

Australian Competition & Consumer Commission (ACCC)

Retail Electricity Pricing Inquiry – Preliminary Report Response

Submission

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Executive Summary

The Tasmanian Small Business Council (TSBC) welcomes the opportunity to provide a submission to the Australian Competition and Consumer Commission's (ACCC) Preliminary Report on its Inquiry into Retail Electricity Prices.

TSBC Positions on Key Inquiry Issues

We seek the ACCC's consideration of our positions below.

We support strong and vigorous competition in energy markets where possible, including in Tasmania. This is likely to deliver the best sustained price and non-price outcomes for small business. But there have been too many past compromises and trade-offs in this regard.

We are sceptical about the value to consumers of Government regulation in the electricity market, beyond basic consumer and market power protections, and are mindful that regulation often has unintended consequences.

We support the Tasmanian Government's decision earlier this year to cap wholesale market prices used in the determination of Tasmanian regulated retail electricity tariffs, as this avoided exposing our sector to large wholesale price increases. However, we also recognise that this approach may not be sustainable and could have unintended consequences.

Regulation of retail electricity prices for small customers in Tasmania, including small business, is also an impediment to new entry into the Tasmanian electricity retail market, although it has delivered electricity prices to small business that are below national average standing offer prices (no comparison is made with discounted market offers). Despite the absence of competing retailers for small consumers in Tasmania, regulated tariffs contain unjustified Customer Acquisition and Retention Cost (CARP) and a premium on Aurora's retail margin based on the presence of (non-existent) competition.

The absence of structural reform in the Tasmanian wholesale market is a major reason for the lack of retail competition and the related absence of competitive prices and retail offers.

The TSBC generally favours private over government ownership, believing this to deliver superior outcomes to consumers, but notes that electricity privatisation has too often favoured asset proceeds over competition. Government owned Tasmanian generators and retailers has created virtual monopolies and left the market devoid of choice and competing offers for small business, with regulation a response to the resulting market power. There is significant evidence from sources such as the Australian Energy Regulator's (AER) economic benchmarking studies that privately owned networks in the NEM are more efficient and productive than government owned ones.

The Renewable Energy Target (RET) adds 5 per cent to the costs of electricity for Tasmanian small businesses. With wind and solar now cost competitive with thermal generation, it is time to end the RET and there should be no further expansion of it after 2020.

The lack of action on and uncertainty about carbon reduction policy is contributing to investment uncertainty and higher wholesale prices in the NEM, with Tasmania impacted by virtue of its links to the NEM wholesale market. This is of concern to the TSBC.

The TSBC supports the introduction of electricity competition and choice in Tasmania. Competitive electricity prices and more innovative services are a key outcome sought by Tasmanian small businesses and their absence has been a source of frustration to them.

The Tasmanian gas market suffers from multiple shortcomings – some local and some associated with its links to the mainland – that significantly constrain what it can deliver to small business. These also have implications for electricity through gas-fired generation, fuel substitution and synergies between the two fuels.

Responses to ACCC Preliminary Report

Overall, we find the Preliminary Report to be a welcome addition to, and extension of, the analysis of and knowledge about how the NEM is impacting on electricity consumers, including small business. However, the narrow range of recommendations contained therein is somewhat disappointing, as is the limited attention given to Tasmanian issues. We recognise that this is impacted by its preliminary nature.

We support the ACCC's clear conclusion that the NEM has an electricity affordability problem. It has also reached the broad conclusion that there is insufficient competition in the generation and retail markets, which both raises prices and increases barriers to entry. We concur with this whilst noting that there is virtually no competition in Tasmania.

The 2015/16 Tasmanian cost stack for small business differs from the national cost stack as network charges are significantly larger and retail charges significantly lower. However, in common with national trends, the share of wholesale costs has increased markedly since then (but not by as much as it would have had the State Government not intervened), whilst network charges have fallen significantly).

The ACCC's has found that the wholesale (generation) market is highly concentrated and this is likely to be contributing to higher wholesale electricity prices. In Tasmania, Hydro Tasmania is a dominant generator and hedging provider with the Independent Panel concluding it possessed "latent market power", which deterred new entry. The ACCC's finding is also important to Tasmania due to its links to the mainland (especially Victorian) wholesale market. Up until this year, Victorian wholesale prices have been used to set wholesale costs in regulated tariffs for small business, but the closure of Hazelwood power

station and resultant high wholesale prices prompted the Tasmanian Government to cap Tasmania wholesale prices. We urge the ACCC to examine the Tasmanian wholesale market closely and make recommendations in its Final Report on how it could be improved.

The ACCC has found that concentration in NEM retail markets and vertical integration with generators has disadvantaged non-vertically integrated) retailers and delivered outcomes not consistent with vigorous competition. In Tasmania there is simply no retail competition for small business customers and ERM the only retailer attempting to provide some (not very successfully). Moreover, Aurora Energy has been provided with CARC costs and a retail margin as if it faced competition, which adds costs to small business regulated tariffs.

