Goanna Energy Consulting Pty Ltd

Tasmanian Small Business Council
Uniting Small Business

# Australian Competition & Consumer Commission (ACCC)

## Retail Electricity Pricing Inquiry – Issues Paper

*Report Submission*

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# Executive Summary

- Review of Assumptions
- Statement of Reasonableness

Goanna Energy Consulting Pty Ltd

Tasmanian Small Business Council
Uniting Small Business

# Executive Summary

The Tasmanian Small Business Council (TSBC) welcomes the opportunity to participate in the ACCC's Retail Electricity Prices Inquiry. We provide a voice for Tasmanian small businesses on range of issues, including electricity. Tasmanian small businesses are highly reliant on electricity and have been hit hard by recent electricity price increases. They are concerned that the path of future electricity prices is significantly upwards. We look to this Inquiry to propose reforms that will deliver competitive retail electricity prices in future that are commensurate with Australia's rich energy endowment. This submission focuses on issues from a Tasmanian small business perspective.

Tasmania's retail electricity market is different from other parts of the NEM: it is virtually devoid of retail competition for smaller consumers; retail prices for small consumers are regulated; generation is predominantly hydro-electric (energy constrained) and one generator, Hydro Tasmania, has 95 per cent of capacity; Basslink provides a single unregulated DC link to Victoria operated under contractual arrangements with Hydro Tasmania; there is a lack of liquidity in the wholesale market; all the main electricity entities are State owned; and nearly all smaller customers remain on regulated standing offers. These characteristics have implications for the issues under consideration in this Inquiry.

## Issue 1 – Prices, costs and profits

Regulated retail prices (standing offers) for small customers in Tasmania are approved annually by the Tasmanian Economic Regulator (TER). Wholesale, network, Renewable Energy Target (RET) and market charges make up 88 per cent of the retail price and are passed through, i.e., not determined by the TER. The remaining 12 per cent are retail costs and are TER determined. Aurora's retail costs increased from $39.6 million in 2008/09 to $58 million in 2017/18, an increase of 46 per cent. An increase of this magnitude is of concern to the TSBC as TER regulation is intended to prevent monopoly power being exercised by Aurora and to approve only efficient costs. We have doubts about this.

A TER biannual comparison of Tasmanian standing offers with those elsewhere in Australia shows that Tasmanian standing offers for small business are at the lower end of the range. However, this does not compare standing offers with the significant market offer discounts available to small businesses in most other parts of the NEM. According to the Australian Energy Regulator (AER), these can be up to 22 per cent in Victoria.

The TER includes a retail margin and Customer Retention and Acquisition Costs (CARC) in its allowance for Aurora's standing offer. Both components raise points of contention.

The inclusion of CARC is controversial as Aurora faces no retail competitor and is unlikely to. It is reasonable to suggest that it has no need for this expenditure (and that it may even allow Aurora to fend off potential new entrants). Regulators in other NEM jurisdictions with weak or no competition have either not allowed CARC or questioned its need. In its 2016 Determination, the TER also queried the need for CARC but still included a reduced allowance. It did so in a non-transparent way. We estimate that CARC cost Tasmanian smaller energy consumers $16.4 million for the two and a half years up to 30 June 2016.

The TER's approach to setting Aurora's standing offer retail margin is also controversial as it reflects that Aurora faces competitors. In its 2013 Determination, the TER increased the retail margin from 3.7 per cent (which applied when Aurora had a small customer monopoly) to 5.7 per cent. We estimate that the higher retail margin costs smaller electricity consumers $10.8 million annually.

We believe that neither the CARC nor the higher retail margin is consistent with the TER's role of ensuring Aurora does not price with monopoly power and has efficient costs. Should a robust competitor emerge, Aurora can seek to have the TER's Determination changed.

