after recent price rises. As Western Australia and the short lived Queensland price freezes show, downward pressure on prices are unsustainable unless they are underpinned by cost reductions. The Government should therefore look to provide the right policy and regulatory settings to ensure efficient price outcomes.

Government's role in the electricity sector

The paper flags a number of areas where the Government could play a more direct role in the energy sector; whether it be directing businesses to pursue certain options like price path certainty, new investment or the use of the energy sector to underwrite industry. This interest stems in part from the fact that four customers account for more than half of the state's electricity consumption. This creates a relatively unique set of problems for Tasmanian electricity businesses. The closure of one or more of these facilities would have a material adverse impact on both the electricity supply chain and the Tasmanian economy at large.

The Government is interested in using energy policy as a means to retain and attract new industrial load. However, electricity prices are just one component that affects the profitability of business. There are other far more critical elements, such as the exchange rate and level of global supply, which are outside the control of government.

Based on the current macro climate and recent investment in other countries, such as China, it is difficult to see where any substantive new industrial load would come from. The current Australian Energy Market Operator (AEMO) forecasts have industrial load staying relatively flat under the medium scenario and falling by over 50 per cent in the next 20 years under the low scenario.

If the Government wishes to take more direct action to support industry, the esaa would encourage the consideration of budget support to avoid distorting efficient price signals. Ultimately, a dollar from artificially reducing electricity prices costs the Government no more than a dollar of direct subsidy, but by distorting input costs for businesses, the Government will be ensuring a sub-optimal outcome. For example, modelling undertaken by the Queensland Government, as a part of their PowerQ energy strategy, concluded that a subsidy to reduce electricity prices by 1 per cent per year cost more than \$10 billion by 2044-45 and would achieve very little difference to overall economic growth.

Retail competition

National experience has shown that open, competitive energy markets free from distortions - such as retail price regulation - naturally encourage prices to be efficient through the development of competitive market offers. Competition in retail electricity markets, as in other sectors of the economy, provides incentives for businesses to improve consumer offerings, find ways to lower their costs and to pass those savings onto consumers. As a result, where effective competition exists, retail prices are set as low as is sustainably possible while businesses can still make an appropriate return.

Full retail contestability started on 1 July 2014 for small customers; this is an important milestone. Understandably the Government may want to bed down the recent changes before embarking on any further reforms. The Government's objective should be to foster growth in retail competition, so that over time prices are set by the competitive market pressures, rather than through regulation.

The Government is encouraged to sell Aurora's customer base to further encourage competition in the retail market. This process should involve a scoping study to determine the most appropriate way to construct the sale, factoring in both the wholesale and regulatory risk faced by any potential buyers.

Tasmania should work towards retail price deregulation once effective competition has developed to provide consumers with greater choice and opportunities to save money. While retail and wholesale price regulation remains in place it is important that it is overseen by an independent regulator. The regulator's independence provides industry participants with confidence that prices are set free from government interference.

Tariff reform

Australia wide, the uptake of rooftop solar photovoltaic (PV) panels and high penetration of energy intense domestic appliances – such as air-conditioners – has reinforced the need for more efficient and equitable tariff structures. Under the current flat rates offered, consumers do not face cost-reflective prices and this leads to unfair cross-subsidies.

Over time this may lead to inefficient system utilisation and also require an increasing proportion of consumers – particularly low income households – to pay more than their fair share of network costs; this is a particularly relevant consideration in Tasmania given the relatively large share of low and fixed income households.

To address the underlying inequity and allow for more efficient use of the electricity network, it is important to encourage the development of, and allow transition to, a new tariff structure that reflects, as far as practical, the true cost drivers of the system. This implies accounting not only for how much energy is consumed from the grid, but also the time and rate at which it is consumed, consistent with the make-up of network costs.

There is a range of tariff structures that can potentially achieve the desired outcome. It must be noted that although time-of-use tariffs are a step in the right direction, they are not necessarily fully cost-reflective and may only be an interim solution. Tariffs based on capacity rather than consumption are likely to offer more efficient solutions over the long term.

Advanced metering is an important element of the reform agenda. In conjunction with market deregulation and more cost-reflective and flexible tariff structures, advanced metering will enable consumers to realise the full benefits of broader and more diverse product offerings tailored to their particular needs. Wide-spread uptake of advanced metering will also play an important role in driving efficient outcomes across the entire supply chain where electricity tariffs better reflect the costs of energy supply.

Governments have a key role to play in providing the appropriate framework to allow industry to deliver the most efficient long-term tariff solution. This includes enabling the deployment of advanced metering infrastructure to the extent it is inhibited in some regions and assisting industry with communicating benefits to consumers.

Energy Efficiency

The esaa supports greater efficiency and productivity across the Australian economy. This includes the use of energy itself. Energy efficiency is not an end in itself, but is worthwhile when the costs to achieve lower energy use are lower than the costs to produce and transport the energy saved.

In general, the users of energy should be best-placed to make that trade-off. There may be some barriers to their doing so, for example:

- static, inefficient and non-cost reflective consumer pricing;
- information asymmetries in consumer education;
- capital constraints faced by financially vulnerable consumers;
- split incentives (landlord/tenant) to install energy efficient products; and
- bounded rationality (limited understanding/interest dictating product purchase).

The best incentive for households and businesses to use energy efficiently will be cost-reflective pricing. This will give customers the true signal they need to determine whether using energy at a particular time is efficient or not.

We would note that based on the current tariff design, energy efficiency is over compensated. As the volume based retail price is designed to recover both variable and fixed costs, each unit of energy efficiency (kWh or MJ saved) is rewarded as if it results in infrastructure savings.

Under the current market conditions, it is unlikely that all energy efficiency is avoiding infrastructure costs, due to oversupply in the generation/wholesale market and the relationship between consumption and capacity on networks.

If energy consumption was growing, there would be ongoing investment in generation assets. Under this scenario it would be reasonable to assume that a reduction in consumption would contribute to reduced investment in new plant. But this is not currently the case in the National Energy Market. AEMO forecasts that no new generation investment is required till after 2023-24. Given these circumstances, any reduced consumption is only avoiding the variable component of generation costs (fuel costs, variable operational maintenance). Given the make-up of the Tasmanian system, this is primarily the opportunity cost of the water used in hydro generation.

Assessing the network benefits of energy efficiency is challenging, as network savings are driven by capacity not consumption and are geographically dependent. Unless energy efficiency investment is concentrated in a given area, and that area is approaching a network constraint, network savings will be negligible. Further, not all types of savings will have a network impact. Only consumption reductions from peak demand should be counted. This, for example, rules out reductions from hot water systems, as they are used in off peak times.

If the Government wishes to provide incentives for households and businesses to take up energy efficiency, it should be through direct on-budget subsidies, not a white certificate scheme. The combination of the fact that cost-reflective pricing is the only price-based barrier to energy efficiency and the administrative complexity of establishing a scheme means it makes little sense to try to address the remaining barriers to energy efficiency through a market-based white certificate scheme.

Remove overlapping regulation.

This review should also be used an opportunity to ensure that as part of the shift to national regulation, any overlapping and duplicative state based laws are removed to lower costs.

Yours sincerely

A handwritten signature in blue ink that reads "Kieran Donoghue". The signature is written in a cursive, flowing style.

Kieran Donoghue
General Manager Policy