The Preliminary Report makes few recommendations on how to improve competition in the retail sector and we look forward to a more complete treatment of this in the Final Report.

Network prices and regulation have been identified by the ACCC as making a major contribution to electricity price increases, notwithstanding recent moderation, through excessive allowances and over-investment (gold plating). These issues have also impacted Tasmania and the TSBC has concerns that network prices and regulation need further attention. We have identified a range of issues in our submissions including: remaining imperfections in the regulatory regime, inefficiencies in government owned networks, ongoing monitoring and improvement to recent regime changes, ensuring the AER remains accountable following the removal of Limited Merits Review appeals and the need for ongoing improvements in consumer engagement by networks.

The TSBC does not accept that past excesses in regulatory allowances provided to networks should continue to be borne by consumers, some of them for several decades according to the ACCC. These impacts should be unwound from network charges as soon as possible. The TSBC encourages the ACCC to develop a set of strong recommendations that will deliver better network regulation and efficient prices.

The RET subsidy imposes costs on Tasmanian small businesses. As wind and solar costs have now reduced and compare favourably with thermal generation, it is time to unwind this subsidy. There should be no subsidy for new projects after 2020.

Consumer experience issues raised in the Preliminary Report are relevant in markets where there is retail competition, which is not the case in relation to small consumers in Tasmania. The first order of business in Tasmania is how to create a competitive environment.

Tasmanian Electricity Issues for Further ACCC Consideration

Given the ACCC is undertaking additional work for its Final Report and has made limited recommendations in its Preliminary Report, we repeat below some of the Tasmanian issues raised in our initial submission and not canvassed earlier in this submission. The TSBC looks

to this Inquiry to propose reforms that will deliver competitive retail electricity prices that are commensurate with Australia's rich energy endowment.

We note that neither the CARC nor a competitive market retail margin is consistent with the TER's role of ensuring Aurora does not price with monopoly power and has efficient costs. The review of Tasmanian wholesale market price regulation by the Tasmanian Department of Treasury and Finance referred to in our earlier submission has now commenced.

The ability of Tasmanian small businesses to save through Time-of-Use (TOU) network tariffs may be limited by the nature of their operations, will be offset by (unknown) metering costs and is constrained by Aurora Energy having only recently introduced retail TOU tariffs with little promotion. The timeframe to remove cross-subsidies from Tasmanian small business tariffs is too long (15 years) and the two-block retail tariff is inconsistent with the equivalent network tariff.

Hydro Tasmania dominates the ownership of wind generation in Tasmania and controls access to wind capacity as the only natural seller of firming capacity. This creates an additional barrier to entry. The transfer of the TVPS from Aurora Energy to Hydro Tasmania altered its role from one of competing with Hydro Tasmania to portfolio optimisation and stand-by operation for energy security.

TOU tariffs may stimulate some competition through energy service providers but need to be accompanied by retail competition if consumers are to take full advantage of this.

Energy consultants and brokers can help small businesses access what retail competition and tariff choice exists in Tasmania, but cannot derive a commission where a Regulated Standing Offer Tariff is recommended, which has been further compounded by the capping of wholesale prices in regulated tariffs for 2017/18.

The still to be renegotiated gas transmission contract to supply the TVPS after the end of this year could impact the viability of the Tasmanian gas market and is of concern to the TSBC.

Conclusions and ACCC's Next Steps for the Inquiry

We urge the ACCC to provide a comprehensive blueprint for competitive electricity throughout the NEM in its Final Report focused on the key areas of the wholesale market, network regulation and charges, environmental charges and the retail market. This should include more focus on jurisdictional issues, including Tasmania and small business impacts. TSBC is keen to engage further with the ACCC and would welcome a public hearing in Tasmania.

1 Introduction

The Tasmanian Small Business Council (TSBC) welcomes the Australian Competition and Consumer Commission's (ACCC) Inquiry into Retail Electricity Prices in the National Electricity Market (NEM) and the release of its Preliminary Report. We also welcome the opportunity to provide this submission responding to the Preliminary Report. We draw the ACCC's attention to our earlier submission on the ACCC's Issues Paper for this inquiry which raises issues we hope that the ACCC will address more fully in its Final Report. Many of these issues are important to the Tasmanian small business sector and the benefits (or costs) that they derive from the electricity market in Tasmania.

Our approach to this submission has been to:

- Set out our position in relation to the issues that the ACCC Inquiry raises for small business in Tasmania;
- Respond to the Preliminary Report, especially as it relates to Tasmania and its small business sector; and
- Reiterate a number of points raised in our earlier submission that we wish to draw to the ACCC's attention again to ensure they are considered as the Commission finalises its inquiry.

