



Tasmanian Economic Regulator

Proposed Changes to the Interim Price-Regulated Electricity Retail Service Price Determinations & Draft Electricity Wholesale Contract Guideline

Submission

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Contents

Executive Summary.....	4
1 Introduction	7
1.1 Background to Tasmanian Small Business & the TSBC	7
1.2 TSBC's Interest in Tasmanian Energy Reforms & the TER's Consultations	8
1.3 Electricity Price Trends in Tasmania.....	9
1.4 Outline of This Submission	9
2 TSBC Position on Tasmanian Energy Reform & the Government's Reform Package.....	10
2.1 The Government's Energy Reforms	10
2.2 Failure to Sell Aurora Energy's Retail Customer Base.....	11
2.3 Recommendations (for the Tasmanian Government)	13
3 Changes to TER's Retail Price Determination	14
3.1 Need for the Changes.....	14
3.2 TSBC Concerns about the Previous Determinations	14
3.2.1 Impacts of Policy Changes on Retail Margin.....	16
3.2.2 Impacts of Policy Changes on Customer Acquisition and Retention Costs (CARC)	17
3.3 Impact of TSBC's Alternative Proposals on Aurora's Revenue and Prices.....	18
3.4 Other Conclusions	19
3.5 Impacts on Prices	19
3.6 Recommendations	20
4 Draft Wholesale Electricity Contract Guideline	21
4.1 Scope of the Guideline	21
4.2 Weekly Contract Prices & Offers.....	21
4.3 Weekly Offer Process	23
4.3.1 Role and Responsibilities of the Regulator	23
4.3.2 The Process	23
4.4 Other Matters	24
4.4.1 Record Keeping	24
4.4.2 Fines & Penalties.....	24

4.4.3	Compliance Enforcement	24
4.4.4	Regulatory Audits.....	25
4.4.5	Information Disclosure & Reporting.....	25
4.4.6	Updating Values under the Wholesale Contract Regulatory Instrument	25
4.5	Recommendations	26

Executive Summary

This submission responds to the Tasmanian Economic Regulator's (TER) request for comments on its *Proposed Changes to the Interim Price-Regulated Electricity Retail Service Price Determinations* (Interim Price Determinations) and its *Draft Electricity Wholesale Contract Guideline* (Draft Guideline) and the associated *Consultation Papers*, released in November 2013. The Tasmanian Small Business Council (TSBC) welcomes the opportunity to comment on the important document. We also comment on the recent changes in Government electricity reform policy, especially the withdrawal of Aurora Energy's retail customer base, which lead to the need for the TER to change its Interim Determinations.

Electricity Reform and Failure to Sell Aurora Energy's Retail Customer Base

The TSBC strongly supports the need for competitive electricity in Tasmania with consumers being the primary beneficiaries, including small businesses. It is therefore disappointing that small business in Tasmania have yet to experience any type of choice in their electricity retailer or gain access to competitively priced electricity, a situation which places them at a disadvantage against their inter-state and international competitors, as well as small business in other parts of the National Electricity market (NEM). Meanwhile, electricity prices for small business increased by 101 per cent between 2000 and 2011, with predictions that they could increase by a further 17 percent between 2012/13 and 2014/15.

The breakup and sale of Aurora's retail customer base to private interests was seen by the TSBC as a key element in successful electricity reform and the ability of the reforms to deliver benefits to small customers. The TSBC therefore sees the recent failure of the Government to sell Aurora's retail base as a major setback to reform and the interests of Tasmanian small businesses. Among the serious concerns for Tasmanian small business are:

- It has failed to establish the 'beachhead' for retail competition in electricity.
- The continued retail dominance of Aurora may well act as a disincentive for other new entrant retailers and further limit competition.
- It confines small customers to continued reliance on regulated retail tariffs, which are no substitute for a competitive retail market and choice.
- There will be limited incentive for Aurora, given an effective monopoly over small customers, to offer improved and more innovative services to small customers.
- There will be fewer electricity retailers in Tasmania with less ability for them to add scrutiny over a dominant Hydro Tasmania, which paradoxically is now an even stronger generator with a near monopoly due to the transfer of the Tamar Valley Power Station (TVPS) from Aurora Energy to it.

- As a consequence, the important role that new entrant retailers were expected to play in helping the TER to more effectively oversight the regulation of Hydro Tasmania's wholesale market contracts, will also be diminished.

As a result of this situation, in making this submission we are calling on the Tasmanian Government to urgently review its reform strategy. It should encourage entry by new retailers, thus allowing Aurora's retail base to be successfully offered for sale, by: introducing competition into the wholesale market, bringing forward unrestricted FRC to 1 July 2014 and reviewing the need for continuing retail price regulation by 1st July 2015 (see Section 2.3). The work of the Expert Panel and a report by Goanna Energy for the TSBC clearly show that retailers are interested in entering the Tasmanian electricity market but are being held back by a failure to reform the wholesale market such that there is competition in generation – which TSBC believes played a major role in the failed attempt to sell Aurora's retail base – and continued regulation of retail prices.

Regulated Electricity Price Determination

In relation to the TER's proposal to change its Interim Determinations, we support this given the changed circumstances that now exist. However, we have several concerns with the earlier Determinations, beyond those areas raised in its Consultation Paper, which we believe the TER needs to address.

The lack of consultation on its Interim Determinations, which were completed in very short time frames due to the Government's reform timetable, meant that there was no participation by consumers. The TER had to rely on two submissions from (or commissioned by) the Government (which was the vendor in the sale of Aurora's retail base), was unable to verify key data, which left it with little choice but to accept the Government submissions, and queried other information but was not provided with complete answers. We believe this necessitates that the TER conduct a more 'ground up' review before amending its Interim Determination, including of the cost pass through elements of those decisions (i.e., wholesale electricity costs, network charges and renewable energy charges), which make up nearly 90 per cent of retail electricity costs.

