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John Pierce
Chairman
Electricity Supply Industry Panel Expert
Po Box 123
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Dear Mr Pierce,

Submission in response to Issues Paper

Tas Gas appreciates the opportunity to respond to the Electricity Supply Industry Expert Panel's (Expert Panel's) Independent Review of the Tasmanian Electricity Sector Issues Paper, published on 24 June 2011.

Tas Gas enjoins the Expert Panel to consider Tasmanian electricity and gas markets holistically. Integrated energy markets would promote the efficiency, reliability and sustainability of the Tasmanian energy sector and reduce:

- energy expenditure for homes and businesses;
- the need for State Budgets to fund subsidies for low income households;
- the need for State Budgets to finance investment in expensive new electricity infrastructure; and
- carbon emissions cost effectively.

Tas Gas looks forward to a continuing constructive engagement with the Independent Review and the subsequent implementation process.

We should be happy to provide further information and data to assist the Review Process. I invite the Panel and Secretariat to make contact with myself or my colleague Simon Himson. I may be contacted on 03 6208 6410 and Simon can be contacted on 03 6208 6402.

Yours sincerely

A handwritten signature in black ink, appearing to read "R. J. Sheather".

Richie Sheather
Chief Executive Officer

SUBMISSION TO THE TASMANIAN ELECTRICITY SUPPLY INDUSTRY EXPERT PANEL

THE ROLE OF NATURAL GAS IN THE
TASMANIAN ENERGY MARKET

HOW GAS CAN CONTRIBUTE TO REDUCING
ELECTRICITY COSTS TO CONSUMERS AND
SECURING TASMANIA'S ENERGY FUTURE

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EXECUTIVE SUMMARY

Gas has an important role to play in the delivery of efficient, reliable and sustainable energy to Tasmanian households and businesses. Tas Gas therefore enjoins the Electricity Supply Industry Expert Panel (Expert Panel) to consider Tasmanian electricity and gas markets holistically.

Tas Gas encourages the Expert Panel to support reforms to promote convergence of delivered energy markets which would:

- maintain high levels of reliability and security of energy supply;
- moderate households, businesses and taxpayer exposure to rising wholesale gas prices;
- minimise the capital funding requirements of State-Owned Energy businesses (SOEBs); and
- promote the National Electricity and Gas Objectives.

Tas Gas proffers the following proposals for consideration by the Expert Panel.

1. Tasking the Department of Infrastructure, Energy and Resources (DIER) to form an energy infrastructure panel to improve energy policy development and the planning and delivery of reliable and low cost energy for all Tasmanians.
2. Re-commitment from the Tasmanian Government to support competitive neutrality between public and private energy suppliers in Tasmania.
3. Consider raising the hurdle rate at which SOEBs may invest in network augmentations and extensions in order to mitigate asymmetric network incentives with regard to non-network alternatives.
4. Tasking the DIER to review the implementation of the Municipal Guidelines or the like under which Tas Gas accesses public roads and other areas controlled by local authorities.
5. Engaging in the Australian Energy Market Commission's review of distribution reliability standards framework and potentially tasking the Office of the Tasmanian Economic Regulator (OTTER) to review the 2007 distribution network reliability standards to enable efficient and reliable non- network solutions.
6. Tasking the DIER to consider extending electricity emergency management arrangements to gas.
7. Requesting the OTTER move toward cost reflective retail pricing (CRRP) for non-contestable customers, to address falling load factors and likely over-investment in energy infrastructure serving peak demand.

Changes where the Tasmanian government can influence national frameworks include:

1. Enhancing the incentives and provide national frameworks for electricity networks to support demand side participation (DSP).
2. Supporting the development of a national framework for the introduction of competition in new network connections.
3. Encouraging and supporting the removal of current regulatory barriers for the deployment of smart metering, to remove barriers to CRRP and DSP.

1. INTRODUCTION

Tas Gas welcomes the opportunity to engage with the Electricity Supply Industry Expert Panel's (Expert Panel's) Independent Review of the Tasmanian Electricity Sector, in response to the Review Panel's Issues Paper published on 24 June 2011. The Review is an opportunity to put in place far-sighted changes to Tasmania's energy regulation and governance frameworks, in the long term interests of Tasmanian energy consumers, businesses and taxpayers.