2 TSBC Positions

The TSBC's positions in relation to the central issues for Tasmanian small business under consideration in this Inquiry are as follows:

- We support strong and vigorous competition in energy markets wherever possible, including in Tasmania, as this is likely to deliver the best sustained price and non-price outcomes for small business. However, we are wary of competition being used as a 'label' for energy markets that are far from being robustly competitive, including in the NEM. There have been too many compromises and trade-offs where competition has been compromised and consumers left short-changed involving maximising the proceeds from the sale of government owned assets, supply-side preferment and jurisdictional priorities (including protecting government owned assets). The ACCC's Preliminary Report contains some examples of this but it has (unfortunately in our view) ignored other glaring ones. The ACCC is encouraged to come up with a forward looking plan that avoids such mistakes in future, places consumer benefit at the 'head of the table' and unwinds past errors.

- We are sceptical about the value to consumers of Government regulation in the electricity market, beyond basic protections, the avoidance of market or monopoly power, or other robustly assessed exceptions. Even seemingly well-intended regulation of the electricity market can often result in unintended consequences that leave consumers worse not better off. The ACCC Preliminary Report has examples of this, as does our earlier submission.
- Having said that, we support the Tasmanian Government's decision earlier this year to cap wholesale market prices used in the determination of Tasmanian regulated retail electricity tariffs. These comprise around 37 per cent of the retail electricity bill of a typical small business and this move kept in check what would have been substantial increases in small business electricity prices with likely significant adverse consequences for our sector, the Tasmanian community and its economy. We note that the decision was itself necessitated by large increases in mainland NEM wholesale electricity prices, especially in Victoria, to which Tasmanian prices were closely linked, itself a consequence of poor policy choices, delays in making decisions, a failure to address market power problems and poor regulation. Some of these faults were outlined in the Preliminary Report, although in our view some were not explored fully enough. Nevertheless, there could be unintended consequences from continuing with such intervention and it is useful that the Tasmanian Government has established a review of wholesale market regulation to assess the future needs of the State.
- We recognise that the continued regulation of retail electricity prices for small customers in Tasmania, including small business, is an impediment to new entry into the Tasmanian electricity retail space. This has been a two-edged sword for Tasmania's small businesses. On the one hand it has delivered standing offer prices that are below the national average and allowed the government to cap 2017/18 retail prices for small consumers. In the case of small business, this has resulted in reductions in prices for small business tariff customers of between 4-6 per cent. On the other hand, it has also been a barrier to the entry of new retailers who could have provided competitive market offers with access to discounts. Moreover, regulated retail tariffs have included costs – such as a Customer Acquisition and Retention Cost (CARC) and premium on Aurora's retail margin that reflect the need for it to compete with other retailers, when it clearly has no competitors and little prospect of having any for the foreseeable future.
- The decision of the former Tasmanian Government not to undertake structural reform of the Tasmanian wholesale electricity market as recommended by the Independent Panel on the Tasmanian Electricity Supply Industry (Independent Panel) in 2012 but opt for regulation of Hydro Tasmania's wholesale contracts instead (and the current Government's continuation of this) has been a barrier to the entry of new electricity retailers and helped prevent the sale of Aurora Energy's retail book.

This has contributed to the absence of both retail choice and competitive electricity offers for small businesses.

- The TSBC generally favours private over government ownership of assets, believing this to deliver greater cost efficiency, productivity and innovation in services. Provided the relevant markets are competitive (or regulated to avoid monopoly excesses where competition is not possible), consumers will benefit from lower prices on a sustained basis. However, again the NEM has been characterised by a series of compromises and poor decisions that have too often favoured owners over consumers, entrenched market power or resulted in poorly conceived regulation with consumers 'short changed'.
- The continued State Government ownership of electricity assets in Tasmania is of concern to the TSBC. The associated virtual monopoly status of both Hydro Tasmania and Aurora Energy has all but eliminated retail choice for small businesses and prevented them from gaining access to the sorts of discounts available in most other parts of the NEM. Even though standing offer tariffs are on the low side compared to elsewhere in the NEM, this takes no account of the absence of discounting.
- TasNetworks' monopoly is unavoidable given its network cannot be economically duplicated but government ownership is a choice of the Tasmanian Government. There is significant evidence from sources such as the Australian Energy Regulator's (AER) economic benchmarking studies that privately owned networks in the NEM are more efficient and productive than government owned ones. We also note that TasNetworks, in line with other network businesses, especially government owned ones, sought large increases in expenditure and excessive rates of return around the turn of the last decade (also referred to in the ACCC's Preliminary Report). Although TasNetworks' recent proposals to the ACCC have moderated, this has been significantly impacted by the position of the Tasmanian Government in supporting lower electricity prices. Nevertheless, we remain concerned that its asset base and expenditures reflect inflated costs that consumers will continue to pay for in decades to come, as the ACCC has observed in its Preliminary Report. Our concern is that it remains inefficient, notwithstanding some welcome recent steps to lower the extent of these inefficiencies, and that current Government support for lower network prices could turn against consumers in future, depending on fiscal and political exigencies. With network charges in Tasmania accounting for around 46 per cent of a typical small business electricity bill, these are important considerations.
- The Renewable Energy Target (RET) now accounts for around 5 per cent of small business electricity costs, having increased its share considerably over the past decade. The TSBC is agnostic in regard to electricity generation technologies whilst recognising the contribution that renewable technologies (hydro-electric and to a lesser but growing proportion wind and solar) make to Tasmania's electricity