Whist not directly under inquiry by the ACCC, rises (or falls) in spot prices will impact retail prices, albeit muted by hedging. Following an extended period of subdued prices, the past year or so has seen large increases in NEM wholesale prices driven by thermal generator closures, subsidised renewables, and gas price and supply uncertainty. This has also been the case in Tasmania, which has a strong link to Victorian wholesale prices. Aurora's 2017/18 pricing proposal forecasts wholesale costs of $181.4 million for 2017/18, up from $132.2 million the year before, an increase of $49.2 million, or 37 per cent.

There have been a series of interventions to help prevent Tasmanian retail prices increasing significantly due to wholesale price increases. Hydro Tasmania capped 2017/18 wholesale prices at 2018/19 future price levels, a difference of $20/MWh. Meanwhile, the Government has capped regulated prices for 2017/18.

After more than a decade of vertical integration, three retailers—AGL Energy, Origin Energy and EnergyAustralia—supply 70 per cent of retail electricity customers in the NEM and have expanded their market share in NEM generation capacity from 15 per cent in 2009 to 48 per cent in 2017. In Victoria, they hold a 70 per cent retail share and a 64 per cent generation share. The extent of vertical integration is a concern for wholesale prices in Tasmania given the strong links to Victorian wholesale prices. It has reduced participation in contract markets and reduced their liquidity, posing a potential barrier to entry and expansion for generators and retailers that are not vertically integrated. They provide an important source of competition in the NEM and this may also impact entry to the Tasmanian market.

Network charges make up nearly 60 per cent of smaller customers' retail bills. They increased significantly from 2008/09 to 2012/13 due mainly to regulatory shortcomings, but have moderated since due to the removal of some of these shortcomings and more modest regulatory proposals. The Tasmanian Government has also sought to have TasNetworks moderate its price increases due to concerns about business and consumer impacts.

TasNetworks' 2017 Distribution Determination and a reduction in cross-subsidies in the main small business tariff would see an average small business reduce its electricity bill by $1,800 (32 per cent) between 2016 and 2019. According to TasNetworks, a typical small business adopting time-of-use pricing would save $2,400 (42 per cent) assuming it could take advantage of such tariffs, which not all small businesses can. These are welcome reductions in network charges and would translate into 14-18 per cent reductions in retail bills. However, severe wholesale cost increases have lead Aurora to estimate that average small businesses will see annual retail bills reduced by only between 4.1% and 5.7%.

The Renewable Energy Target (RET) adds to retail electricity prices in Tasmania and accounts for over 5 per cent of a small business bill. RET costs of $27.5 million are forecast for 2017/18. This compares to a RET pass through of only $5.1 million for 2008/09. Suggestions that RET induced capacity places downward pressure on wholesale prices to offset the costs of the RET subsidy may have some validity in the short term, but as thermal generation supply exits the market in response, wholesale prices will increase (as is now occurring). In Tasmania there is the added complication that all wind capacity is wholly or partly owned by Hydro Tasmania. The increasing cost of the RET is of concern to the TSBC.

Metering costs have increased substantially from $1 million in 2008/09 to $13.2 million in 2016/17. With the adoption of new time-of-use tariffs by TasNetworks, there will be an associated need to install advanced meters with communications. Although commencing on an opt-in basis, eventually all Tasmanian consumers will be assigned to the new tariffs. However, the meters are an additional (still unknown) cost that will offset to some extend any benefits from the new tariffs. Rising metering costs are of concern to the TSBC.

There are cross-subsidies in Tasmanian electricity prices, with the main small business retail (T22) and network (TAS22) tariffs being the source of a cross-subsidy. This imposes costs, inefficiencies and distortions on electricity and gas markets, small business and the State's economy. A 2016 study by Goanna Energy Consulting commissioned by us found that the cross-subsidy imposed a $400 annual cost on a typical small business, with a total annual cost of $10 million to the sector. The cross-subsidy will be removed over a long period of up to 15 years, due to the political impacts of the subsidy on heating and hot water tariffs.

Aurora's T22 retail tariff contains a two block consumption component (the TAS22 network tariff has a single use block), with the first block levied at a higher rate than the second, the TAS22 usage component and the equivalent residential tariff. Aurora says this reflects the costs of serving small business but has provided no evidence of this.