We are concerned about the proposal to provide Aurora Energy with essentially the same retail margin as would have been provided to the two retailers who purchased Aurora's retail base, had its sale been successful (except for differences due to changes in restrictions on customer churn). We note, in particular, that the conditions for entry by new retailers have been adversely affected by the failure to sell Aurora's retail base and that retailer interest in Tasmania is likely to have been weakened by this. In the circumstances, small customers would be paying Aurora a retail margin that is far too high. A retail margin of around 3.8 per cent (what it was previously in receipt of) would be more appropriate.

The TER also proposes to provide Aurora with Customer Acquisition and Retention Costs (CARC) to cover costs associated with these functions as if it will be operating in a mature competitive market. As with the retail margin, this would be inappropriate as it does not reflect the circumstances Aurora is likely to face. Until there is evidence of some competition to Aurora for small customers, Aurora should not receive a CARC allowance, which would provide it with money that it does not need. We therefore propose that the TER not allow a CARC allowance.

If circumstances change and it becomes clear that Aurora will face some retail competition, its need for a higher retail margin and some CARC allowance can be reviewed as part of the TER's annual review of regulated retail tariffs or as a cost pass through application. Our complete recommendations on changes to the Retail Price Determination can be found in Section 3.6.

TSBC calculates that the impact of its recommendations in relation to Aurora's retail margin and CARC allowance would lower the Notional Maximum Revenue (NMR) to be provided to Aurora by around \$37.5 million over the period of the Determination (i.e., 1 January 2014 to 30 June 2016). These proposals are significant enough for the TER to amend its Interim Determination in relation to the retail margin, the CARC and the NMR.

Hydro Tasmania's Wholesale Electricity Contract Guideline

The TSBC views the Wholesale Electricity Contract Guideline as an important part of the Government's regulatory approach to wholesale market reform, particularly to ensure that there is some attempt made to discipline the near complete dominance by Hydro Tasmania of the wholesale electricity market. However, as already indicated, we have serious doubts about the regulatory approach to wholesale market reform in Tasmania and its ability to entice new retailers into the market. This places even more emphasis on the role which the TER will play in the wholesale market.

We are also concerned about the costs involved in wholesale market regulation – to Hydro Tasmania, the TER and retailers. If retail market competition does not emerge (or is weak) these costs could quickly outweigh any benefits.

We have made several recommendations (see Section 4.5) which we believe will help to improve the ability of the TER to effectively regulate Hydro Tasmania's wholesale electricity contracts by improving information and communications to the market place (and customers), adding to transparency, more effectively curbing Hydro Tasmania's market dominance and ensuring that Hydro Tasmania is subject to enforcement powers (fines and penalties) that match the seriousness of any non-compliance.

1 Introduction

This submission responds to the Tasmanian Economic Regulator's (TER) request for comments on its *Proposed Changes to the Interim Price-Regulated Retail Service Price Determinations* (Interim Determinations) and its *Draft Electricity Wholesale Contract Guideline* (Draft Guideline) and the associated *Consultation Papers*, released in November 2013. The Tasmanian Small Business Council (TSBC) welcomes the opportunity to comment on the important matters raised by the Regulator. In preparing this submission, we also considered various other related information, including the TER's *Report on the investigation of maximum prices for interim price-regulated electricity retail services for small customers on mainland Tasmania* (July 2013), the Tasmanian Government's *Wholesale Contract Regulatory Instrument*, the TSBC's *Submission on the Government's Tasmanian Energy Reform Market & Regulatory Framework – Position Paper* (March 2013) and a report *The Final Step: Moving to full retail contestability in the Tasmanian electricity market* (January 2013), which we commissioned from Goanna Energy.¹

1.1 Background to Tasmanian Small Business & the TSBC

Small business is the 'engine room' of the Tasmanian economy. There are more than 37,000 small businesses in Tasmania, 30,000 of which are employers, employing over 70,000 full and part-time people. They make up in excess of 96 per cent of all businesses in Tasmania and the sector provides more than half of the private sector employment in the state. Understanding the SME sector is of vital importance both to the enterprises themselves, and Government and regulators as decision-maker. The resources to address the future needs of the state can only come from the generation of new wealth and healthy, vibrant small businesses are critical to this.

The Tasmanian Small Business Council (TSBC) is an "association of [small business] associations", each of which represents their market grouped industry sector. The TSBC seeks to provide the representative voice of small business in Tasmania. The TSBC's role in facilitating meetings of these trade associations, whose members are predominately small businesses, is paramount to providing informed insights and advice to both governments and the small business sector as a whole. An obvious difficulty for owners of small and

¹ The latter two documents are available from the TSBC's website at <http://www.tsbc.org.au/webs/tsbc/tsbc.nsf/vwall/Submissions> and <http://www.tsbc.org.au/webs/tsbc/tsbc.nsf/vwall/Reportper cent20per cent27Theper cent20Finalper cent20Stepper cent27> respectively.

micro businesses is the absolute necessity to spend their time working “in the business”, while those with larger numbers of employees take a more managerial role and begin to spend some of their time working “on the business”. Small business is therefore even more reliant on groups such as the TSBC to develop and put forward informed policy positions to Government and regulators that truly represent their interests.

1.2 TSBC’s Interest in Tasmanian Energy Reforms & the TER’s Consultations

Energy is important to the health and vibrancy of the Tasmanian small business sector. Tasmanian small businesses have a need for competitively priced energy that supports their competitive advantage *vis-à-vis* larger competitors in the local market, inter-state firms providing goods and services in Tasmania and international competitors (where they sell into export markets or compete against imports). Many of the competitors to Tasmanian small businesses have access to cheaper energy or to competitive energy offers. Tasmanian small businesses therefore suffer a disadvantage in these respects and the TSBC supports policy and regulatory steps to help redress this.