production, at the same time keeping its carbon output down. However, the RET subsidy is a costly addition to small business electricity bills and the TSBC does not support its continuation. Over-reliance on intermittent renewable technologies, such as wind and solar, can also create reliability issues or impose additional costs on consumers to keep the system reliable – a concern for Tasmanian small business given its heavy operational reliance on electricity. We note the renewable industry's claims that wind and solar are now cost competitive with thermal generation and on this basis an important argument in support of the RET is no longer applicable. Its removal would help to take some of the pressure off small business electricity bills.

- A lack of action on and uncertainty about carbon reduction policy has been identified as a factor in forestalling investment in new thermal generation and in the price pressures in the wholesale electricity market. Tasmania has sufficient capacity and hence little need for new generation capacity to serve its local consumers at present but, due to its links to the NEM, is being impacted by this policy uncertainty elsewhere in the NEM, including through wholesale price pressures. This is therefore an issue of concern to the TSBC.
- The TSBC supports the introduction of electricity competition and choice for small businesses in Tasmania. Competitive electricity prices and more innovative services are a key outcome sought by Tasmanian small businesses. Notwithstanding the application of FRC in Tasmania, the virtual absence of any real competition for small business consumers has been a frustration for the TSBC and its members.
- The TSBC is concerned with the current state of the Tasmanian gas market which suffers from a range of shortcomings that could even threaten its viability. These include: its very small size; its lack of expansion to attain critical mass; its retail duopoly and the almost complete absence of competitive tension; the high transportation charges imposed by the unregulated monopoly transmission and distribution pipelines; its lack of diversity in gas consumption; the need for the major gas user, Hydro Tasmania's Tamar Valley Power Station (TVPS), to negotiate a new gas transmission contract by the end of 2017; the gas security risk posed by a single source of supply through a single transmission pipeline; and the apparent lack of progress in addressing such issues. Given Tasmania sources gas from Longford Victoria, it is also exposed to the risks to gas supply and gas commodity and transportation price pressures being seen in Eastern Australia.
- The Tasmanian gas market has important relationships to its electricity market including: through the use of gas fired generation, mainly through the TVPS; through its ability to act as a substitute for some forms of electricity use (e.g., space and hot water heating, cooking and some production processes; as the gas market could provide additional market opportunities to electricity retailers entering Tasmania, who mostly offer dual fuels, especially if it is encouraged to grow and expand.

We are seeking that the ACCC consider our positions in its assessment of the Tasmanian electricity market as part of its Final Report and recommend necessary improvements to ensure the market works more for the long term benefit of Tasmanian electricity consumers, including small business.

3 Responses to ACCC Preliminary Report

Below are our responses to the ACCC's Preliminary Report.

3.1 Overall Views

We find the Preliminary Report to be a welcome addition to and extension of the analysis of and knowledge about how the NEM is impacting on electricity consumers, including small business. In some cases, it confirms what is already known and generally accepted but adding the ACCC's authority to this is still important. Whilst the ACCC makes clear that the report is preliminary in nature, that it lacked or did not have the time to consider some information and data in putting the report together, and that it will be undertaking substantially more analysis and assessment in preparing its Final Report, the narrow range of recommendations contained in the Preliminary Report is somewhat disappointing. This also makes responding to the ACCC's current thinking more problematic.

The limited commentary and recommendations on Tasmanian (and other jurisdictionally specific) issues is of concern to the TSBC and we hope that the ACCC will place more emphasis on this in its Final Report, especially as Tasmania has some unique characteristics that differ from most other parts of the NEM (outlined in our earlier submission).

Whilst the formation of the NEM and other reforms that followed, such as the National Energy Retail Law and Rules (NERL and NERR), have created a more national energy market, the jurisdictions still play an important role in determining market outcomes, including competition and prices. In Tasmania, the State Government plays such a role through its ownership of assets, regulation of retail and wholesale prices for small customers, licensing of energy businesses and its role in energy security.

Nevertheless, we welcome both that the ACCC has reached some strong conclusions and that the directions it intends to take on a number of important issues are reasonably clear.