Tas Gas considers gas has an important role to play in the delivery of efficient, reliable and sustainable energy to Tasmanian households and businesses.

In this submission, Tas Gas sets out a series of practical and sensible reforms to promote the efficiency, reliability and sustainability of the Tasmanian energy sector and thereby reduce:

- energy expenditure for homes and businesses;
- the need for State Budgets to fund subsidies for low income households;
- the need for State Budgets to finance investment in expensive new electricity infrastructure; and
- carbon emissions cost effectively.

2. WHO WE ARE

Tas Gas is Tasmania's only natural gas distribution business. The Tas Gas distribution network delivers in excess of 2 PJ p.a. (560 GWh) of gas to over 9,000 gas users. In addition to Tas Gas' investment, the Tasmanian Government has contributed \$55.2 million to the cost of the distribution network on behalf of the Tasmanian community to make it commercially viable.

Until recently Tas Gas was also Tasmania's only natural gas transmission business. Brookfield, the owner of Tas Gas Networks (TGN) and Tas Gas Retail (TGR), has sold the Tasmania Gas Pipeline (TGP) to Palisade Investment Partners Ltd (Palisade). Palisade is an infrastructure boutique fund manager within the Pinnacle Investment Management Group. Tas Gas provides operational and management services to Palisade in relation to the TGP. The Tasmanian Gas Pipeline has a capacity of 47 PJ p.a. (13 TWh) and currently delivers 15.7 PJ p.a. (4.4 TWh).

Tas Gas is a wholly owned subsidiary of Brookfield Partners L.P. a global leader in the development, ownership and operation of high quality infrastructure assets. Tas Gas is part of Brookfield's platform for future investment in the Australian energy sector.

2.1. TAS GAS' COMMITMENT TO TASMANIA

Tas Gas has invested more than \$200 million in gas infrastructure in Tasmania, alongside \$55.2 million invested by the Tasmanian Government. Tas Gas is continuing to invest by connecting new customers to its existing network.

It is actively considering the feasibility of major new investments to extend its current networks. Tas Gas considers that, from an overall societal perspective, there continues to be a sound business case to extend the gas network to enable around 100,000 Tasmanian households and businesses to access natural gas. This is consistent with the planned 100,000 connections as envisaged under the Memorandum of Understanding (MOU) between Tas Gas and the Tasmanian Government.

Tas Gas is also actively considering investments in major cogeneration opportunities, providing highly efficient distributed electricity generation, alongside heat and cooling, as well as network reliability benefits. These could defer or avoid augmentations and extensions to electricity networks. Support by the Expert Panel for changes along the lines proposed herein would increase Tas Gas' confidence to make further investments in Tasmania.

3. POTENTIAL BENEFITS FROM ENERGY MARKET REFORMS

Tas Gas proposes the Expert Panel support reforms to promote convergence of delivered energy markets. We believe reforms in the recommended direction would:

- maintain high levels of reliability and security of energy supply, against a background of hydrological variability and where 20 per cent of energy use is required to be renewable by 2020;
- moderate exposure of households, businesses and taxpayers to rising wholesale gas prices;
- minimise the capital funding requirements of State-Owned Energy businesses (SOEBs); and
- promote the National Electricity and Gas Objectives.

These potential gains reflect a range of efficiencies from gas and electricity market convergence. These gains include energy efficiency, avoided carbon emissions, fuel substitution and peak demand shifting. These gains would in turn promote the efficient investment in, and use of, energy infrastructure in the long term interests of Tasmanian consumers.

3.1. THE KEY DRIVERS – COST AND PRICE

As demonstrated in figures 1 and 2 below, the delivered price of gas in Tasmania is less than 55 per cent of electricity on an energy equivalent basis. This reflects avoided energy conversion losses, together with avoided generation infrastructure and financing costs.

