

Part Three

Specification

Introduction

The Electricity Supply Industry Expert Panel Act 2010 (the Act) establishes an independent Panel to conduct an investigation into, and provide guidance to Parliament on, the current position and future development of Tasmania's electricity industry. The terms of reference for the Panel require it to investigate and report on:

1. The current efficiency and effectiveness of the Tasmanian energy industry with particular reference to the existing regulatory framework and the cost and operation of the energy industry elsewhere in Australia.
2. The primary factors that have driven recent increases in non-contestable electricity prices in Tasmania including the impact of major infrastructure development decisions.
3. The competitiveness of non-contestable electricity prices in Tasmania compared with those in other states.
4. The financial position of the state-owned energy businesses: Transend Networks, Hydro Tasmania and Aurora Energy.
5. The impact of interaction between the three state-owned businesses on the effective operation of the Tasmanian energy industry and Tasmanian energy prices.
6. Having regards to trends in electricity prices and market developments at the national level and Tasmanian-specific circumstances, the implications of Tasmania's market and regulatory arrangement for electricity tariffs over the coming years.
7. Actions that would guide and inform the development of a Tasmanian Energy Strategy particularly in relation to the Government's primary objectives of minimising the impact on the cost of living in Tasmania and ensuring Tasmania's long term energy sustainability and security.
8. The advice that was provided to the State Government by the senior management or Directors of Aurora Energy from 1 October 2009 to 16 June 2010 inclusive.
9. Any other matters that the Expert Panel considers are relevant to the above matters.

The Panel is supported by a small Secretariat, which is responsible for:

- managing and undertaking the detailed work program under the direction of the Panel;
- undertaking research relevant to the review;
- represent that Panel in engaging with stakeholders on issues relevant to the Inquiry; and
- the development of papers, advice and other materials for the Panel's consideration and the preparation of reports on its behalf.

The Panel is seeking to appoint an **economic advisor** to assist it meet its Terms of Reference. The principal focus of the consultancy is to assist the Panel identify the efficiency and effectiveness of the Tasmanian electricity market and to assess the potential impact of changes in market structure and regulatory arrangements on the **economic** (as distinct from the technical and financial) performance of the Tasmanian electricity system. A second objective of the assignment is to develop qualitative and quantitative advice in relation to the outlook of prices in Tasmania, particularly (but not limited to) the impact of carbon pricing on Tasmanian wholesale energy costs.

The successful Tenderer is expected to have a:

- deep understanding of the operation of the National Electricity Market, and preferably a solid understanding of the Tasmanian region of the NEM;
- comprehensive existing market modelling capacity of the NEM, and particularly the Tasmanian region;
- team that includes strong competition economics/industrial organisation capability, preferably in an energy context.

The successful Tenderer will be expected to work closely with the Secretariat and the Panel's Financial Consultant (Ernst and Young) in fulfilling this assignment. A key element of the selection decision is the ability of the Tenderer to work with the Secretariat to enhance its understanding of the detail economic matters relevant to the scope of this assignment.

Objectives of the Consultancy

The primary objectives of the consultancy are to:

- Assist the Panel in analysing the current economic efficiency of the Tasmanian electricity wholesale markets (the spot market, contract and FCAS markets) and their interaction with related markets in the context of:
 - Tasmania's participation in the NEM;

- existing policy and regulatory arrangements;
 - efficient management of Tasmania’s hydro-electricity system with its variable water inflows; and
 - The size and profile of Tasmania’s electricity demand.
- Work with the Panel and the Secretariat in the development of structural, regulatory and governance options to address any identified inefficiencies in the performance of the market;
 - Undertake analysis and modelling of structural, regulatory and governance reform options to determine the nature and extent of anticipated changes in the performance of the market, including the impact of introducing full retail contestability;
 - Undertake modelling and analysis of the forward projections for Tasmanian electricity prices, with particular regard to the impact of national carbon pricing arrangements.

1. Wholesale Market Efficiency

A range of informed commentators have made observations about the efficiency of the Tasmanian wholesale market and the nature of the outcomes arising from its current structure. It is argued by some that the structural features of the wholesale market in the Tasmanian region of the NEM, including Hydro Tasmania’s dominant position and its commercial arrangements with Basslink, create a range of incentives for commercial behaviour that generate outcomes that are inconsistent with those that might be observed in a more competitive market.

On the other hand, Hydro Tasmania has argued that a range of considerations (such as its contracting position and spot market participation by customers) mitigate its ability to utilise any transitory market power that it might possess in the Tasmanian region of the NEM.

A key task for the Panel is to analyse the structure, incentives, behaviour and outcomes within the Tasmanian wholesale market and determine the extent to which these drive outcomes that reduce the static and dynamic efficiency of the energy, contract and FCAS markets and the wider consequences of these outcomes for the Tasmanian economy (for example, to what extent do these result in economic transfers rather than efficiency losses).