We note that, based on its consultations and information gathering to date, the ACCC has concluded that:

“... there is a severe electricity affordability problem across the NEM and the price increases over the past ten years are putting Australian businesses and consumers under unacceptable pressure.”¹

We would strongly agree with and endorse this comment and note its application to Tasmanian small businesses. Notwithstanding the Tasmanian Government’s decision to cap wholesale price increases for 2017/18 (at least partly due to past electricity price increases) and reductions in TasNetworks’ small business tariffs, this was preceded by earlier large increases in small business electricity tariffs. Tasmanian small businesses were also further disadvantaged by these increases through their inability to seek out competitive market offers and discounts due to the lack of competing retailers.

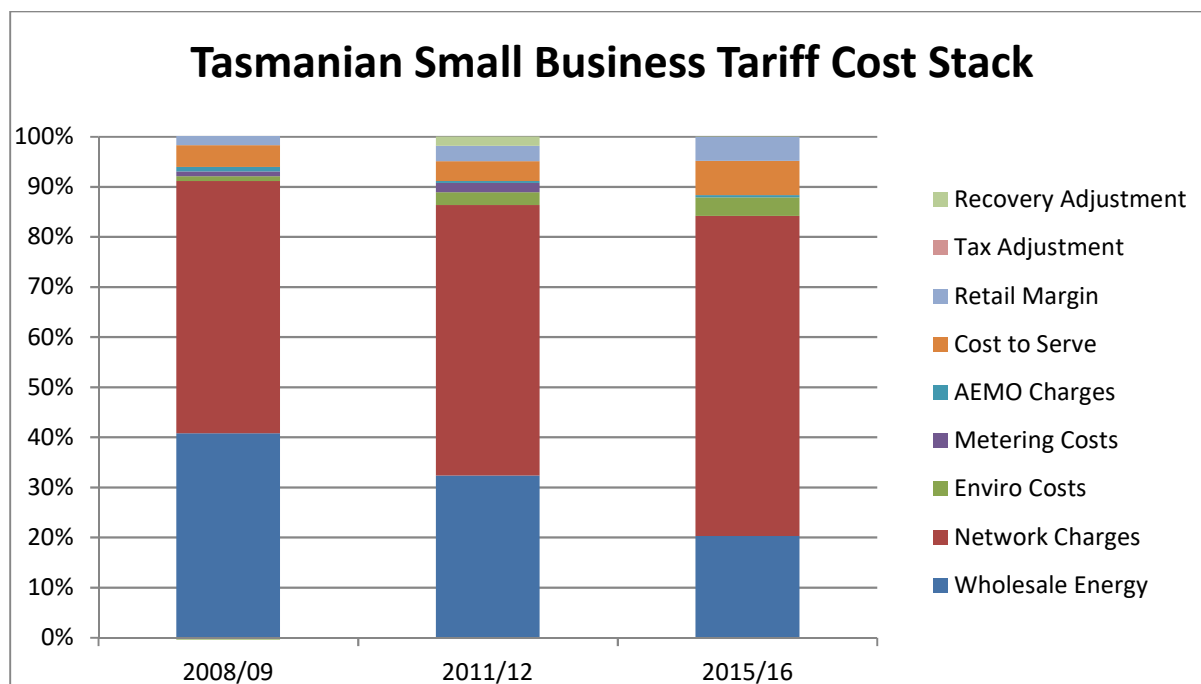
The Commission has also reached the broad conclusions that there is insufficient competition in the generation and retail markets, which both raises prices and increases barriers to entry, that retail price deregulation has benefited some and hurt others, that the market is exceptionally complex, and that consumers have no ability to exit the market. We concur with these conclusions and note that in Tasmania there is virtually no competition in the small business retail market. Consequently FRC operates in a ‘Claytons’ environment and consumers rely on the benevolence of the Tasmanian Government and its three electricity entities to ensure they pay fair and reasonable prices. Whilst the Tasmanian electricity market may not be as complex as most other parts of the NEM, this comes at the expense of a lack of access to competition and discounting.

3.2 Drivers of Electricity Price Increases

Analysis of small business tariffs in Tasmania for the TSBC shows some differences relative to the ACCC’s national cost stack but similar trends (based on annual expenditure). The Tasmanian small business cost stack is shown in the Figure below.

Most importantly, network charges contributed 64 per cent in 2015/16 (compared to 48 per cent nationally), wholesale costs accounted for 20 per cent (22 per cent nationally), retail costs and margin 12 per cent (24 per cent) and environmental costs 4 per cent (7 per cent nationally). Moreover, network charges had increased from 50 per cent in 2008/09, whilst wholesale costs had decreased from 41 per cent. Retail charges have increased from 7 per cent and environmental costs from just 1 per cent.

¹ ACCC, *Retail Electricity Pricing Inquiry – Preliminary Report*, p. 5 (hereafter *Preliminary Report*)
TASMANIAN SMALL BUSINESS COUNCIL



Source: Goanna Energy Consulting Pty Ltd and Savvy Plus Consulting Pty Ltd.