Looking across the small business sector overall, electricity is a middle sized cost of production, typically making up between 3-5 per cent of total costs although within some sectors, such as Tasmanian Independent Retailers, it can be substantially more. This, in itself, makes electricity important. However, its importance to small businesses in Tasmania is elevated by:

- The need to have access to a reliable source of supply, as most businesses are heavily dependent on a continuous supply of electricity.
- The fact that some small businesses have energy costs well in excess of the average and, for them, access to competitively priced energy is particularly important.
- The recent large increases seen in Tasmanian electricity prices, which have affected small businesses, many of whom have been unable to access competing suppliers, due to an absence of Full Retail Competition (FRC), making their disadvantage referred to above worse.

The TSBC therefore sees the Government’s energy reforms – and related decisions by the TER – as being very important to supporting small business in Tasmania by helping to provide it with access to competitive input costs, encouraging it to prosper and allowing it to contribute towards a healthier State economy.

1.3 Electricity Price Trends in Tasmania

The rapid rate of increase in Tasmanian electricity prices is of significant concern to the TSBC and its members. Our interest in electricity reform has been heightened by this.

As the final report of the Tasmanian Electricity Industry Expert Panel (Expert Panel) shows:

- Electricity tariffs for small business increased by 101 per cent in nominal terms from 2000 until 2011, or by around 6 per cent per annum.
- The average annual increase was 3 per cent in real terms, or roughly double the rate of inflation.
- Fixed charges increased by around 3.5 per cent per annum over the same period.
- Increases were particularly pronounced in 2010-11 and 2011-12.
- Network charges accounted for half of the increase and wholesale charges for 40 per cent.

Moreover, the AEMC has forecast that electricity prices could increase by a further 17 per cent from 2012-13 to 2014-15, or almost 7 per cent per annum.

1.4 Outline of This Submission

The remainder of this submission is structured as follows. First, we briefly outline the TSBC's position on energy reform in Tasmania and on the Government's package of reforms, including recent key developments. The submission then provides our response to issues raised in the TER's Consultation Paper on Price Determination Changes. Finally, it provides the TSBC's response to the Draft Wholesale Guideline. Each section ends with a set of recommendations (for the Tasmanian Government in regards to section 2 and for the TER in regards to sections 3 and 4).

2 TSBC Position on Tasmanian Energy Reform & the Government's Reform Package

This section briefly discusses the TSBC's position in relation to the Tasmanian Government's energy reform package and the recent failure of the Government to sell the retail arm of Aurora Energy. This is done as a precursor to the discussion on the TER's current consultations which stem directly from these two matters. The recommendations at the end of this section are directed at the Tasmanian Government (and a copy of this submission will be forwarded to them) but they also have potentially important implications for the TER and its ongoing role in the reforms.

2.1 The Government's Energy Reforms

The TSBC strongly supports the need for competitive electricity in Tasmania with consumers being the primary beneficiaries, including small businesses. It is disappointing that small business in Tasmania have yet to experience any type of choice in their electricity retailer or gain access to competitively priced electricity. We note that small business in every other part of the National Electricity Market (NEM) has had a choice of their electricity retailer for some time and this makes the need for reform in Tasmania even more pressing for our small businesses if they are to keep pace. Related to this, electricity prices have increased considerably in recent years – and well ahead of inflation. The upshot is that the present situation is placing small business in Tasmania at a disadvantage compared to other parts of the NEM in terms of their electricity purchasing.

We therefore strongly support the Tasmanian Government's desire to undertake additional electricity reforms, a key objective of which is that smaller users should have access to a choice of retailer and that electricity prices be set in a competitive environment. We also agree on the fundamental areas for the Government's reforms covering as they do:

- A competitive retail market with entry by new retailers.
- The sale of Aurora Energy's retail customers to a number of private retailers.
- The move to Full Retail Competition (FRC).
- The use of independent price regulation to provide a 'safety net' for small consumers and to counteract Hydro Tasmania's considerable market power at the wholesale end.

Nevertheless, we would much prefer that some important reforms go further and faster so that benefits can accrue more quickly to small businesses in Tasmania, who are seeing cost pressures from a number of directions, including rising electricity prices. This applies particularly to:

- Faster completion of FRC so that all small customers, including small businesses, have an unrestricted choice of who to buy their electricity from.
- Concerns about the reliance on regulation to discipline the wholesale market and create a more level playing field for new retailers, which will continue to be dominated by Hydro Tasmania.
- Concerns about the need for regulation of retail prices and how long it will remain in place. Whilst we appreciate that this could be seen as a ‘necessary evil’ given the absence of any retail competition for small consumers to date and the uncertainties about its emergence in the immediate future, it will inevitably have weaknesses and pitfalls that carry risks in terms of how much smaller consumers will actually benefit.

2.2 Failure to Sell Aurora Energy’s Retail Customer Base

As mentioned above, and depending on how well it was handled, the breakup of Aurora’s retail customer base and its sale to private interests was seen by the TSBC as a key element in successful electricity reform in Tasmania and the ability of the reforms to deliver benefits to small customers. The TSBC therefore sees the recent failure of the Government to sell Aurora’s retail base as a major setback to reform and the interests of Tasmanian small businesses. We understand that there was an inability to attract any willing buyers. The inability to sell Aurora’s retail base is of major concern to the TSBC. It is also the reason why the TER must now amend its interim regulated retail price determination, which was to apply to two separate Regulated Offer Retailers (ROR), but will now only apply to Aurora, which will remain the sole provider of regulated retail electricity services to small customers in Tasmania.