Whilst the TSBC welcomes the removal of cross-subsidies, we support a shorter transition and the removal of Aurora's higher rate first-block consumption charge.

## Issue 2 – Market structure and the nature of competition

It is disappointing and frustrating to the TSBC that there is very little retail competition in Tasmania, including for small business customers. Aurora retains a market share of 99.7 per cent. Only 110 or so small business customers do not have Aurora as their retailer. Moreover, only about 15 per cent of small businesses are on a market offer, with 98 per cent of these being with Aurora. This places Tasmanian small businesses at a disadvantage compared to their peers in most other parts of the NEM who benefit from competition, including through price discounting.

It can be argued that regulated prices for Tasmanian small businesses are relatively low, but a lack of 'headroom' in these prices also discourages competition. Even though competitive retail electricity markets have not always worked in the interests of consumers (as argued in a recent Grattan Institute report), the shortcomings of such markets are surmountable and price regulation, which has its own shortcomings, should be a last resort.

The introduction of time-of-use tariffs in Tasmania should be an incentive for competition in energy services but is not a substitute for retail competition but rather complementary to it.

For Tasmanian small businesses a better price seems to be the primary attraction of retail competition, but they have limited and sporadic access to it. ERM have tended to rely on energy consultants and brokers to help them win and retain small business customers, but less so now than in the past. At the low consumption end of the small business market, brokers are more heavily used to save on search and transaction costs. Our limited analysis of the AER energy price comparator tool revealed offers from only two retailers (Aurora and ERM) with only a few small business offers and virtually no price competition. Time-of-use tariffs offered the prospect of more significant cost savings, provided they could be taken advantage of, but not all small businesses can do so. Non-price retail competition is of secondary importance. Market offers have become uncompetitive with standing offers and small business in retreating to standing offers.

The impediments to retail competition in Tasmania include:

- The small size of the market is an impediment but is not insurmountable.

- A lack of 'headroom' in standing offer retail tariffs may have failed to stimulate retailer interest in competing this away. Meanwhile, the provision of CARC allowances and retail margins reflecting competitive market conditions has left small business consumers with higher prices but no real competition.
- The delays in introducing FRC may have deterred interested retailers.
- Aurora's position as a dominant government owned retailer may also have done so.
- The dominant position of Hydro Tasmania in generation and in the Tasmanian wholesale market (hedging) is a major barrier to retailer entry. Having rejected the option of breaking up Hydro Tasmania into three separate 'gentailers', the then Government opted to regulate its wholesale contracts instead. However, this has failed to entice any new entrants. It must be judged to have failed in its objective.
- Transferring ownership of the TVPS from Aurora – which used it to hedge its exposure to Hydro Tasmania's market power – to Hydro Tasmania, has created a barrier to competition. Presently, TVPS is of no competitive value.
- On the consumer side, a lack of knowledge and sophistication, search costs and times, few offers with limited benefits and inertia are likely barriers to competition.
- Tasmania's gas market is also a barrier to competition in electricity retailing and *vice versa*. This market is small (even compared to electricity), is a retail duopoly, has high unregulated monopoly transportation charges, is heavily dependent on gas generation and is a policy backwater. In common with the rest of eastern Australia, there are also uncertainties about future gas prices and supply. A dark cloud hanging over its future – possibly even its survival – is a need to renegotiate the contract to supply gas to the TVPS by the end of 2017.

There is evidence of retailer interest in entering the Tasmanian market. Several retailers indicated this to the Expert Panel and in retailer interviews by Goanna in a study for the TSBC. The main obstacles were similar to those mentioned above with further wholesale and retail market reform needed to entice retailers into Tasmania.