This analysis further shows that wholesale costs increased to 24 per cent in 2016/17 (driven mainly by the treats to Tasmania’s energy security in the second half of that year) and would have increased to 35 per cent of the small business cost stack in 2017/18 were it not for the State Government cap on wholesale prices. Meanwhile, network charges reduced their share to 57 per cent in 2016/17 and 46 per cent in 2017/18, driven by TasNetworks’ lower growth in revenue and the reduction in the small business tariff cross-subsidy. The share of retail charges remained steady.

3.3 How Electricity Markets Are Functioning

We note the ACCC’s comment that “the wholesale (generation) market is highly concentrated and this is likely to be contributing to higher wholesale electricity prices.”² This is of interest to the TSBC for two reasons.

First, as the Tasmanian market is dominated by Hydro Tasmania it certainly has the ability to impact Tasmanian wholesale spot and contract prices should it wish to do so. This was a concern for the Independent Panel who described Hydro Tasmania as possessing “latent

² Preliminary Report, p. 7.

market power” and recommended structural reform to make the Tasmanian wholesale market more competitive and encourage entry by new retailers. The Independent Panel recognised that Hydro Tasmania had shown restraint in exercising its market power but found that reliance on its benevolence was not sufficient to give comfort to potential new entrants. As mentioned earlier, the then Government decided to impose regulation of Hydro Tasmania’s wholesale contracts in the hope of encouraging new retail entry but there has been none forthcoming. This is consistent with the position of potential new entrants in their input to the Independent Panel on the regulatory option for reform.

Secondly, the Tasmanian and mainland NEM wholesale markets are linked (through physical and financial flows) so that outcomes in the latter (especially in Victoria) will have an impact on Tasmania. In the case of smaller customers on regulated retail tariffs, the setting of wholesale costs in these tariffs has, until this year, had a direct link to Victorian wholesale prices. The Preliminary Report makes clear that the closure of coal-fired plant and the subsequent substitution of gas-fired generation (which is subject to gas price and availability pressures) has contributed to wholesale electricity price pressures. It specifically refers to the closure of Hazelwood power station in Victoria as contributing to tighter supply, higher concentration and higher prices in the wholesale market. Given the links that Tasmania has to the Victorian wholesale market this is a matter of concern to the TSBC.

Hydro Tasmania also exercises significant control over the Basslink interconnector and (subject to hydrological considerations) normally exports electricity into Victoria when prices there are high and imports from Victoria when prices there are low. Its control of Basslink adds further to its considerable market power.

We urge the ACCC to examine the Tasmanian wholesale market closely in the lead up to its Final Report and make recommendations on how it could be improved for the long term benefit of Tasmanian electricity consumers.

The ACCC Preliminary Report outlines how retail markets in the NEM have an abundance of retailers but are, for the most part, dominated by ‘the big three’ vertically integrated retailers. The report also shows how this market structure has disadvantaged the smaller and non-vertically integrated retailers through limiting their access to risk management products and produced outcomes for consumers that are not consistent with vigorous competition. In Tasmania retail concentration is even more detrimental to consumers, especially small ones. There is simply no retail competition. ERM has attempted to compete for small business customers but has apparently found the going tough. With little ‘head room’ in regulated tariffs, it has lost customers and market share and the capping of wholesale prices within the retail tariffs for 2017/18 has driven small customers on market contracts back to the safety of regulated tariffs, which are now lower than market offers.

Vertical integration is not an issue *per se*, but government ownership of both Hydro Tasmania and Aurora Energy creates at least a perception of opportunities for joint action and market dominance, which is a barrier to new retail entry. Hydro Tasmania's dominance of the wholesale market also acts as a risk management constraint and deters new entry.

As alluded to earlier in this submission, in setting regulated retail tariffs, the TER sets a CARC and a retail margin for Aurora as if it were competing with a new entrant retailer, which it is not and has no real risk of facing unless current policy settings change. Whilst retail charges remain a far lower proportion of retail bills in Tasmania than nationally, this merely imposes additional (unnecessary) costs on Tasmania's small businesses and households. In the unlikely event that Aurora was to face a competitor, it could always seek to reopen the TER's determination.

Notwithstanding its finding of shortcomings in retail markets, we note that the ACCC has made few recommendations to overcome these in its Preliminary Report. We assume that this is due to the fact that it has not yet completed its analysis of data and information about the retail sector. We look forward to a stronger and more comprehensive set of recommendations and actions in the Final Report. We also urge that, in its Final Report, the ACCC more closely consider the impacts of the Tasmanian specific retail issues we have raised above on Tasmanian consumers and recommend appropriate reforms.

