



Public Hearing – Hobart 2 February 2012

Summary of Proceedings

The Electricity Supply Industry Expert Panel held a half-day Public Hearing on 2 February 2012.

The key aim of the Hearing was to provide stakeholders with the opportunity to engage directly with the Panel and to provide feedback on its key findings and recommendations contained in its Draft Report. The intention was also to encourage some interactive discussion amongst participants to inform the development of their formal written submissions.

The Panel had planned to hold a second Hearing in Launceston on 1 February 2012, but this session was cancelled due to only a single registration for participation. The Panel made alternative arrangements to hear comments and feedback from the one stakeholder who wished to present to the Panel but was unable to attend the Hobart Hearing.

The Public Hearings were advertised in Tasmania's three daily newspapers on 14 January 2012. Registrations were initially due by 23 January, and this timeframe was extended until 30 January, in recognition of the Launceston cancellation.

The Panel also extended targeted invitations to a range of stakeholders, including the State-owned electricity businesses (SOEBs), other Tasmanian market participants (both current and potential), major energy users and relevant industry peak bodies.

In total, there were 38 registered participants in attendance at the Hobart Hearing. The three SOEBs declined the Panel's invitation to present at the Hearing but attended as observers. The complete list of registered participants who attended the Hearing is available on the Panel's website.

The Hearing was open to the public and was also attended by representatives from a number of media outlets, including the Mercury and the Examiner.

Below is a brief summary of the key issues raised by participants at the Hearing during both the formal presentations and the facilitated plenary discussion. The agenda and slide-show presentations (where available) from the Hobart Hearing are available on the Panel's website.

Opening Presentation - Mr John Pierce, Chair of the Panel

Mr Pierce delivered a 40 minute introductory presentation, which outlined the Panel's key findings and reform recommendations, in the context of its foundational assumption that "the electricity supply industry will make the best contribution to the growth and development of Tasmania, and to the economic welfare of Tasmanians, if it is operated on the most *economically efficient* basis possible".

Mr Pierce briefly explained the Panel's reform priorities and also outlined some (conservative) estimates of the economic benefits of reform to non-contestable customer pricing.

Mr Pierce also responded to several questions from the floor:

- Mr David Asten queried the Panel's approach to measuring efficiency, particularly operational and technical efficiency. Mr Pierce advised that the Panel had undertaken analysis of the effectiveness of the sector from a technical/reliability perspective, but was focused on broader economic efficiency – that is, the efficient allocation of resources and prices that reflect this. Mr Pierce advised that the Panel did not go down to the level of detail that saw it assess whether or not individual components of each of the SOEBs were operationally efficient – as this is the appropriate domain of other regulatory agencies.
- Mr Marc White (Goanna Energy) queried the impact of reform on tariffs in terms of a percentage reduction. Mr Pierce advised that the Panel had estimated that its recommended changes to the methodology for setting the regulated wholesale energy allowance would lead to a 5-10% reduction compared to what they would otherwise be in the absence of such changes.
- Mr Roman Domanski (Energy Users Association of Australia - EUAA) raised a point of clarification regarding the Panel's modelling of the economic benefits of reform, noting the significance of the Major Industrial (MI) load and contestable customer load in Tasmania meant that modelling that was based on changes to non-contestable pricing alone could significantly underestimate the benefits to the Tasmanian economy of more efficient prices. Mr Pierce agreed and noted that the modelling was by its nature conservative in its estimates of likely economic benefits.
- Ms Penny Cocker sought to clarify whether the estimated economic benefits (\$600-960 per household as a measure of Gross State Product) was a total figure over the period 2012-20 or if this represented an annual figure. Mr Pierce confirmed it was a total cumulative per-household GSP benefit over this period. This figure does not, however, represent a measure of likely savings on individual customers' power bills.