The failure of the attempted sale raises serious concerns for small business in Tasmania and its desire to gain access to competitive electricity retail offers as soon as possible:

- It fails to establish the ‘beachhead’ for retail competition in electricity that would have been created by establishing two RORs, who most likely would have been established electricity retailers with the scale and business underpinnings to secure a healthy start to FRC.
- The continued retail dominance of Aurora may well act as a disincentive for other new entrant retailers and further limit competition. Unless the Government can find other ways to overcome this obstacle and entice them into the market, small consumers face the unenviable prospect of a continuation of existing electricity retail market conditions, with no competition for smaller customers.
- It confines small customers to continue reliance on regulated retail tariffs, which despite the best efforts of the TER, are no substitute for a competitive retail market and the choice it could offer these customers.

- There will be limited incentive for Aurora, as the ongoing incumbent retailer with an effective monopoly over small customers, to offer improved and more innovative services to small customers, e.g., tariffs that better meet their needs, energy efficiency improvements to lower electricity costs, improved billing and customer service, access to the greater range of services that larger retailers with national operations can offer, and greater scale in operations.
- There will be fewer electricity retailers in Tasmania with less ability for them to add scrutiny over a dominant Hydro Tasmania, which paradoxically is in an even stronger generator with a near monopoly position following the reforms, due to the transfer of the Tamar Valley Power Station (TVPS) from Aurora Energy to it. Aurora previously provided the only effective generation competition to Hydro Tasmania by virtue of its ownership of the TVPS.
- As a consequence, the important role that new entrant retailers were expected to play in helping the TER to more effectively oversight the regulation of Hydro Tasmania's wholesale market contracts, will also be diminished and Hydro Tasmania's market dominance made more manifest. It is worth reiterating that the Expert Panel found the regulation of Hydro Tasmania's wholesale contracts to be a flawed approach to reform of the wholesale electricity market, with the Panel (and most experts) seeing effective wholesale market competition as fundamental to effective electricity retail competition.
- The previous 'spot fires' in disputes between Hydro Tasmania and Aurora may well occur again, themselves being a function of the poor structural and ownership characteristics of the Tasmanian electricity industry. In fact, there are some grounds to believe they could even intensify, given the additional pressures that Hydro Tasmania's ownership of the TVPS creates. It is doubtful that customers will be beneficiaries in this.

The absence of serious bidders for Aurora's retail base represents a very poor outcome for Tasmanian electricity consumers and calls into question the Government's reform strategy and the reasons behind it. It is even more disappointing given that the Expert Panel clearly warned about the flaws in regulating the wholesale market and the disincentives that this would create for new entrants into electricity retailing in Tasmania. A number of existing electricity retailers in the NEM also told the Expert Panel, in submissions and at public hearings, that their interest in participating in the Tasmanian electricity market would be severely diminished, or non-existent, under this model and unless the risks to them from Hydro Tasmania's dominance of the wholesale market was effectively curtailed.

Goanna Energy's *The Final Step* report for the TSBC included the results of an assessment of potential new entrant retailer interest in the Tasmanian market based on a survey of NEM retailers in late 2012. The report found that sufficient retailers were interested in

participating in the Tasmanian electricity market to provide a foundation for competition, but that their interest was diminished by two things in particular:

- The existing wholesale market arrangements (i.e., the dominance of Hydro Tasmania as a generator and the unacceptable degree of risk this entailed for them); and
- The continued regulation of retail prices for small customer.

On the other hand, it can be gleaned from both the Expert Panel and Goanna's report that retailer interest in participating increased under reforms which introduced competition into the wholesale market as this provided a more level playing field and lowered risk exposure. This was particularly so if they gained access to a generation portfolio which allowed them to better manage the inherent risks of participating in the Tasmanian electricity market (e.g. hydrological, import constraints, small size). The flaws in the Government's wholesale reforms were themselves therefore probably serious enough to dissuade retailers from seeking to acquire Aurora's retail base. This combined with the small size of the market would have almost certainly been a 'show stopper' leading to the failure to successfully prosecute the sale of Aurora's retail base.

2.3 Recommendations (for the Tasmanian Government)

1. The Government should review its reform strategy as a matter of urgency, particularly to publicly assess the reasons for the failure to sell Aurora's retail customer base and take steps to overcome these with the intension of again placing Aurora's retail operations for sale but this time with pre-conditions that will ensure success.
2. It should also consider more fundamental reforms to the wholesale market that would promote greater competition and help to secure a successful sale of Aurora's retail operations. The minimum requirement would be adopting the Expert Panel's recommendation to separate Hydro Tasmania's hydro power assets into three trading entities, preferably privately owned, and the sale of the TVPS.
3. The Government should bring forward Full Retail Competition (FRC) to 1st July 2014.
4. As part of this, the Government should retain its existing stance of no restrictions on the number of customers that can transfer to another retailer.
5. The Government should review the need for continuing regulation of electricity retail prices with a view to announcing a decision on this before 1st July 2015.

3 Changes to TER's Retail Price Determination

This section discusses the implications of the TER's proposed amendments to its Retail Price Determination made in July of this year, with particular reference to the interests of Tasmania's small business electricity consumers.

3.1 Need for the Changes

As mentioned in the previous section, the TSBC is disappointed that the Government has failed to sell Aurora's retail operations. It believes that aspects of the Government's reform package, notably flaws in its approach to reform of the wholesale market via regulation of Hydro Tasmania's contracts, transfer of ownership of the TVPS to Hydro Tasmania and the constraints it has put on FRC were critical factors in the lack of interest in the sale of Aurora's retail base. This has prompted the need for the TER to change its determinations.