## Issues 3 – Customers and their interaction with the market

The single biggest impediment to small business choice of electricity provider in Tasmania is the lack of retail competition. On other potential obstacles mentioned in the Issues Paper:

- Retail offers in Tasmania are no more complex but are fewer and less competitive.
- The structure and content of bills is also similar but can still be improved.
- For small business, non-price factors are secondary to price though not irrelevant.
- Small business switching is very low in Tasmanian due to a lack of competition.
- Aurora is the only retailer offering both electricity and gas. Bundling of other items with power is possible. Small businesses can benefit and save from bundling.
- The AER's energy comparator tool is potentially useful to small business but the lack of competition and competitive offers limits this. We believe that awareness is low.
- Time-of-use tariffs may benefit Tasmanian small businesses depending on their operations and advanced metering costs. A lack of retail competition is a limitation.

**Recommendations** for the ACCC to consider are shown prominently in the submission.

# Table of Contents


Acknowledgements & Disclaimer ... 2

Executive Summary ... 4

1. Introduction ... 11

2. Prices, Costs & Profits ... 13

2.1 Retail Prices and Price Regulation ... 14

2.1.1 Regulation of Retail Prices ... 14

2.1.2 Comparing Tasmanian Standing Offers ... 15

2.2 Retail Component ... 16

2.2.1 Customer Acquisition and Retention Costs ... 16

2.2.2 Retail Margin ... 17

2.3 Wholesale Prices ... 18

2.3.1 Tasmanian Wholesale Prices ... 18

2.3.2 Vertical Integration in the NEM and Tasmanian Wholesale Prices ... 20

2.4 Network Charges ... 22

2.5 Renewable Energy Target Costs ... 23

2.6 Metering Costs ... 24

2.7 Cross-Subsidies and Time-of-Use Tariffs ... 24

26

3. Market structure and the nature of competition ... 27

3.1 Competition between Electricity Retailers in Tasmania ... 27

3.2 How Retailers compete in Tasmania ... 29

3.3 Impediments to Retail Competition in Tasmania ... 32

4. Customers and their interaction with the market ... 36

4.1 Impediments to Small Business Choice in Tasmania ... 36

4.2 How the Ability to Choose can be Improved ... 37


## Tables


Table 1: Number of Tasmanian Electricity Customers by Type ... 28

Table 2: Breakdown of Tasmanian Standing Offer and Market Offer Customers ... 28

Table 3: Summary of Small Business Market Offers in Tasmania ... 31

Table 4: Retailer Views on Tasmania Retail Electricity ... 34

# Figures

Figure 1: Breakdown of a Typical Tasmanian Retail Electricity Bill ........ 14
Figure 2: Wholesale Settlement Prices – Tasmania and Victoria ........ 19

# 1

# INTRODUCTION

# 1 Introduction

The Federal Government has requested that the Australian Competition and Consumer Commission (ACCC) inquire into the retail electricity market. The Tasmanian Small Business Council (TSBC) welcomes the opportunity to participate in the ACCC's Inquiry, initially by providing this submission in response to the ACCC's Issues Paper.

The TSBC provides a voice for Tasmanian small businesses and advocates on their behalf. It has taken a strong interest in Tasmanian electricity issues for a number of years. This Inquiry provides an important opportunity for us to raise issues relevant to the ACCC's deliberations from a Tasmanian small business perspective.

Electricity prices and how they are determined is of vital interest to small businesses in Tasmania. They are highly reliant on electricity to sustain their operations and have been hit hard by recent electricity price increases. They are concerned that the future path of electricity prices could well involve further significant increases. There are many Tasmanian small businesses for which electricity now makes up their second or third most important operating cost after labour.

The Tasmanian retail electricity market is virtually devoid of competition – at least as far as smaller consumers are concerned – and this is an issue which has concerned the TSBC for some time. We believe that Tasmanian small businesses are disadvantaged by this and look to this Inquiry to begin a process of reform to improve the current situation by putting in place a series of reforms that will deliver more competitive electricity prices in future that are commensurate with our rich energy endowment as a nation.

Being a Tasmanian focused organisation, the TSBC has taken an approach in this submission of responding to questions and matters raised in the Issues Paper from a Tasmanian small business perspective. We have structured this submission along the lines of numbered Issues and Questions presented in the Issues Paper.