Mr Peter Brownscombe

Mr Brownscombe raised a number of points in response to the Draft Report, structuring his presentation around the Panel's Terms of Reference. Mr Brownscombe's key points included that:

- The Panel should be commended on its work in undertaking the Review, noting that the Draft Report is a good information source for the community on key issues in the sector.
- With regard to ToR 5 (interaction between the SOEBs), the disaggregation of the Hydro-Electric Commission in 1998 had undoubtedly been 'a good thing'.
- The Panel had not sufficiently addressed issues of future price trends (ToR 6), particularly with regard to the impact of the carbon tax.
- With regard to actions to inform an energy strategy (ToR 7), the Panel's 'neoclassical' approach to economic efficiency may lead to reforms that would not necessarily suit the Tasmanian market, noting that there are a number of important factors in Tasmania (e.g. welfare dependency, dominance of MI customers) that act as a barrier to the effective operation of the 'invisible hand' of the market. It was suggested that there was insufficient consideration of utility for Tasmanians in the reform options being proposed.
- With regard to governance, the effectiveness of improvements to systems and processes is questionable if there was sufficient knowledge and expertise in Government to make good judgements on the information that is being provided to it (as a Shareholder) by the SOEBs.
- The Panel's view that latent market power is a deterrent to entry for new retailers (and hence competition) is correct, but is concerned that the Panel's proposed reform options would lead to the transfer or export of 'consumer surplus' (and hence value) out of Tasmania – suggested that the nature of the Tasmanian market means that there are benefits in retaining regulated monopolies.
- The Panel's Basslink analysis was by and large sound, but would encourage the Panel to look at the possibility of a second interconnector in the event that Tasmania loses one of the MIs in the next 5-10 years.
- There are significant 'biases' in the NEM framework against Tasmania's position as a State largely reliant on 'green energy', but that the Report is largely silent on this issue.

- That the Panel has done a good job of explaining MI pricing with valid and legitimate explanations, but that these explanations do not address the *magnitude* of the disparity in prices faced by MIs compared to other customers. Also suggested that the true opportunity cost of energy sold to the MIs is not properly reflected/modelled in the Panel's analysis – that the alternative might not be net exports, rather the attraction of mid-level energy users to Tasmania with a greater capacity to pay than the current MI customer base (and potentially more valuable than net exports).
- That a single Victoria/Tasmania NEM region is a 'novel concept' but ultimately misguided in terms of delivering benefits to Tasmania.
- That the Panel needs to consider alternatives to selling Aurora Energy's retail business.

Mr Peter Dane

Mr Dane focused largely on the practical barriers to effective retail competition in Tasmania (and therefore the delivery of lower prices to customers), given the unique nature of the market. His key points included that:

- The Draft Report provides an excellent information base for decision-makers.
- The Tasmanian customer base is highly unique – i.e. small, high level of welfare dependency – and the Panel may be underestimating the significance of this.
- That experiences in many other sectors (e.g. telecommunications) show that effective retail competition in Tasmania is difficult to achieve and that the experience of elsewhere in Australia (particular the major cities) does not necessarily provide a good guide to likely developments in Tasmania.
- The Draft Report's reform recommendations are broad and that the impact on and reaction of customers is unknown and untested. Questioned whether competition and trading would work to reduce to prices and if any reductions would be simply 'washed away' by the carbon tax and other price increases.
- The Report lacks short-term wins for the 'man in the street' to encourage support for longer-term reform objectives. Suggested that at present there is no compelling 'story' around the need for reform.
- The Report does not look at the options for greater customer cost control – for example, where are the incentives for the roll-out and uptake of natural gas? APAYG is a 'success story' because it responds to the desire by customers to actively monitor and manage their consumption.

Mr Roman Domanski (EUAA)

Mr Domanski's presentation focused primarily on the drivers of price increases particularly increases in network costs. With regard to specific comments on the Draft Report, Mr Domanski noted that the EUAA:

- Welcomed the work of the Panel and the manner in which the Review has been conducted.
- Strongly supported and endorsed the need for more competition at the wholesale level and for the roll-out of FRC, but also suggested that the FRC declaration could be done immediately ('why wait?') and that this in itself would stimulate new entry.
- Questioned previous speakers' cynicism with regard to the potential for genuine retail competition in Tasmania, pointing to industries where there had been success, with clear benefits to consumers – e.g. domestic air travel.
- With regard to the Panel's three reform paths, suggested that the 'gen-trader' model may be more competitive than a regulatory option but that further testing with retailers and other stakeholders was required. Suggested that complexity inherent in delivering the gen-trader model was a 'serious issue' and recommended that the Panel look at the experience of Ontario, Canada, and how this type of model worked in that jurisdiction.
- Supported the Panel's recommendations for a more rational and efficient way of setting the regulated wholesale energy allowance.
- Supported the principal of putting the TVPS on a sustainable commercial footing, but more detail is required (especially with regard to the impact on prices for contestable customers).
- Broadly supported the governance recommendations relating to objective-setting and oversight of the SOEBs by the Government, including greater clarity on how the Government's shareholder function interacts with and relates to pricing and other energy policy objectives.
- Noted that the SOEBs were operating at a 'satisfactory' level within their existing incentive frameworks, but that there is significant room for improvement.
- Had identified what it saw as significant gaps in the Panel's work, particularly in relation to the regulation and ownership of networks and the ownership and structure of generation assets.