Through the completion of this consultancy, the Panel is seeking to develop its understanding of the following matters:

- How and to what extent is the current structure of the Tasmanian wholesale market giving rise to market power in the energy, contract, FCAS and other markets. What is the range of incentives that empower Hydro Tasmania to exercise, or not exercise, market power in these markets?
- What evidence is there that market power has been exercised and what are the likely consequences? Is there evidence that the potential to exercise market power is being mitigated by other incentives that promote efficient behaviour and outcomes?
- To what extent does the exercise of market power (or the potential to do so) create a deterrent to entry in the Tasmanian wholesale and/or retail markets, and how important is it relative to wider issues such as the size and shape of the demand side of the industry in Tasmania and the size and variability of the hydro-electric system (relative to demand and other on-island generation options)?
- What are the consequences of market power for dynamic efficiency in the Tasmanian energy sector and more widely?

The Panel considers that addressing these questions through qualitative and quantitative analysis will lay the foundation for the development of sound policy advice on reform directions for the Tasmanian electricity sector. A key aspect of the work is expected to be market modelling of the Tasmanian region of the NEM to identify and separate the impacts of strategic bidding and related behaviour from the consequences of more typical competitive market behaviour.

The Panel is seeking a fixed-price bid to complete this package of work.

2. *Reform Scenarios*

The Panel is seeking to develop a number (probably 3) of potential reform paths that would be assessed, along with the status quo, against a suite of energy policy objectives in order to develop recommendations for reform for the Tasmanian Parliament's consideration. A core task of this assignment is to work with the Panel and Secretariat to develop these reform paths and to undertake the analysis and modelling of their impact on the Tasmanian electricity sector (particularly in relation to the competitive sectors).

The reform paths will be internally consistent packages of structure, regulatory and/or governance changes that aim to improve the efficiency and effectiveness of the Tasmanian energy sector, and are expected to be more broadly based than the wholesale market alone. The reform measures could include combinations of:

- changes in the structural design of the Tasmanian electricity supply industry, including potential options to address competition-related matters in the wholesale and retail sectors (including the introduction of full retail contestability) and potential changes in the network businesses to drive greater efficiency;
- changes in the market design in Tasmania, including for example, potential changes to the financial and market-related operation of Basslink (such as it becoming a regulated interconnector) or changes in the application of the NEM regional boundaries;
- changes in governance arrangements that apply to the SOEBs or Tasmanian-based regulatory arrangements to alter the nature of commercial incentives that drive the behaviour of the businesses; and
- the enhanced rollout and/or uptake of natural gas in Tasmania.

The Panel wishes to examine the market-related outcomes of the reform packages, which is a core task for the consultant under this assignment.

A key aspect of this task is to model the impacts the reform scenarios identified by the panel are expected to have on future Tasmanian spot, contract and retail prices compared to a business-as-usual scenario.

The Panel is also seeking to understand financial consequences of the reform packages for the SOEBs and for the Tasmanian Government. This aspect will be the responsibility of the Panel's Financial Adviser, and it is imperative that both work together to integrate the output of the economic work into the financial model being developed by the Financial Adviser.

Given the lack of specificity at this time regarding the nature and number of potential reform paths the Panel may consider, the Panel is not necessarily seeking a fixed-price bid for this aspect of the assignment. Tenderers are requested to consider either a fixed-rate approach or an hourly-rate approach to this aspect of the assignment and to explain the rationale and details of that approach in their tenders.

3. Future Tasmanian Electricity Prices

Terms of Reference 6 requires the Panel to consider the outlook for Tasmanian electricity prices. This work will need to reflect the anticipated impact on electricity costs and prices of existing cost drivers such as network investment requirements, the reform options identified by the Panel as well as the impact of external cost and price drivers such as the introduction of a national carbon pricing scheme and the operation of the Commonwealth renewable energy programs.

As one aspect of this task, the successful tenderer will be required to model the impacts the reform scenarios identified by the panel are expected to have on future Tasmanian spot, contract and retail prices compared to a business-as-usual scenario.

Given the large share of hydro-electricity in the Tasmanian region of the NEM, coupled with Hydro Tasmania's price-setting abilities in the Tasmanian region of the NEM, the extent to which carbon pricing will impact on Tasmanian wholesale electricity costs requires careful analysis. The Panel is keen to understand, *inter alia*, the wealth transfers that are likely from a price on carbon in relation to the Tasmanian energy market.

The Panel's approach to this aspect of the assignment will be to specify a national carbon-pricing scenario (in discussion with the successful Tenderer), and for the successful Tenderer to model the ramifications of that scenario for Tasmanian wholesale electricity spot and contract prices.

Another key driver of future retail prices is the Commonwealth Renewable Energy Programs. The Panel considers it necessary for its Reports to canvass the potential impact that these arrangements will have on retail prices, and, therefore, seeks some informed market observations (but not detailed modelling) about the likely future prices of certificates under the Large-Scale Energy Target and the Small-Scale Renewable energy Scheme and the subsequent impacts on Tasmanian retail prices.