Figure 1: retail gas prices as a percentage of retail electricity prices

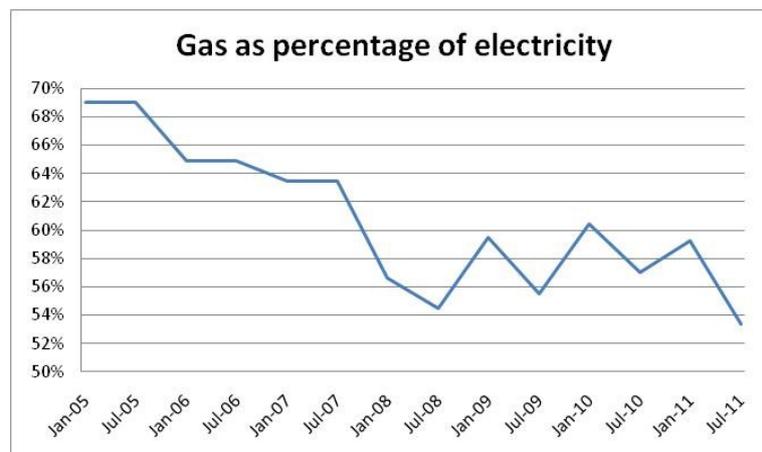
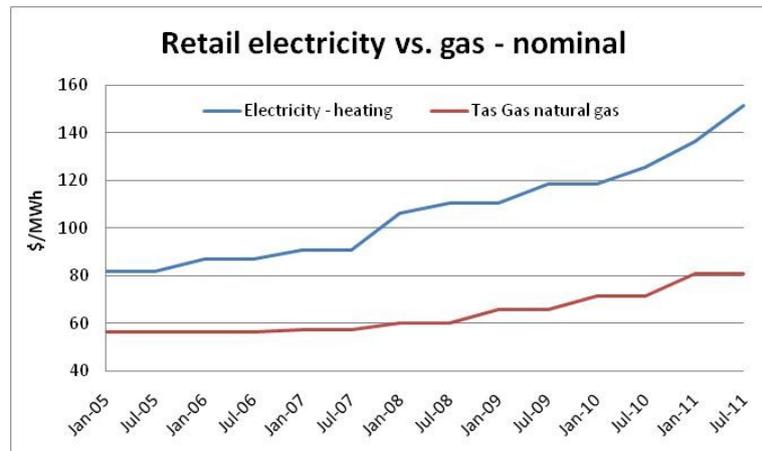


Figure 2: retail gas prices and retail electricity prices (heating) on an energy equivalent basis.



3.2. SUBSTITUTION OPPORTUNITIES

Gas end-use can substitute for some electricity end-use. Where substitutable, gas use is more energy, capital and carbon emissions efficient than electricity use.

3.2.1. DIRECT GAS SUBSTITUTION

The typical gas network customer is saving \$800 per annum by switching to gas for heating uses. The cumulative residential consumer saving is therefore around \$7 million (excluding appliance upgrades). There are further significant gains for businesses.

If overall gas penetration increased to around 7-8 per cent of the total number of Tasmanian residences, or 43 per cent of those passed by the current natural gas network, the cumulative benefit could be around \$14 million per annum. Compared with a notional Government investment of \$1,300 per connected household, household energy savings would offset this investment within two years. There would be few societal investments that would provide that type of return for Tasmanian constituents.

In terms of overall economic stimulus for every dollar of economic support the Government may provide to support a rollout Tas Gas will be spending in the order of \$2.00 per customer. This will be going straight back into the community in terms economic stimulus on top of the appliance and gas fitting spend of the consumer..

The average cost of new customer gas connections via the existing network is \$3000. Where customer consumption is above 40 GJ per annum, which is typical of the installation of two appliances. Tas Gas finances the new connection cost and recovers this from retail tariffs over a number of years.

3.2.2. PEAK SHAVING DRIVEN SUBSTITUTION

Tasmanian gas networks have ample spare capacity and gas end-use substitution can reduce coincident peak electricity demand. Growth in peak demand typically drives the need for network and generation infrastructure investment, which in turn places upward pressure on electricity prices. Gas substitution therefore benefits electricity as well as dual fuel consumers.

The following table demonstrates the potential for reducing the peak electricity demand available from transferring electricity heating and hot water to gas by increasing the number of connections to the 43,000 currently fronted and further increasing the number of connections to 100,000 as envisaged

under the MOU. It assumes that the distribution system Coincident Maximum Demand of the 2009 – 10 year remains constant, which we note is negligible as Aurora have forecast this at 1.8 per cent per annum out to 2020.¹

Table 1: Potential to Reduce the Electricity Peak

Gas Connections	Peak Demand Reduction (MW)	Distribution System Peak Demand (MW)
9,000	31.5	1,042
43,000	150	892
100,000	350	692

This example assumes 3.5kW average heating requirement per household, which is the minimum allowed under Aurora Energy's Uncontrolled Energy (N05) Tariff and Controlled Energy Tariff (N06).