2

# Issue 1:
# Prices, Costs & Profits

- Retail Prices and Price Regulation
- Retail Component
- Wholesale Prices
- Network Charges
- Renewable Energy Target Costs
- Metering Costs
- Cross-Subsidies & Time-of-use Tariffs

# 2 Prices, Costs & Profits

The Tasmanian retail electricity market differs from that in most other parts of the NEM:

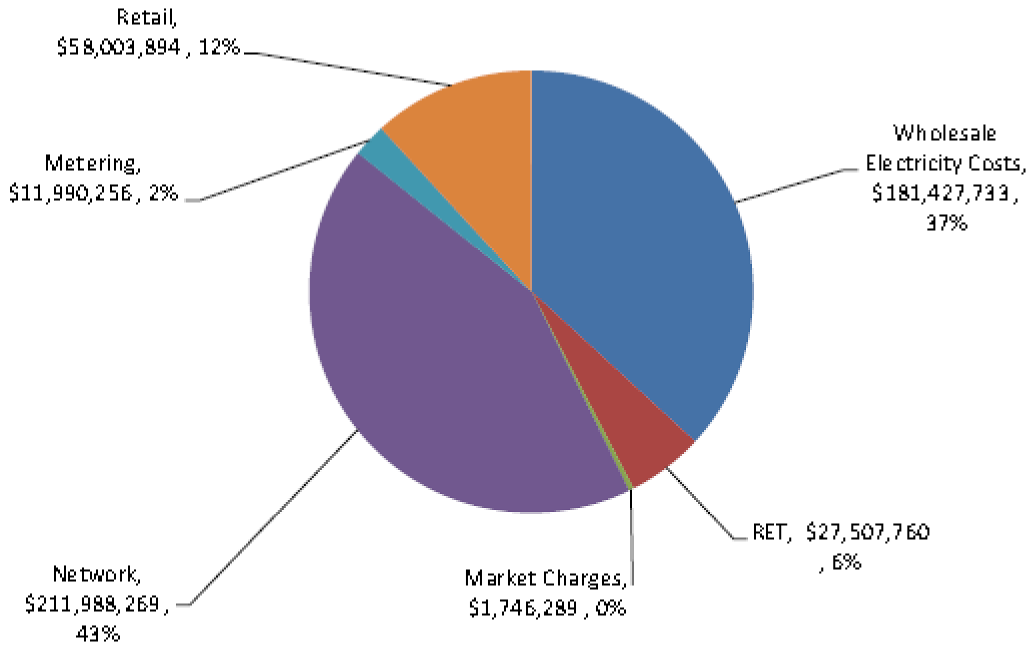
- The Tasmanian market is characterised by no competition at the small customer end, with the local government-owned retailer, Aurora Energy (Aurora), having a dominant market share. Small business customers experience very little competition. There is no competition for residential customers, despite the existence of Full Retail Competition (since 1 July 2015). The only part of the NEM with less competition is regional Queensland where there is a single retailer.
- Retail prices for small customers (consumption below 150 MWhpa) are regulated as standing offers for Aurora by the Tasmanian Economic Regulator (TER). The only other parts of the NEM with regulated prices are regional Queensland and the ACT.
- The generation sector is predominately hydro-electric (energy constrained), whereas other parts of the NEM are predominately thermal coal or gas (capacity constrained).
- Hydro Tasmania, a government-owned corporation, holds a dominant share of generation capacity (95 per cent). Other parts of the NEM also show significant market concentration in generation but no other generator is so dominant.
- Tasmania is linked to the NEM by a single DC undersea interconnector, Basslink, which operates on an unregulated merchant basis under a licence and contract with Hydro Tasmania. Other parts of the NEM are mainly linked by regulated AC links.
- There is a lack of liquidity in the Tasmanian wholesale market due to the dominance of Hydro Tasmania and Aurora as counterparties, a consequent lack of transparency and Hydro Tasmania's wholesale contracts are regulated. The remainder of the NEM wholesale market is largely unregulated and more liquid.
- Electricity networks on mainland Tasmania are government-owned so that virtually the whole Tasmanian market remains in public ownership. Other parts of the NEM are either fully privately owned or are a mix of private and public ownership.
- The vast majority of smaller customers remain on regulated prices (see Table 1).