Nevertheless, we understand and support the need for the TER to review its earlier decisions, given that there will now be a single ROR, Aurora Energy, rather than two. We have previously expressed our concern that this will place limits on the ability of small customers to benefit from FRC and competition in electricity more broadly.

3.2 TSBC Concerns about the Previous Determinations

Given that the previous TER determinations provide the starting point for the TER's consideration of the need for changes, it is worth setting out TSBC's concerns about certain aspects of them. For the record, TSBC was constrained from participating in the TER's consultations on these due principally to the short time frame in which TER had to consider them. We appreciate that the TER was restricted to a short timeframe due to the timing of the Government's reform process and particularly its desire to conclude the sale of Aurora's retail customer base by the end of 2013, but note that this severely limited the opportunity for participation in the TER's process by TSBC (and any other customers). Such a situation is inconsistent with good regulatory practice by with having customers participate in regulatory processes. It also diminishes the level of scrutiny over a regulatory process that is important to small customers. In this regard we note the TER's comment that:

The time constraints upon this investigation also meant that the Regulator did not have sufficient time to consult on its intended approach or draft investigation findings as would normally occur and as it strongly prefers to. (TER, Standing Offer Determinations – Report, July 2013, p. viii)

We also note with concern other aspects of the TER's previous determinations and the impact which they might have on a new Determination, including the following:

- That the TER's previous Determinations were obviously made under severe and unusual time constraints, and without adequate external scrutiny, such that the thoroughness may have been compromised, with adverse impacts on the Determinations. A thorough re-examination of the earlier Determinations could well be justified. However, we note that this has not been done and, in particular, that the pass through costs in relation to wholesale electricity costs, network charges and renewable energy charges, which make up nearly 90 per cent of retail electricity costs have not been reviewed. We believe that this is a serious omission in the TER's approach and urge that it be corrected.
- We also note that the TER relied upon only two submissions – one from the Tasmanian Government and another from Ernst Young (EY) commissioned by the Tasmanian Government – in framing its previous Determinations. These parties effectively 'stood in the shoes' of the two ROR retailers in providing these submissions given that the sale had not yet proceeded. We do not believe that this provides a sound basis for regulatory determinations that have an important bearing on electricity prices for small customers in Tasmania, especially as these customers have no choice but to pay the regulated retail price. Whilst we recognise that the Government is meant to be a custodian for good energy policy, we also note that it is the owner of Aurora and therefore the vendor in the sale process. This raises additional concerns about the basis for its input to the TER and the constraints which the TER faced in being able to scrutinise the submissions.
- In this regard, we note the TER's comments about the differences in the data on customer numbers and load contained in a letter from the Minister compared to those contained in information the Regulator obtained from the Department of the Treasury. Specifically the TER commented in its Determinations Report that:

"... the Government's submission presented one set of customer numbers and load whilst the Minister's covering letter to the Government's submission referred to separate advice being provided to the Regulator on the make-up of the respective customer bases." (p. 13)

Whilst the Treasury subsequently provided an explanation for these differences, the TER commented that:

"The Regulator noted that whilst the exclusion of APAYG customers and the inclusion of the Tranche 5a Tariff 22, irrigation and demand charge customers had resulted in a slight increase in load, total customer numbers had in fact decreased by approximately 15 800. The Regulator therefore sought an explanation from Treasury as to the reasons for the material difference in

customer numbers. The Regulator had not received a response to this request at the time of writing.” (p. 17)

It concerns us that an anomaly that existed even after the explanation was provided, and was considered by the Regulator to be material, was not explained by Treasury before the Determinations were finalised. As far as we can ascertain, there has still not been an explanation from the Treasury. If so, this would affect the changed Determination and we urge the TER to ensure that such any anomaly is removed.

- Certain other aspects of the initial Determinations also concern us. More specifically, we note that the Regulator commented in several areas where it did not have time to establish the robustness of certain information and therefore accepted what was provided by the Government. The TER Report on its initial Determinations makes clear that this was the case with respect to load, customer numbers, the Wholesale Electricity Price (WEP), the Wholesale Electricity Cost (WEC) and the AEMO Budget Unit Costs. These are all central inputs into, or components of, the building blocks which the TER uses to set regulated retail tariffs. It is not clear from the Consultation Paper whether the Regulator has been able to verify the data in the meantime. If not, then it should do so.

Given the above, we believe that the Regulator should clarify that status of the matters raised above and, if necessary, take steps to remove any remaining doubts or uncertainty.

3.2.1 Impacts of Policy Changes on Retail Margin

The Consultation Paper sets out TER’s assessment of the impacts of the failure to sell Aurora’s retail base on the retail margin to be allowed to Aurora Energy as the sole ROR. Essentially, the TER estimate a slight reduction in the retail margin for Period 1 (from 5.1 per cent to 4.85 per cent), a slight increase for Period 2 (from 5.5 per cent to 5.7 per cent) and no change in Period 3 (5.7 per cent). The Period 1 reduction being due to the removal of any customer churn in this period, the Period 2 increase being due to the removal of any restrictions on customer transfers in this period and no change in the retail margin in Period 3 being due to no change in the policy settings for customer churn (i.e., unrestricted).

The TSBC has concerns about the TER’s proposals.

We are concerned about providing Aurora with essentially the same retail margin as would have been provided to the two RORs, had the sale of Aurora been successful (except for differences due to changes in restrictions in customer churn). We note in particular that the conditions for entry by new retailers have also been adversely affected by the failure to sell Aurora Energy’s retail base and that available information, referred to in the previous

section, suggests that retailer interest in Tasmanian market entry is likely to have been weakened by the outcome of the sale process.