In relation to network charges and their regulation, the ACCC has found that electricity network operators have been able to over-invest in poles and wires as a result of the network regulation framework and the limited merits review (LMR) regime. This is a disturbing but factually correct conclusion. As mentioned in section 3.2, network charges in Tasmanian small business tariffs increased significantly from around 2008/09 until 2015/16 reflecting these factors. Since then network charges for small business have fallen on account of the changes to the regulatory regime mentioned by the ACCC and (even more importantly), the impact of low interest rates on the cost of capital and TasNetworks' moderating its expenditure proposals (in support of the Tasmanian Government's policy to restore Tasmania's advantage in competitive energy).

Nevertheless, the TSBC has concerns about several aspects of network pricing and its regulation, which can embed inefficiencies in energy networks and spark a new outbreak of price increases in future:

- Notwithstanding some improvements, the network regulation remains imperfect (this is recognised in the Preliminary Report) and is in need of further overhaul. Some examples of this include, still excessive rates of return due to inappropriate setting of some Weighted Average Cost of Capital (WACC) parameters (hopefully the current AER review of its Rate of return Guideline will progress this) and setting the cost of debt for government owned networks so that it reflects their actual debt raising costs not (higher) private borrowing costs.

- Available evidence such as AER economic benchmarking of networks and other research confirms that government owned networks are less efficient and productive than privately owned ones, with consumers paying higher prices as a result. Whilst public ownership gives Governments more control over network price outcomes, this can work for or against consumers. In Tasmania at present the Government is supportive of efforts to lower network prices or maintain them at current levels. But this is not always the case with governments also supporting (or turning a blind eye towards) substantial increases in network prices, from which they can benefit financially through higher dividends and taxes.
- There should also be ongoing monitoring of and improvement to recent changes in the regime, including areas such as the capex and opex efficiency benefit sharing schemes, economic benchmarking and service target performance incentives.
- The ACCC has welcomed and supports the removal of LMR. We agree that this means of appeal has worked massively to the advantage of network owners and against consumers. Nevertheless, an appeal mechanism (if well put together) can play an important role in keeping the AER accountable. Our concern is that reliance on judicial review will lower the AER's accountability and will not be accessible to consumers. The AER has signalled that it intends to engage in more detail with networks and consumers after the removal of LMR in order to obtain less adversarial regulatory outcomes. This is welcome but it remains to be seen if it will achieve an acceptable level of accountability and agreement between the parties.
- Consumer engagement has improved but the efforts of the networks need to progress further so that customer preferences are more central to their efforts. We note that TasNetworks is actively engaged in such a process and welcome this.

The ACCC has noted that the impact of past regulatory decisions will be felt in network prices for decades to come, but appears to have accepted this as a *fait accompli*. It is not acceptable to the TSBC that regulatory shortcomings should be paid for by consumers and we strongly urge the ACCC to consider how these can be unwound from network prices, including options such as downward adjustment in asset valuation.

The TSBC encourages the ACCC to develop a set of strong recommendations that will deliver better network regulation with prices based on improved cost efficiency and productivity, efficient rates of return (reflecting realistic costs of debt and equity), the knowledge that private ownership delivers better outcomes for consumers and that involves a high degree of accountability to consumers.

We note and support the ACCC's finding that environmental schemes have increased the cost of electricity to consumers and created cross-subsidies. As alluded to in Section 3.2, they have grown from 1 per cent of small business electricity bills in Tasmania to 5 per cent in less than ten years. Given this and the renewable energy sector's position that the

continuing decline in wind and solar costs is now approaching the point where they can compete with thermal power, we can see no reason why the RET should continue to support new projects beyond 2020. Moreover, under the National Energy Guarantee the RET would be closed off to new projects after that date.

3.4 Consumer Experience

The most significant issue for customer interaction with the Tasmanian retail electricity market is, without doubt, the lack of competition in the market for the reasons explained in other parts of this submission and in our previous submission. The matters raised in the ACCC's Preliminary Report in relation to customer experience are no doubt very important in parts of the NEM where competition is active but are of limited relevance to Tasmanian small businesses in the absence of retail competition. Hopefully, this will change in future including as a result of the ACCC's Final Report. In the meantime, we support many of the findings of the ACCC in relation to gaps in customer interaction with the retail market and look forward to additional recommendations on these matters in its Final Report, recognising that improved interaction with the retail market will benefit Tasmanian consumers once they have access to a competitive market.

4 Tasmanian Electricity Issues for Further ACCC Consideration

Although we do not intend to repeat all the information provided in our submission on the ACCC's Issues Paper here, in light of the limited recommendations in the ACCC's Preliminary Report, its limited coverage of Tasmanian issues and the Commission's intention to undertake further assessments for its Final Report, we will summarise below some of the issues raised in our earlier submission (not discussed earlier in this submission) that are relevant to Tasmanian small business, as well as updating some in light of more recent information. The Commission is referred to our earlier submission and the various supplementary documentation we provided in support of it for more detail.