These somewhat unique aspects of the Tasmanian retail electricity market have important implications for retail competition and prices in the State, including for small business. Due to these differences, it is more meaningful to respond to matters raised in the ACCC Issues Paper that are relevant to Tasmania from a Tasmanian perspective. Bearing this in mind, the following sections respond to matters raised under Issue 1 of the Issues Paper.

## 2.1 Retail Prices and Price Regulation

Retail electricity prices in Tasmania are made up of wholesale costs, network charges, retailer costs, the Renewable Energy Target and other charges, such as those to run the NEM. These components are shown in the Figure 1 for Aurora's 2017/18 Notional Maximum Revenue (NMR) and discussed in more detail elsewhere in this section.

*Figure 1: Breakdown of a Typical Tasmanian Retail Electricity Bill*




Source: Aurora Energy, Pricing Proposal for Period 2 of the 2016 Standing Offer Price Determination, 1 July 2017 to 30 June 2018, Figure 1, p. 2.

### 2.1.1 Regulation of Retail Prices

Retail prices for small business (and residential) consumers are regulated as standing offers by the TER using a 'building block' approach. Under this approach the various costs that make up the total cost of supplying electricity to customers are added together to arrive at a maximum revenue figure, the NMR. The TER annually approves the maximum prices that Aurora can charge its regulated customers. This is intended to ensure that regulated prices reflect the efficient costs of supplying electricity.

The TER exercises decision making powers only in respect of the 12 per cent of costs that make up the retail component of standing offer prices. The remaining 88 per cent are determined exogenously by the AER (network charges), the regulation of Hydro Tasmania's wholesale contracts (by the TER), the Renewable Energy Target (RET) and AEMO (market charges) and passed through into the TER's determination of NMR.

The average small business retail tariff (T22) has increased from 16.3 cents/kWh in 2008/09 to 25.2 cents/kWh in 2017/18 (55 per cent).

According to the TER:

> *"By setting caps on the amount of revenue that can be earned by the regulated entity, the Australian Energy Regulator and the Tasmanian Economic Regulator seek to protect customers from the risk that [TasNetworks and Aurora] may misuse their market power and charge higher prices than they ought to due to the fact that there is inadequate competition to prevent this type of behaviour."*[1]

Whilst this may provide consumers with a degree of protection from excessive prices, any regulation is far from perfect and, in the case of Tasmania, retail price regulation is needed due at least partly to a failure of successive Tasmanian Governments to adequately reform the Tasmanian electricity market. Further on in the submission we refer to several instances where regulation is not serving the best interests of smaller Tasmanian electricity consumers, or resulting in efficient costs.

**1. We recommend that the ACCC investigate the impacts of retail price regulation on the Tasmanian retail electricity market and its impact on consumers including small business.**

### 2.1.2 Comparing Tasmanian Standing Offers

The TER publishes a biannual comparison of Tasmanian electricity and gas standing offers with those in other jurisdictions.[2] This has consistently shown that standing offer prices for both small business and residential customers fall in the lower range of standing offers across Australia. Whilst this is welcome, one significant shortcoming with this assessment is that it does not take into account that competition in other jurisdictions has a significant impact on retail prices and market offers, and that there are significant discounts available to small business customers in other jurisdictions. According to the AER, Victorian market offers average 17–22 per cent lower than the same retailer's standing offer. In other regions, market offers average 8–13 per cent lower than standing offers.[3] As shown in Table 3 there is presently no discounting of standing offers in Tasmania.