This suggests that the retail margin to be provided to Aurora should be lowered overall to reflect this. The margin being proposed by the TER reflects conditions that will no longer exist and would provide Aurora with a form of monopoly rent. The margin proposed is more reflective of a retailer operating in a market with meaningful competition. Such a high margin would also be contrary to the objectives of reform in creating competition and would not be in the interests of electricity consumers. It could even have the perverse effect of providing Aurora with additional financial scope to fend off new entry.

TSBC would suggest that a retail margin closer to 3.8 per cent, which was previously provided, would be more appropriate, at least until there is evidence that Aurora will indeed face increased competition in future. In proposing this, we also note that the TER intends to conduct annual pricing reviews, which will provide an opportunity to assess any changes in the outlook for new entry and adjust the retail margin if necessary.

3.2.2 Impacts of Policy Changes on Customer Acquisition and Retention Costs (CARC)

Customer Acquisition and Retention Costs (CARC) are those incurred by retailers operating in markets where they face competition and are endeavouring to attract customers from one another. We believe that the TER needs to set these costs so that they reflect these conditions and are efficient. That is, so they reflect the limited likelihood of competition emerging in Tasmania and are the minimum necessary given these conditions.

Given that competition is now less likely (see our earlier comments on this), the CARC provided in the TER's earlier Determinations is too high and no longer appropriate. However, this is not the outcome which the TER has proposed. It has instead concluded that Aurora should be given the same level of CARC as would have been provided to the two RORs who would have purchased Aurora's retail base had the sale gone ahead, save for that part of Period 1 in which there will now be no churn permitted and that part of Period 2 in which there will now be no restriction on churn.

We note that the level of CARC allowed by the TER in its earlier Determinations relates closely to that provided by regulators in mature markets where competition already exists. We suggest that it is highly optimistic to conclude that Tasmania will reach this state by Period 3, that is, by 2015/16.

The only difference between the situation that will exist under the new policy and the current situation is that from Period 2 there will be FRC and Hydro Tasmania's wholesale contracts will be regulated. As we have discussed above, it is doubtful that this will be

sufficient to encourage sufficient retail entry into Tasmania to equate to a mature market. Potential new retail entrants have an aversion to the Tasmanian market unless Hydro Tasmania's market power is diluted regardless of the existence of FRC. FRC alone seems unlikely to entice them in sufficient numbers and strength to provide the strong competition that characterises mature markets in the NEM. Aurora's continued dominance of the retail market can only add to their reluctance.

This suggests that any significant allowance for CARC that is based on conditions in interstate markets where competition has taken hold is inappropriate and likely to merely impose additional costs on small consumers on regulated tariffs. These consumers may well be left with little choice but to continue to pay the (CARC inflated) regulated tariff.

The TSBC would therefore suggest that the TER provide no allowance for CARC in its revised Determination for Aurora. If the TER believes that one should be provided it should be set at, or close to, the \$6.24 per customer proposed to be allowed in Period 1 for the duration of the Determination. This could be reviewed if necessary during the course of the Determination and modified if circumstances change.

3.3 Impact of TSBC's Alternative Proposals on Aurora's Revenue and Prices

The table below shows the estimated impact of our alternative proposals on Aurora's Notional Maximum Revenue (NMR).

We believe that our proposals on the retail margin and CARC significantly alter the impact of the change in Government policy on the TER's Determination and that it should therefore be amended. The materiality of their impact is on the basis that:

- There should be a significant change in the retail margin (3.8 per cent) due to the change in policy (amounting to -\$21.1 million over the period of the Determination).
- There should be a significant change in the CARC (no allowance for this) due to the change in policy (amounting to -\$16.4 million over the period of the Determination).
- The combined impact on Aurora's revenue of \$37.5 million over the period of the Determination is material.

We therefore do not agree with the TER's conclusion that the impact of the change in Government policy has an immaterial impact on the NMR and its components. Rather the impact is material and significant so that the TER should amend the previous Determination in relation to both the retail margin and the CARC.

Period	TER Proposal (\$m)	TSBC Alternative (\$m)	Difference (\$m)
Period 1			
CARC	1.24	0	-1.24
Retail margin	12.03	8.96	-3.07
NMR	247.8	243.49	-4.31
Period 2			
CARC	6.29	0	-6.29
Retail margin	27.46	18.97	-8.49
NMR	526.7	511.92	-14.78
Period 3			
CARC	8.87	0	-8.87
Retail margin	28.714	19.14	-9.57
NMR	532.5	514.06	-18.44
All Periods			
CARC	16.4	0	-16.40
Retail margin	68.2	47.08	-21.12
NMR	1 307	1 269.48	-37.52

Source: TER and TSBC calculations

3.4 Other Conclusions

The TER has also concluded that its Determination for Retailer A contains some material errors. These relate to procedural, typographical and presentational matters. The TSBC agrees with the TER's conclusions on these and its proposal to amend the Determination.

3.5 Impacts on Prices

The TSBC proposals to change the retail margin and CARC would have some impact on reducing average prices over and above those that would prevail under the TER's proposal not to amend the Interim Determination in relation to both these items. The exact impacts would not be known until Aurora submits a new standing offer following a new Determination.

3.6 Recommendations

6. The TER should review all aspects of the building blocks in its previous Determinations given the severe time constraints it was under, its inability to consult adequately with stakeholders, including small consumers and its apparent inability to verify certain significant information provided by the Government and the Department of the Treasury.
7. The TER should provide a retail margin to Aurora at, or close to, the 3.8 per cent which was provided to Aurora under the 2010 Determination, as this would be more appropriate to the weak competitive environment Aurora is likely to face, at least until there is evidence that Aurora will indeed face increased competition in future.
8. The TER should provide no allowance for CARC in its revised Determination for Aurora on the basis that it is far from certain that Aurora will face sufficient competition in future to justify such an allowance.
9. Given the impacts of our Recommendations 7 and 8 above are material in that they would result in an estimated \$37.5 million reduction in Aurora's NMR over the period of the Determination, the TER should amend the Determination to account for this.