Distributed, gas-fired generation has inherent advantages compared with remote gas fired generation. Advantages include avoided energy losses and avoided fuel use associated with lost heat, alongside possible avoided or deferred transmission and distribution infrastructure and financing costs.

3.2.3. COGENERATION

In a report for the Tasmanian Government in 2009,² McLennan Magasanik Associates (MMA) highlighted the potential for gas fired cogeneration projects to provide cost-effective carbon emissions reduction. MMA identified a series of potential industrial cogeneration opportunities. In addition, it identified residential cogeneration opportunities based on systems serving clusters of homes. We would also refer the Expert Panel to the "Wedges Report" as prepared by DPAC in 2009

Tas Gas is pursuing a variety of cogeneration projects. For example, Tas Gas has been involved in the installation of a cogeneration facility at Launceston General Hospital. The cogeneration facility provides the hospital with nearly 80 per cent of its annual electricity requirement (predominantly heating), including nearly 60 per cent of its peak electricity requirement. With capital expenditure of \$4.8 million, the project resulted in \$1.5 million of deferred network capital expenditure. Importantly, the project also provided the hospital with access to stable and low cost energy, improved energy system reliability and efficiency, and minimised the carbon footprint of the hospital.

To date, Tas Gas has identified cogeneration projects with a combined potential network unloading of more than 110MW. Noting that the hospital project was for a load of only 2MW, the potential savings are significant, potentially in the order of tens of millions of dollars.

3.2.4. NON-NETWORK ALTERNATIVES – EMBEDDED GENERATION

There are a number of opportunities for the consideration of embedded generation in Tasmania. These relate to distribution and transmission substations that require augmentation for reliability and peak demand growth reasons. In its 2010 Distribution System Planning Report, Aurora identified network capacity constraints in Hobart's northern suburbs and suggested network options to address these. As gas networks are available in this area, embedded generations and other non-network solutions may be feasible and efficient.

¹ See page 3 Aurora Energy – Distribution System Planning Report June 2010

² Tasmanian Greenhouse Gas Emission Reduction Project - Understanding the Potential for Reducing Tasmania's Greenhouse Gas Emissions, Report to Tasmanian Climate Change Office, Department of Premier and Cabinet, McLennan, Magasanik Associates, 30 November 2009, pages 170 - 173

3.2.5. NON-NETWORK ALTERNATIVES – GENERATION

Significant benefits could be realised from large scale projects involving indirect substitution. An example is the electricity transmission network augmentation on the Waddamana – Lindisfarne 220 kV transmission line. This project (undertaken by Transend) augments the existing transmission capacity to deliver power to Southern Tasmania, principally Hobart.

A non-network solution considered was local generation in the Hobart locality near the Lindisfarne grid exit point. Tas Gas estimates that such an embedded generation project could have been undertaken at a lower overall cost.

3.2.6. SYNERGIES BETWEEN SUBSTITUTION OPPORTUNITIES

There are strong synergies between the gas substitution opportunities identified above. For example, if a co-generation or network alternative project proceeds, this could underpin extensions to the gas network. This increases the number of domestic customers and businesses that can access the gas network and hence the direct substitution opportunities and benefits.

4. SHORTCOMINGS OF CURRENT FRAMEWORKS

There are well known shortcomings in current regulatory and institutional frameworks governing energy markets. These shortcomings limit the potential benefits from full gas and electricity market convergence.

4.1. NATIONAL MARKET CONCERNS

The Ministerial Council on Energy (MCE) recognised shortcomings in current frameworks when it directed the Australian Energy Market Commission (AEMC) to investigate and identify market and regulatory arrangements needed across the supply chain to facilitate the efficient investment in, and operation and use of demand side participation (DSP) in the NEM. As noted in a Discussion Paper³ released in April 2011, the AEMC recognises DSP includes substitution by other energy sources, including gas. The AEMC also recognises the potential benefits associated with cogeneration.