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[1] See http://www.economicregulator.tas.gov.au/domino/otter.nsf/8f46477f11c891c7ca256c4b001b41f2/11e8fac1b072a8e3ca2577ca000aff8d?OpenDocument

[2] See the latest report released in February 2017 at http://www.economicregulator.tas.gov.au/domino/otter.nsf/LookupFiles/Final%20Report%20 %20Comparison%20of%20Australian%20Standing%20Offer%20Energy%20Prices%20as%20at%201%20February%202017.PDF/$file/Final%20Report%20-%20Comparison%20of%20Australian%20Standing%20Offer%20Energy%20Prices%20as%20at%201%20February%202017.PDF

[3] AER, State of the Energy Market, May 2017, p. 16.

The TSBC intends to undertake its own analysis of Tasmanian small business electricity prices with those in other jurisdictions using market offers and discounts. We expect that the results of this work will be available before the ACCC completes its inquiry and will make it available to the Commission.

**2. We recommend that the ACCC should examine further the approach of the TER in comparing Tasmanian standing offer prices with a view to recommending that future TER reports be extended to compare Tasmanian electricity standing offers with discounts and market offers in other jurisdictions. International comparisons would also be useful.**

## 2.2 Retail Component

The TER determines a standing offer retail component that includes costs for billing, account management, call centre, retail margin, and retention of existing customers and attracting new ones. The retail component of Aurora's NMR has increased from $39.6 million in 2008/09 to $58 million in 2017/18, an increase of 46 per cent. The inclusion of Customer Acquisition and Retention Costs (CARC) and setting of the retail margin provides points of contention for the TSBC.

### 2.2.1 Customer Acquisition and Retention Costs

The TER controversially included CARC costs in Aurora's MNR in 2014.[4] This was done on the presumption that Aurora would face new entrant retailers following the opening of the Tasmanian electricity market to Full Retail Competition (FRC) and sale of Aurora. However, Aurora was withdrawn from sale and, to this point, no new entrants have emerged, apart from the limited presence of ERM and Progressive Green (no longer active) in the small business segment; and it appears very unlikely that any will emerge for the foreseeable future. Given this, Aurora faces virtually no threat to its small customer base and has no need for CARC associated expenditure. The TSBC therefore opposed the inclusion of CARC.

In its most recent (2016) determination, the TER expressed concern about allowing Aurora to continue to receive all or some of the benefit of a CARC allowance. It noted that in the ACT, which has only limited competition, there is no CARC allowance and in regional Queensland, which has no competition, the QCA has noted that there are arguments against including CARC in markets with little or no competition. The TER has nevertheless continued to provide Aurora with a CARC allowance for costs relating to "defensive campaigns and advertising costs which would be incurred should a new retailer or retailers enter the Tasmanian residential electricity market." We find this to be a disappointing and unsatisfactory outcome for small customers in Tasmania who are being asked to fund expenditure by Aurora that is clearly not necessary, and at a time when electricity prices are under considerable pressure. Arguably, providing Aurora with a CARC allowance may also be detrimental to competition if it allows Aurora to fend off potential new entrants. Moreover, the TER's 2016 Determination lacks transparency on the CARC as it has not

[4] CARC is the cost incurred by retailers in contestable markets where new entrant retailers endeavour to attract customers away from incumbent retailers and incumbent retailers seek to both retain existing customers and attract new customers.

disaggregated the allowance from other operating costs. Consequently, consumers have no way of knowing with certainty what the allowance costs.

We also note that the TER has pointed out that, if a new retailer entered the Tasmanian electricity market, and Aurora sustains a material change in costs, or is materially adversely affected, it is able to seek approval to either adjust, or amend the Determination. This approach would provide a more equitable outcome and would avoid providing Aurora with an allowance for expenditure for which it has no need until it faces competition.

In a submission to the TER on its 2013 amended determination, we estimated that including a CARC allowance in the NMR added $16.4 million to Aurora's revenue over the two and a half years of this Determination. As the TER has not disaggregated CARC in its 2016 Determination we have no way of knowing the current cost of CARC.