We reiterate our comment that the TSBC looks to this Inquiry to propose reforms that will deliver competitive retail electricity prices in future that are commensurate with Australia's rich energy endowment, including in Tasmania.

We maintain our belief that neither the CARC nor the high retail margin is consistent with the TER's role of ensuring Aurora does not price with monopoly power and has efficient costs. Aurora's costs and returns are unnecessarily inflated by the TER's approach (i.e., not efficient) and it is possible for Aurora to use this revenue to help it fend off competition.

The review of Tasmanian wholesale market price regulation by the Tasmanian Department of Treasury and Finance referred to in our earlier submission has now commenced³ and the TSBC hopes to contribute input to the review. One early concern we have is that the review should not be narrowly focused and should not focus solely on regulatory options.

The introduction of time-of-use (TOU) network tariffs in Tasmania is estimated by TasNetworks to allow a typical small business to save \$2,400 per annum (42 per cent) compared to 2016/17 tariffs (with around \$1,800 of this accounted for by the cross-subsidy in the legacy network tariff). Such savings are welcome but we note that not all small businesses can take advantage of TOU pricing (e.g., their ability to change their consumption patterns may be constrained by inflexible operations) and to take advantage of TOU tariffs, they must install a three rate meter, which carries additional offsetting costs. In addition, Aurora has only recently introduced corresponding TOU pricing at the retail level and little promotion of these new options has been undertaken.

Additionally, the timeframe for removing cross-subsidies in Tasmanian network tariffs is inordinately long (up to 15 years), disadvantaging those who bear the costs of cross-subsidies (including small business) and there are inconsistencies between small business network and retail tariffs (e.g., the latter contain two consumption blocks).

In Tasmania the RET contributes to the market dominance of Hydro Tasmania, which owns (solely or jointly) nearly all the State's wind capacity and it is virtually the only party entering into Power Purchase Agreements for wind energy as the only natural seller of "Firming" capacity. This poses a further barrier to entry.

Hydro Tasmania also owns the TVPS (previously it was owned by Aurora Energy), which has further enhanced its market dominance and discouraged generator competition. The change in ownership has altered the role of the power station from one of competing with Hydro Tasmania to a portfolio optimisation tool and being operated for energy security purposes. The Independent Panel had recommended the sale of the TVPS, with transfer to Hydro Tasmania being its least preferred option and then only if accompanied by the separation of Hydro Tasmania's trading functions into three competing entities.

The introduction of TOU tariffs in Tasmania should be an incentive for competition in energy services but to be fully taken advantage of by consumers this needs to be complemented by retail competition.

³ See <http://www.treasury.tas.gov.au/government-businesses/strategic-reviews/review-of-the-tasmanian-wholesale-electricity-market-regulatory-pricing-framework>.

Brokers and energy consultants, who can assist small business exercise choice and access competing market offers find the Tasmanian market difficult due to the lack of competition, a situation exacerbated by the capping of 2017/18 wholesale prices in regulated tariffs, which has resulted in market offers often being higher than regulated tariffs. A brokerage firm identifying a regulated tariff as the most economical choice for the consumer is unable to access a Retail commission where the consumer takes up that impartial advice.

At the time of writing, the contract for gas transmission to the TVPS (which needs to be renegotiated by the end of the year) remains outstanding. As indicated in our previous submission, the existing contract largely underpins the viability of the Tasmanian Gas Pipeline (TGP) and keeps transmission charges for all gas customers lower. This is a matter that could impact the survival of the Tasmanian gas market and the access of Tasmanian small business to gas. We remain hopeful that it will be satisfactorily resolved but register it as an ongoing concern for the ACCC Inquiry to consider.

5 Conclusions and ACCC's Next Steps for the Inquiry

The ACCC has said that it intends to undertake additional work and thinking in the period between the release of its Preliminary Report and due date for its Final Report. We welcome this and urge that it focus on the key areas of the cost stack, that is, how to improve the wholesale market, network regulation and pricing, environmental charges and the retail market. On the latter, its competitiveness, its costs and what reforms would benefit consumers would seem to be paramount for consumers.

More generally, we note the limited range of recommendations and actions in the Preliminary Report and urge the ACCC to provide a comprehensive blueprint for competitive electricity throughout the NEM in its Final Report. Its information gathering powers can be used to assist in this regard. Moreover, we would welcome a stronger jurisdictional focus encompassing Tasmania and its small business consumers.

The ACCC has indicated that it intends to engage with consumers, electricity businesses and other stakeholders in developing its Final Report, that it may hold meetings with stakeholders and that it may convene public hearings. It should include Tasmania in such consultations, including public hearings. The TSBC would welcome additional engagement with the ACCC as it prepares its Final Report, including in helping it formulate its final recommendations, especially as they impact Tasmanian small businesses.