The AEMC Discussion Paper identified a range of technical, market and regulatory barriers to DSP. These include:

- absence of data gathering infrastructure to measure accurately and verifiably mass market electricity consumption at different times of day (other than in Victoria);
- ongoing retail regulation and limitations on retail pricing structures necessary to provide incentives for consumers and DSP suppliers to enter into commercial arrangements; and
- the absence of a carbon price (as at April 2011).

Tas Gas notes that in March 2011 the Australian Energy Regulator (AER) announced that it would be examining whether the current regulatory frameworks appropriately balance the competing interests of consumers and the needs of network businesses, and also the role of the regulatory framework plays in only allowing efficient investment.⁴ This further reinforces concerns that current frameworks are not delivering efficient outcomes in line with energy market objectives.

Retail electricity prices do not reflect the true cost of peak electricity consumption in Tasmania – and elsewhere. Peak electricity prices for customers with accumulation meters are based on average demand profiles.

There are substantial cross subsidies between users with differing demand profiles. The absence of cost reflective retail pricing (CRRP) means that consumers may collectively demand electricity that is

³ See page 39 of the AEMC's 2011 Discussion Paper: 'Strategic Priorities for Energy Market Development' dated 1 April 2011.

⁴ See Australian Energy Regulator, Media Release NR 004/11, issued 29 March 2011.

above their willingness to pay. The lack of CRRP removes or weakens incentives for DSP solutions, including gas substitution.

Tas Gas submits there are significant shortcomings in existing governance of network capital expenditure. The basic problem is that electricity networks have little or no incentive to pursue or consider DSP opportunities. This increases the risk of inefficient investment in electricity networks.

As noted in a submission to the AEMC's Strategic Priorities for Energy Market Development Paper by AusGrid: *'The structure of the distribution regulatory regime provides little incentive for the implementation of demand management. Risk management considerations and 'business culture' mean that distributors prefer network augmentation solutions to demand management solutions.'*⁵

4.2. TASMANIAN CONCERNS

Tas Gas agrees with the AusGrid assessment and considers it also applies to the two Tasmanian networks. As noted earlier with respect to the Waddamana – Lindisfarne 220 kV line, Tas Gas considers that network solutions in Tasmania have proceeded where lower cost alternatives were available.

Against this background, Tas Gas is concerned that:

- electricity peak demand forecasts used for regulated price setting, and in the absence of cost reflective retail prices, may not take into account the full potential for gas substitution;
- the Regulatory Investment Test (RIT) may not function as intended and may not provide a process that enables non-network options to succeed on their merits; and
- network reliability settings set jurisdictionally may effectively rule out non-network options.

With regard to the RIT, our concerns include the following matters.

The majority of proposed network augmentations where gas could play its part are below the \$5million to trigger a RIT. Where a RIT is not triggered, the opportunity to review proposed augmentations is contained in the network's annual planning report.

Only 20 business days are allowed for interested parties to identify potential alternatives and submit proposals to the relevant network. This is not sufficient to develop credible alternatives.

For proposed augmentations that do trigger RIT, there is a 12 week time period for submissions. We suggest that this places non-network options at a disadvantage compared with network options which are likely to have been developed over longer time periods.

The Waddamana-Lindisfarne transmission augmentation example, discussed above, illustrates a further problem with the RIT. This is the possibility that a network solution is the lowest cost *ex ante* but not *ex post*.

The project proceeded on the basis it was the lowest cost option. The *ex ante* capital cost estimate was \$48.5 million (in \$2007). The final cost of this project is reported to have been \$130 million (in \$2011).

This outcome highlights problems with existing frameworks. The impacts of the cost blow out include higher retail prices for consumers and businesses, alongside an increased financing commitment on the part of Tasmanian taxpayers.

While the regulated network receives some penalty for higher actual costs, under current regulatory frameworks, at the following regulatory reset the asset enters the Regulated Asset Base at its actual (*ex post*) value. In the latter part of the regulatory period, the adverse financial impact of the excess investment for the network may not be sufficient to deter such investment in the future.

⁵ See page 1 of AusGrid submission dated 20 May 2011.

Tas Gas anticipates this feature of economic regulation may come under scrutiny as part of the AER Review. It highlights the existence of real barriers to non-network alternatives.