Ms Lana Stockman (TRUenergy)

In her presentation, Ms Stockman made the following key points in response to the Panel's Draft Report:

- The Report should be commended for putting to rest some 'myths' about the TESI, particularly around MI pricing, Basslink and the TVPS.
- There is a need to ensure there are clear benefits from reform and, if there are, ensure that community is engaged and understands what these are.
- Of the three reform paths, option 2 (gen-trader) is preferred over option 1 (contract auction), which would not change things significantly enough, with no preference for option 3 (single Vic/Tas NEM region).
- With regard to hydro-specific issues and how they may impact on the delivery of the gen-trader model, there are examples where this has been done elsewhere and Panel can look to these for guidance.
- Pro-active FRC with sale of Aurora retail business preferred – NZ experience suggests that 'organic' approaches to FRC take too long, to the detriment of customers. Price deregulation of retail is also consistent with the Commonwealth's recent Energy White Paper.
- There remain a number of gaps and unanswered questions, particularly with regard to the future of Basslink (in order to bring additional competitive pressure to bear in Tasmania – currently 'too hard' to get generation into Tasmania from the mainland), expectations around TVPS and the (realistic) timeframes for the achievement of reforms.

Mr Jamie Lowe (Alinta Energy)

Mr Lowe made a number of substantive points in his presentation from Alinta's perspective as a prospective entrant to the Tasmanian market. In summary, Mr Lowe noted that Alinta Energy:

- Concurs with the Panel's views around current wholesale market issues in Tasmania and agrees that Hydro Tasmania does have latent market power.
- Sees that the entry path into Tasmania currently relies on Hydro Tasmania's willingness to 'do a deal' rather than the effective operation of competitive forces, and this makes entry commercially unattractive.
- Would ultimately prefer a separation and sale of Tasmanian generating assets. However, in the context of the reform options that the Panel has put forward, reform path 2 (gen-trader) represents a 'logical and proportionate' response to the current issues in the market.

- Does not support reform path 1 (contract auction) and see this approach as inconsistent with the NEM more broadly.
- Is currently looking to grow by entering new markets, with Tasmania representing a potential opportunity in this regard if wholesale market reform adequately addressed the current issues.
- Sees Tasmania as large enough to justify entry and that entry is no more costly than in other regional areas. Noted that achieving a significant share of the Tasmanian retail market through acquisition as being potentially attractive relative to a battle to achieve churn in established markets (particularly as customers acquired through churn already exhibit a propensity to switch suppliers and be less 'sticky'). He noted that Aurora as dominant incumbent is a concern, however. Supports the introduction of FRC and the scoping study for the sale of packaging and sale of the Tasmanian retail business.
- With regard to governance and other issues, agrees that Government needs to be clearer about its rationale for continued ownership of the businesses and questioned the scope of Hydro Tasmania's activities outside of Tasmania.
- Believes that the future of Basslink, including current bidding behaviours and auction process for Inter-Regional Residues (IRRs), needs to be addressed as a priority.

Plenary Discussion and Panel Q&A

Following the delivery of formal presentations to the Panel, the Hearing was opened up for a facilitated discussion. Participants were invited to make comment or ask questions of the Panel and the other presenters. Below is a brief summary of the main issues that were discussed during this session.

Network regulation and demand-side management - Mr Pierce opened the session by revisiting a point from Mr Domanski's presentation as to why the Panel had not considered reform options with regard to matters such as network pricing and regulation, demand-side management and smart meters. Mr Pierce noted that these matters were currently being dealt with through relevant national forums and that the Panel was not in a position to directly influence these processes, nor does it wish to duplicate them. Mr Pierce emphasised that this should not be taken as suggesting the Panel does not consider these matters to be important, but that it had chosen to focus on those areas which were within the direct control of the Tasmanian Government.