4 Draft Wholesale Electricity Contract Guideline

This section provides the TSBC's response to the TER's Draft Wholesale Electricity Contract Guideline and accompanying Consultation Paper. The TSBC views this document as an important part of the Government's regulatory approach to wholesale market reform, particularly to ensure that there is some attempt made to discipline the near complete dominance by Hydro Tasmania of the wholesale electricity market. However, as indicated in Section 2 of this submission, we have serious doubts about the regulatory approach to wholesale market reform in Tasmania and its ability to entice new retailers into the market. This places even more emphasis on the role which the TER will play in the wholesale market. We are also concerned about the costs involved in wholesale market regulation – to Hydro Tasmania, the TER and retailers. If retail market competition does not emerge (or is weak), these costs could quickly outweigh any benefits.

4.1 Scope of the Guideline

We have examined the scope of the draft Guideline and believe it is adequate.

We have also considered the TER's proposal to address a range of other matters covering the Regulator's broader responsibilities on wholesale contract regulation, updating values under the Wholesale Contract Regulatory Instrument, compliance enforcement, regulatory audits, and information disclosure and reporting, in separate instruments. Given the scope and importance of the regulation of Hydro Tasmania's wholesale contracts to reform and competition in the Tasmanian electricity market, and the communication challenges that will face new entrant retailers and electricity consumers in understanding regulation of the wholesale market, we believe that there would be advantages in the TER either consolidating all matters associated with the wholesale market in one document or ensuring that there is an efficient and easy means of cross referencing/indexing roles, responsibilities and regulatory instruments. This should also be conveniently located on the TER's website, along with the primary and any secondary documents.

Consistent with the need to ensure that consumers, retailers (including potential new entrants) and other interested parties understand wholesale market regulation we believe that the Regulator should also consider the need for user guides, fact sheets and other easy to understand explanatory material, as well as educational opportunities for those interested. We appreciate that the TER may well need to seek funding for these tasks.

4.2 Weekly Contract Prices & Offers

We generally support the Regulator's approach to calculating weekly contract prices.

We support the use of a 'pricing model' for this purpose. Whilst we note the TER's comment that this could involve any of a range of platforms or software, we suggest that it will be important that the Regulator be involved in checking this model, especially if developed by Hydro Tasmania, for consistency with the need for wholesale market regulation to help deliver more competitive electricity market outcomes in Tasmania. As the dominant generator, it could be argued that Hydro Tasmania has an incentive to avoid competition and the TER needs to ensure, and be seen to ensure, that this does not happen. We also note that the draft Guideline requires Hydro Tasmania to comply with the Instrument, that a regulatory audit of the model is required and that the Regulator is able to step in and set prices where there has been repeated failure by Hydro Tasmania to comply. We support all of these measures. We also support that Hydro Tasmania (and the TER) publish the model and all its inputs and parameters, as outlined in the draft Guideline, on their respective websites. Outputs should also be published. We further support that Hydro Tasmania update (and publish) any changes to the model and provide the suggested two week notice of this to the TER (and the market).

In the Consultation Paper, the TER discusses whether it, or Hydro Tasmania, should be responsible for developing and operating the model. On the one hand, if the TER were responsible for this, it would provide greater comfort to retailers (including potential new entrants) and customers that the model was developed independently, and consistent with the Instrument and the electricity reform objectives. However, we also recognise that this could place the TER in a position where it verges on being a 'market maker' and that such involvement by the Regulator in the wholesale market could be seen as inappropriate, involving skills the Regulator does not have. On balance, we support the TER's proposal that Hydro Tasmania be responsible for developing and operating the pricing model, provided there are appropriate checks and balances applied (e.g., checking by the TER, publication, a regulatory audit, and compliance with the Instrument and reform objectives).

However, we believe that the TER's proposal that Hydro Tasmania does not need to use this model is confusing and detracts from the role of the Guideline. If Hydro Tasmania does not need to use the model, why bother to have it? Whilst we note that it would still need to remain compliant with the Instrument and recognise that there could be benefits in having some flexibility in approaches to weekly contract prices, this should be accompanied by additional checks and balances. For example, it would be appropriate for Hydro Tasmania to inform the TER and the market (in a timely way) if it chooses not to use the published model, why not, what alternative it is using, why, how this is consistent with the Instrument and what the impact is on the market.

TSBC supports the TER's proposals set out in the draft Guideline regarding Hydro Tasmania's responsibilities for determining and publishing weekly contract offers, and the outputs involved. We strongly endorse the use of periodic and exception based regulatory audits,

with the latter triggered by potential issues that have emerged through the TER's own investigations, or through third party notification to the Regulator.

4.3 Weekly Offer Process

The TSBC has examined the contents of the draft Guideline in relation to the weekly offer process, and the roles and responsibilities of the TER.

4.3.1 Role and Responsibilities of the Regulator

We support the proposals put forward by the TER. The one matter where we comment further concerns whether the regulator should verify or approve proposed weekly contract price offers, or merely monitor with the 'safety net' of the TER's powers to step in to set prices or investigate.

We agree that retailers (and customers) may take some comfort from the fact that the regulator is independently verifying (or approving) prices. We also agree that there would be practical constraints on the Regulator's ability to act in a timely way. Given this, regulatory approval may be a 'bridge too far' and the TSBC supports a monitoring role for the Regulator, provided that it is accompanied by robust assessment and timely action on any complaints or potential breaches. The TER should also report to the market in a timely manner on any such action.