In 2009, as part of the National Partnership Agreement on Energy Efficiency Australian governments committed to phasing out electric resistance hot water systems (via the National Framework on Energy Efficiency, NFREE). Uniquely, the Tasmanian Government decided to opt out of this aspect of the NFREE. Based on public statements at the time, this appears to have been based on assumptions about the emissions profile of Tasmanian supply. Tas Gas questions whether this decision was soundly based and suggests that the phase out of electric hot water systems in Tasmania is likely to be beneficial.

The high cost of new gas connections in Tasmania is a further barrier. While Tas Gas finances this cost, we consider the cost is significantly higher than it need be and inhibits efficient gas substitution. This reflects two key points:

- non-contestability of new electricity network connections in Tasmania; and
- new gas network connections and infrastructure rollout face onerous requirements imposed by local governments.

In an explanatory note dated November 2009 accompanying the second exposure draft of the National Energy Customer Framework package (NECF2), the Standing Committee of Officials (SCO) stated that: *'SCO notes that there are circumstances where 'network' infrastructure may be constructed by parties other than the distributor itself. There are benefits to customers from being able to access competitive providers of construction services, or for distributors to obtain competitively priced services from third parties. SCO will consider how in future the gas connections framework might facilitate connection competition and connection contestability.'*⁶

Under previous jurisdictional arrangements, new electricity connections in Tasmania were non-contestable. A large portion of connections expenditure is recovered from distribution network use of service charges. In its regulatory proposal for the 2012-17 period, it appears Aurora Energy proposes a continuation of present arrangements, under the NECF.

In some jurisdictions, new electricity connections services are contestable. In the UK, both gas and electricity connections services are contestable.⁷ Contestability enables efficiency gains from multi-utility connections and sharpens incentives for efficiency and innovation.

Connections contestability also opens opportunities for embedded generation as a cost-effective alternative to network augmentation upstream from new connections. This is especially relevant to embedded generation opportunities in new industrial and housing estates.

Tas Gas is unaware of the current status of SCO consideration of new network connections competition. Tas Gas is concerned that significant opportunities are being lost as a result of delay in policy development on this matter.

Local government requirements for new gas connections in Tasmania are overly onerous and complex compared with electricity. While State-wide municipal standards for new connections are in place, there continue to be important differences of interpretation in how these standards are applied in practice.

The Tasmanian Government has recently formed a "Tasmanian Infrastructure Advisory Council" with a secretariat from the Department of Infrastructure Energy and Resources (DIER). This group is charged to develop a coordinated approach to the delivery of economic infrastructure in Tasmania. While this is a welcome development, Tas Gas suggests the new Council is broadly based and not focused on:

- developing a clear overall vision and strategic State energy infrastructure plan; or

⁶ See page 20 of November 2009 explanatory note accompanying NECF2

⁷ See for example page 1 of the Ofgem Gas and electricity connections industry review 2008-09, published on 29 January 2010 available at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=52&refer=Networks/Connectns/ConnIndRev>

- a transparent policy development process within which there is engagement between the Tasmanian Government, SOEBs, private sector energy suppliers, and end-users.

5. OPPORTUNITIES FOR CHANGE

Realisation of the potential gains from gas consumption and associated infrastructure requires far sighted reform of existing regulatory and governance frameworks, both in Tasmania and nationally. The goal of Tas Gas' proposed changes is to address institutional barriers and to create incentives for the creation of truly convergent energy markets, spanning multiple primary energy sources and delivery infrastructure. Tasmania can no longer afford inefficient and artificial barriers between its energy markets.

The present review presents an opportunity to identify:

- change that may be implemented directly by the Tasmanian government and its SOEBs; and
- opportunities for the Tasmanian government to influence the direction of national energy market arrangements.

Tas Gas suggests areas within the government's direct control include:

- reference to DIER to facilitate integrated state infrastructure planning and coordination;
- policy decisions on the introduction of full retail competition;
- reference to the Office of the Tasmanian Economic Regulator (OTTER) toward the objective of retail price regulation reform;
- adoption of COAG policy on phase-out of electric hot water;
- negotiation of performance agreements with SOEBs and policies for allocation of capital to finance SOEB capital expenditure;
- reference to DIER with regard to the terms under which Tas Gas accesses public highways and other areas controlled by local authorities; and
- jurisdictional powers under declared energy emergencies and whether these powers extend to gas infrastructure and supplies.