Impact of the Commonwealth's carbon tax – Ms Penny Cocker asked Mr Pierce if he could elaborate on the impact of the carbon tax on energy prices and queried why Tasmanian customers would not see a direct benefit given that its generation profile is dominated by hydro power. Mr Pierce suggested that it was a matter of what *kind* of benefit or value Tasmania would ultimately see from the carbon tax, noting that Hydro Tasmania would be the most significant beneficiary. Mr Pierce noted that if and how this additional value to Hydro Tasmania is extracted and distributed to the community is a policy decision for the Tasmanian Government.

'Export' of value from Tasmania to mainland Australia – Mr Brownscombe requested that the Panel respond to the contention made in his presentation that the Panel's reform options were designed to improve the efficiency of the national market at the expense of value and utility to Tasmanians. Mr Pierce referred back to the Panel's key contention that the best thing for the Tasmanian economy (and hence the Tasmanian community) is for services to be provided on the most efficient basis possible, otherwise one is effectively subsidising a service to protect the income of a supplier. Mr Brownscombe maintained that certain rigidities in the Tasmanian market – e.g. Basslink and the dominance of MI customers – could limit the economic gains from reform.

Basslink – Mr Simon Camroux of Loy Yang Marketing Management Company (LYMMCO) noted that there was an appetite to enter the Tasmanian market but Basslink acts as a barrier, suggesting that -\$1000 spot market bidding of Basslink was a key issue in this regard. Mr Jamie Lowe lent support to this contention, noting that risks were seen as too great in the situation where Hydro Tasmania effectively controls Basslink. It was suggested that the Panel should be clearer on the physical, technical and commercial challenges of using Basslink as a basis for competition in the Tasmanian market. Mr David Bowker of Hydro Tasmania noted that Hydro Tasmania does offer firm interregional swap products. Mr Pierce noted that the Panel would be seeking to be more specific in its Final Report on how its reform options will impact on Basslink.

A second interconnector? – Ms Penny Cocker queried if there was currently any planning underway for a second cable link between Victoria and Tasmania. Mr Pierce noted that the option had been mooted, but that a second cable was seen as a low priority in the context of AEMO planning. He also noted that the Productivity Commission is currently undertaking some work on the drivers and value of interconnectors – that is, how do customers benefit and what are the costs and impacts on energy? Mr Richard Bevan noted that the Tasmanian Renewable Energy Board had investigated the likely viability of a second cable as part of its 2011 report, which suggested that, given prevailing supply and demand balance, by mid 2020s the project could be viable. Potential market issues were also raised, particularly with regard to how a new, regulated interconnector would work in parallel with the current merchant (i.e. non-regulated) link.

Communication of key messages – Mr Bevan noted that the Draft Report did a good job of identifying the ‘elephants in the room’, particularly the need to take the TVPS out of the commercial space and transparently support it as a ‘drought relief’ station. Mr Bevan noted that the Panel should, however, think more closely about how it ‘sells’ its key messages, particularly around the benefits of reform. He suggested that the Panel should be looking to guard against the potential for detractors to derail reform by focusing on the administrative elements of the gen-trader model – e.g. additional Boards and CEOs. Mr Domanski suggested in this regard that it was also important that the Panel clearly delineate the proposed trader model from arrangements in NSW.

Tasmania a viable retail market? – Mr Brownscombe cautioned against making assumptions that the Tasmanian market could be viewed as a ‘microcosm’ of a larger market like Sydney, noting that Tasmania is highly unique for a range of reasons. Mr Lowe suggested that there were both pros and cons of entering a market like Tasmania, noting that there may be benefits for retailers, such as the ‘stickiness’ of certain customers. Ms Stockman noted that Tasmania bore some similarities to parts of New Zealand and that small niche retailers have emerged to target specific customer groups.

Governance/oversight of the State-owned energy businesses – Mr Brownscombe again raised the issue of shareholder oversight of the SOEBs, questioning the presumption that there was significant expertise within the bureaucracy to support the Government in effectively fulfilling its Shareholder function. Mr Pierce also briefly commented on governance matters, noting that there will always be a level of information asymmetry between the SOEBs and the Government but that the Government must ensure that there are appropriate systems in place for it to act as an informed Shareholder. Mr Pierce also noted that a key influence on SOEB oversight and strategic direction-setting is that governments need to rely on the predictability of a steady stream of revenues to help fund general sector services. Therefore, the risk appetite of governments is – rightly - generally much lower than that of private sector investors.