We do note, however, that if our pessimism about the likelihood of entry by new retailers into the Tasmanian electricity market under current policy settings is realised, there will be few (perhaps only one or two) retailers who are monitoring the market to help ensure Hydro Tasmania's compliance with the Instrument and Guideline. This could limit the degree of active monitoring outside the TER.

In order to provide additional comfort to stakeholders, the TER has also suggested in its Consultation Paper that it could issue a Statement of Regulatory Intent clarifying the process, considerations and approach it may take after fixing weekly offer contract prices. TSBC would support the issuing of such a Statement.

4.3.2 The Process

The TSBC supports most of the proposals for weekly offer contracts outlined in the draft Guideline. However, there are two areas where we feel additional comments are justified.

First, where Hydro Tasmania rejects a nomination by a retailer, it should give the reasons for this to the retailer concerned (with the copy to the TER) and state its reasons for doing so,

including how they are consistent with the Guideline. This will help to ensure transparency in Hydro Tasmania's decision-making and provide a further discipline over its market power in relation to such contracts.

Secondly, in relation to Hydro Tasmania's need to report on exceptional circumstances where it cannot comply with the Guideline, it needs to be clearly stated in the Guideline that the Regulator expects Hydro Tasmania to be able to demonstrate that such circumstances are genuinely outside of its control and that it has appropriate risk mitigation strategies in place to minimise the risk of exceptional circumstances. Hydro Tasmania should also be required to demonstrate that the steps it has taken to minimise the risk of similar circumstances arising again are cost efficient.

4.4 Other Matters

Below the submission addresses some other matters raised in the Consultation Paper or otherwise.

4.4.1 Record Keeping

TSBC supports the need for Hydro Tasmania to be required to keep timely, adequate and accurate records of all information relating to the regulation of its wholesale market contracts, including those mentioned in the Consultation Paper. We also support that the regulator have powers over information collection and treatment of confidential information that reflect the significance of efficient operations in the wholesale market.

4.4.2 Fines & Penalties

In our view, Hydro Tasmania should also be subject to fines and penalties for breaches of its regulatory obligations that match the impact any breaches could have on the market and electricity consumers.

4.4.3 Compliance Enforcement

We support that the TER review its Compliance Enforcement Policy to ensure that it adequately covers the new wholesale contracting regulatory framework and that this be the subject of public consultation. Such a review should be done in a timely way.

4.4.4 Regulatory Audits

The TSBC supports the arrangements for regulatory audits outlined in the Consultation Paper, including the use of periodic and exception based audits, the areas that could be subject to audits, the use of a risk-based approach to determine the timing of audits (including an audit of Hydro Tasmania's pricing methodology before the end of December 2013) and that the scope of audits be determined by the Regulator in consultation with Hydro Tasmania.

We also support that the TER review its Regulatory Reporting Guideline to ensure that it adequately covers the new wholesale contracting regulatory framework and that this be the subject of public consultation. Such a review should be done in a timely way.

4.4.5 Information Disclosure & Reporting

We note the TER's intended approach to information disclosure by Hydro Tasmania and the Regulator's reporting of information covering the regulation of wholesale contracts. We have no objection to these and support the provision of as much useful information as possible to the market place. Accurate, useful and timely information is a key to the efficient operation of markets.

However, we urge that the TER be sensitive to the position of new entrant retailers and consider their likely aversion to onerous regulatory requirements in the information obligations it puts on them. It would be counter-productive if such obligations served as a barrier to entry.

4.4.6 Updating Values under the Wholesale Contract Regulatory Instrument

We have considered the points made in the Consultation Paper on this matter and the TER's proposal that these matters not be included in the Guideline (as they relate to the TER's obligations not Hydro Tasmania's), or in any other regulatory instrument, but rather be identified in the TER's investigations or in regulatory audits with updating proposals to follow. We accept the TER's position. We note that, should a regulatory instrument prove beneficial, it could be introduced at a later time.

4.5 Recommendations

10. There would be advantages in the TER either consolidating all matters associated with the wholesale market in one document or else ensuring that there is an efficient and easy means of cross referencing/indexing roles, responsibilities and regulatory instruments.
11. The Regulator should also consider the need for user guides, fact sheets and other easy to understand explanatory material on wholesale market regulation, as well as providing educational opportunities for those interested.
12. On balance, we support the TER's proposal that Hydro Tasmania be responsible for developing and operating the wholesale pricing model, provided there are appropriate checks and balances applied to it (e.g., checking by the TER, publication, a regulatory audit, and compliance with the Instrument and reform objectives).
13. However, the proposal that Hydro Tasmania does not need to use this model is confusing and detracts from the Guideline. To overcome this, Hydro Tasmania should be required to inform the TER and the market (in a timely way) if it chooses not to use the published model, and to say why it is not doing so, what alternative it is using, why, how this is consistent with the Instrument and what the impact is on the market.
14. Where Hydro Tasmania rejects a nomination by a retailer, it should give the reasons for this to the retailer concerned (with the copy provided to the TER) and state how its reasons are consistent with the Guideline.
15. Where an exceptional circumstance exists, it needs to be clearly stated in the Guideline that the Regulator expects Hydro Tasmania to be able to demonstrate that the circumstances are genuinely outside Hydro Tasmania's control and that it has appropriate risk mitigation strategies in place to minimise the risk of exceptional circumstances occurring in the first place. It should also be required to demonstrate that the steps it has taken against similar circumstances arising again are cost efficient.
16. The regulator must have powers over information collection and treatment of confidential information that match the significance of the efficient operation of the wholesale electricity market.
17. Hydro Tasmania should be subject to fines and penalties for breaches of its regulatory obligations that match the impact these could have on the market and electricity consumers.