In addition, Tasmania can also seek to influence national energy regulatory and institutional frameworks, including via:

- its seat at COAG and Ministerial Councils; and
- participation in AEMC and MCE reviews, including:
 - the AEMC DSP3 review;
 - the AER's review of energy network economic regulation; and
 - the AEMC's review of distribution reliability standards.

6. NEED FOR CHANGE

The need for change is clear and growing. Existing energy market arrangements are contributing to rising delivered energy prices. The outlook is for further substantial increases in retail energy prices payable by Tasmanian families and businesses.

6.1. OUTLOOK FOR ENERGY PRICES

This outlook was reflected in advice provided by the AEMC on future possible movements in retail electricity price movements – 1 July 2010 to 30 June 2013.⁸ For Tasmania, the expected increase in retail prices over the period is 25.28 per cent. Rising wholesale costs are expected to contribute

⁸ 'Future Possible Retail Electricity Price Movements: 1 July 2010 to 30 June 2013, final report, dated 30 November 2010.

47.73 per cent of increased retail prices, with transmission and distribution contributing a further 28 per cent of the increase.

There are grounds for expecting significant further retail price rises beyond 30 June 2013.

Infrastructure capital and financing costs are rising in response to global events. This means higher costs for generation and energy delivery infrastructure.

Global demand for natural gas is rising as an attractive low emission alternative to coal, a lower risk alternative to nuclear and as a hedge against rising liquid fuel prices. There is massive investment in gas transportation infrastructure in Queensland – Liquefied Natural Gas (LNG). According to modelling undertaken for the Commonwealth Treasury, domestic gas prices in the east coast will be linked to changes in world prices by around 2020.⁹

The result is that future wholesale gas prices in Tasmania are likely to be based on world gas prices. This will have profound effects for delivered energy prices in Tasmania.

Other factors are also driving increases in electricity supply costs. These include the introduction of an explicit carbon price and a likely move to carbon permit trading around 2015. There is also a mandatory obligation to source 20 per cent of energy from renewable energy generation by 2020.

Retail prices are currently not cost reflective for households and businesses, and involve very large cross-subsidies in favour of consumption during peak price periods. This is contributing to a long term deterioration in load factors, which in turn results in substantial generation and network infrastructure investments to maintain reliability. These investments are idle for most of the time, but have to be paid for by consumers and financed by Tasmanian taxpayers.

Increased investment in electricity infrastructure by Tasmanian SOEBs means scarce Government capital is diverted from other priorities such schools and hospitals, or debt reduction.

Somewhat paradoxically, the expected increase in wholesale gas prices strengthens rather than weakens the case for convergent electricity and gas markets. As noted earlier, unit retail gas prices have been falling as a percentage of retail electricity prices.

For the reasons explained above, unit gas prices as a percentage of unit electricity prices can be expected to continue to fall even faster in the future. If carbon is effectively priced, higher future wholesale gas prices affect retail electricity prices more than retail gas prices.

7. IMPACTS ON TASMANIAN COMMUNITIES

Rising domestic energy prices are placing increasing pressure on Tasmanian families and businesses. This in turn raises demand for Budget funded subsidies to low income households, to avoid or minimise fuel poverty.

Tasmania is more exposed to rising energy prices than other jurisdictions. It has the highest reliance on electric space and water heating and the lowest usage of gas. At the same time, average household incomes in Tasmania tend to be lower than the national average.

Tasmanian families are more vulnerable to fuel poverty than other Australians. Fuel poverty arises where households – most likely those in the lower income quartile – spend 10 per cent or more of their household expenditure on domestic energy.

8. COMMENTS ON SPECIFIC ISSUES IDENTIFIED BY REVIEW PANEL

⁹ See page 156 of Appendix B to the Commonwealth Treasury's report 'Strong growth, low pollution: modelling a carbon price'. While the gas price projections relate to the 'medium global action scenario', the key point is that gas transport infrastructure will link domestic and international gas prices.

Tas Gas proposals are relevant to several of the key matters identified in the Independent Review's Issues Paper (discussed in the order as set out in the Issues Paper):

Issue 1: Existence and equitable recovery of energy 'diversity' premium to increase security of supply

The Tasmanian government's substantial investment in the existing gas distribution infrastructure represents part of the State's investment in a diverse and hence more reliable and secure energy system. At present, while taxpayers financed this investment, the bulk of benefits are limited to 9,000 consumers – although electricity-only consumers are also receiving some benefit. The gain from the 'diversity premium' is lower than it should be while most funders of the premium are not receiving potential benefits.