The Panel is seeking a fixed-price bid for this aspect of the assignment. Tenders are requested to outline the methodology that they would utilise to undertake this aspect of the assignment.

Other work streams

The Panel is progressing other work streams that will interconnect with this economic analysis consultancy. At this time, the Panel is working with specialist advisers to examine:

- the efficiency and effectiveness of the SOEBs; and
- the financial position of the SOEBs.

The efficiency and effectiveness work will examine how the technical performance and cost structures of the SOEBs have changed over time, and how they compare with relevant peers. It is not anticipated that there will be any material cross-over between that work and that of the economic adviser.

The first stage of the financial performance work aims to, *inter alia*:

- understand the financial performance of Hydro Tasmania, Aurora Energy and Transend Networks, over time, particularly the primary drivers of value and the financial linkages between them – this aspect includes the development of an integrated financial model of the Tasmanian electricity sector;
- compare financial performance with like entities elsewhere;
- understand the impacts of diversification; and
- examine the likely benefits, consequences and risks of the integration of Aurora Networks and Transend Networks.

The Panel expects that the economic consultant will work with the financial consultant to evaluate the portfolio benefits arising from the current ownership arrangements in Tasmania.

The second phase of the financial advisory assignment is to work with this economic consultancy in modelling the impact of reform scenarios on the financial performance of the SOEBs. It is anticipated that the market modelling produced by the economic consultant under this assignment in respect of the reform paths will provide a key input into the financial modelling that will be undertaken by the financial adviser.

The Panel sees this as a material risk in it successfully meeting its objectives. Accordingly, in preparing a response to this scope, Tenderers are requested to identify how they would interact with the financial advisor (including identifying roles and responsibilities) in working through the qualitative and quantitative assessment of reform paths. **Tenderers must specify previous case studies that highlight their ability to successfully interface with financial consultants to deliver integrated market-related and commercial/financial-related assessments.**

With the above in mind, it will be very important that each of these work programs maintain close relationships with Secretariat to ensure that there is no duplication in effort and that all three bodies of work come together in an integrated manner for the Panel's consideration and reporting purposes.

Time frames

The assignment will commence as soon as practical. It is anticipated that the Tender process will be resolved and the contract awarded in late May 2011.

The Panel would like the market power analysis work completed as quickly as practicable, and before late-June 2011. The Panel will be guided by Tenderers regarding the timeframes required to complete the work, and how it might be scheduled.

The Panel would like to commence the work on the implications of a price on carbon and the renewable scheme costs in June, providing that sufficient clarity on national approaches is available at that time to specify the scenario to be modelled.

The timeframes for the modelling of the reform paths are not as clear at this time, but it is expected that this work could be commenced in mid-June 2011. It is anticipated that this work would need to be completed in mid-August 2011.

Methodology

This brief highlights the Panel's objectives for the assignment, and deliberately does not specify how it believes Tenders should go about meeting those objectives. This is a central issue for Tenderers, and the clarity and quality of the proposed methodology is a critical element of the selection decision.

Tenders are required to explain how they will go about achieving **each of the objectives** of the consultancy and to identify, *inter alia*:

- the issues that they would seek to address in meeting the assignment objectives;
- the nature of the involvement of each nominated team member;
- the types of information that they would need to obtain (noting that the Panel has wide ranging information gathering powers under the Act); and
- the way in which they would interact with the Secretariat and with the Financial Adviser.

The Consultant will be required to enter into a Tasmanian Government standard Contract for Services Agreement (proforma attached) and should note that expenses for travel, accommodation and allowances are required to be charged at rates allowable to State Government employees.

Deliverables

The intention is for the Consultant to produce written reports and advice for the Panel, and not for publication. It is anticipated that the Secretariat will develop material for public release, based on the materials developed under this consultancy. Accordingly, Tenderers in framing the budget for this assignment, Tenderers are requested to consider the need for documentation to efficiently and effectively communicate the key findings and analysis to the Panel and Secretariat. Long and detailed written reports are considered to be not required.

Selection Criteria

The selection of the successful Tender will be made according to the following selection criteria and weighting:

Criteria	%
Demonstrated experience of the firm and proposed team members in market modelling, competition analysis and analysing market power issues in the energy sector.	20
Demonstrated understanding of the Tasmanian energy sector.	10
Clarity and quality of methodology.	30
Demonstrated ability to work with Financial advisers to deliver integrated analysis	20
Price (hourly rates and overall fee).	20

Information to be provided by the Tender

Tenderers are to provide:

- completed Tender Form;
- a response to the Selection Criteria;
- CVs for all team members and a clear articulation of the roles that each would play in fulfilling the objectives of the assignment, with a reference to past performance of similar roles;
- contact details for at least two client referees able to confirm the Tenderer's ability to meet the Selection Criteria;
- pricing structure, including fees and methodology for charging services – **estimated time of each team member and the costs per hour must be shown for the two aspects of the assignment for which the Panel is seeking fixed-price bids;** and
- details of the Tenderer's insurance cover, including type and amount of cover, policy number, name of insurer and policy expiry dates.