Issue 2: Competing fiscal, SOEB value and price/service outcomes for consumers

Tas Gas considers there is a material risk that the commercial interests of the SOEBs may conflict with broader fiscal, balance sheet and economic objectives. It therefore supports a re-commitment to competitive neutrality between public and private energy suppliers, alongside accompanying implementation and accountability measures.

Issue 3: The extent wholesale electricity market outcomes are efficient and support or hinder retail competition

Tas Gas considers that existing market frameworks continue to favour indirect (via electricity) over direct use of gas and remote over distributed generation. Consequently, they do not deliver efficient outcomes across the energy supply chain and between physical, financial and retail markets. In this context, the presence of a combined energy generator, distributor and retailer in Tasmania may be problematic. The introduction of further retail competition would be desirable as it would encourage innovation, such as dual fuel convergence, and hasten moves to CRRP.

Issue 4: pre-conditions for effective mass market retail competition

As noted earlier, removal of retail regulation and the introduction of CRRP are highly desirable. Dual fuel retail offerings are a key driver in effective energy retail markets, reflecting the significant synergies between gas and electricity supply at the retail, generation and upstream levels. Because of the significant interactions between wholesale and retail competition, we expect that effective wholesale competition would also be an important pre-condition for retail competition.

Issue 5: Whether rising network costs represent value for money

Rising network costs do not represent value for money. This reflects the fact that network prices are not cost reflective, with heavy subsidies during periods of coincident peak demand. It also reflects regulatory arrangements that encourage network supply augmentation over demand side participation.

Issue 6: Energy sector governance and transparency

Tas Gas is concerned that governments may not always treat SOEBs and other energy suppliers operating in Tasmania on an equal basis. This may deter private investment and increase the requirement for investment financed by the State Budget.

9. TAS GAS PROPOSALS

Tas Gas proffers the following proposals for consideration by the Expert Panel:

1. Tasking DIER to form an energy infrastructure panel to:
 - promote and advance a coordinated strategic approach to the planning and delivery of reliable low cost energy to the meet the States needs;

- foster a shared understanding of opportunities and impediments in respect of infrastructure planning and energy delivery between government, infrastructure managers and private sector user groups.
 - advise to Tasmanian Government in respect of those opportunities or impediments;
 - contribute to the Review Implementation process; and
 - enhance transparency and neutrality between public and private energy suppliers in Tasmania.
2. The government commits once again to support competitive neutrality between public and private energy suppliers in Tasmania.
 3. Consider raising the hurdle rate at which SOEBs may invest in network augmentations and extensions above the minimum rate set by the Australian Energy Regulator, in order to mitigate asymmetric network incentives with regard to non-network alternatives.
 4. Tasking the DIER to review the implementation of the Municipal Guidelines under which Tas Gas accesses public roads and other areas controlled by local authorities
 5. Engaging in the AEMC review of distribution reliability standards framework and potentially tasking the TER to review the 2007 distribution network reliability standards to enable efficient and reliable local generation alternatives to network solutions relying on remote generation.
 6. Tasking the DIER to consider extending electricity emergency management arrangements to gas and imposing distribution network performance standards on gas. This is to put gas and electricity on an equal footing in terms of gas emergency arrangements.
 7. Requesting the OTTER move toward CRRP for non-contestable customers, to address falling load factors and likely over-investment in energy infrastructure serving peak demand

Changes where the Tasmanian Government can influence national frameworks include:

1. Enhancing the incentives for electricity networks to support DSP via:
 - 1.1. Placing greater incentives for electricity networks to invest in and support alternatives to electricity network/remote generation solutions; and
 - 1.2. Rule changes to provide for the creation of a clear national framework for embedded generation, along the lines of Guideline No 15 – Connection of Embedded Generation, Essential Services Commission of Victoria, dated July 2004.
2. Supporting the development of a national framework for the introduction of competition in new network connections, to gain the potential gains from competition and multi-utility connections.
3. Encouraging and supporting the removal of current regulatory barriers for the deployment of smart metering, to remove technical and barriers to CRRP and commercial barriers to DSP.