**3. We recommend that the ACCC examine the appropriateness of the inclusion of CARC in Aurora's NMR, its impact on small business and residential electricity prices and whether that is justified in a market where competition is absent and unlikely to emerge for the foreseeable future.**

### 2.2.2 Retail Margin

According to the TER "the retail margin compensates Aurora for the risks it takes in investing in the business and in providing electricity services to standing offer customers."[5] Prior to its 2013 Determination, the TER had applied a retail margin of 3.7 per cent of costs to Aurora's regulated retail prices. This was based on benchmarking with other jurisdictions where competition was absent or weak. In its 2013 Determination, the TER increased the retail margin (in several steps) to 5.7 per cent (based on benchmarking with jurisdictions with competitive retail markets). It considered this justified for a regulated offer retailer that would face additional risks from energy prices and customer churn compared to the situation where Aurora did not face any competition. However, it should be noted that this was based on an expectation of competing retailers entering the Tasmanian market, which has not eventuated to any significant extent to this day.

In fact, the Tasmanian Government subsequently withdrew Aurora from sale and did not proceed with its plan to have two regulated offer retailers competing (hopefully with other new entrants). However, in reviewing its determination after the withdrawal of Aurora from sale, the TER maintained the 5.7 per cent retail margin once FRC commenced and all restrictions on customer switching had been lifted. But the lack of competing retailers has made switching virtually impossible. Consequently, small business and residential consumers are paying for a retail margin far higher than Aurora's circumstances justify.

Aurora's higher retail margin has increased costs from $15.8 million in 2008/09 to $26.6 million in 2017/18, an increase of $10.8 million, or 68 per cent.

[5] See http://www.economicregulator.tas.gov.au/domino/otter.nsf/8f46477f11c891c7ca256c4b001b41f2/11e8fac1b072a8e3ca2577ca000aff8d?OpenDocument

The significant increases in retail costs allowed Aurora is a matter of concern to the TSBC. We believe that neither the higher retail margin nor the CARC, the two main causes of its higher retail costs, is consistent with the lack of competition in the Tasmanian electricity market, or the TER's role of ensuring Aurora does not price with monopoly power and has efficient costs.

Whist not directly under inquiry by the ACCC, the wholesale market and its prices are inextricably linked to retail prices, being a major component of the latter. Rises (or falls) in spot prices will ultimately find their way into retail prices, albeit with muted impact given that the volatility in the wholesale spot market is hedged by generators and retailers.

The ACCC would be aware of the large increases in spot and forward prices in the wholesale market over the past year or so – driven by factors such as thermal (coal and gas) generator retirements, a subsidised boom in new renewable capacity, and gas market issues, such as rising prices and concerns about future supply – following an extended period of subdued prices. Aurora's 2017/18 pricing proposals forecasts wholesale costs of $181.4 million for 2017/18, up from $132.2 million in 2016/17, an increase of $49.2 million, or 37 per cent.

4. **We recommend that the ACCC support the application of a retail margin to Aurora that reflects the low level of competition in the Tasmanian retail electricity market and that does not needlessly increase electricity prices for small consumers.**

## 2.3 Wholesale Prices

### 2.3.1 Tasmanian Wholesale Prices

Tasmanian wholesale market prices have also been impacted by these factors as the Tasmanian market is closely linked to that in Victoria due to trading of capacity over Basslink. In fact, forward prices in the two regions tend to track each other fairly closely. The large increase in Tasmanian forward prices over the past year or so and their closeness to Victorian prices can be clearly seen in the Figure 2 below. Prices have subsided somewhat since May this year but remain very high.

In Tasmania, spot and forward prices were also impacted in the first half of 2016 by the combined impact of low hydro storages, induced by drought (and prior to it Hydro Tasmania attempting to maximise its profits from the carbon tax) and the major and lengthy (6 month) outage of Basslink from December 2015 until June 2016.

High wholesale prices earlier this year lead to very large increases in prices for Tasmanian customers who renegotiated market contracts. This prompted Hydro Tasmania to intervene and price wholesale contracts for 2017/18 at the 2018/19 Victorian price, a reduction of about $20/MWh, with potential benefits to market customers who had not yet renegotiated contracts, but not those who had.[6]

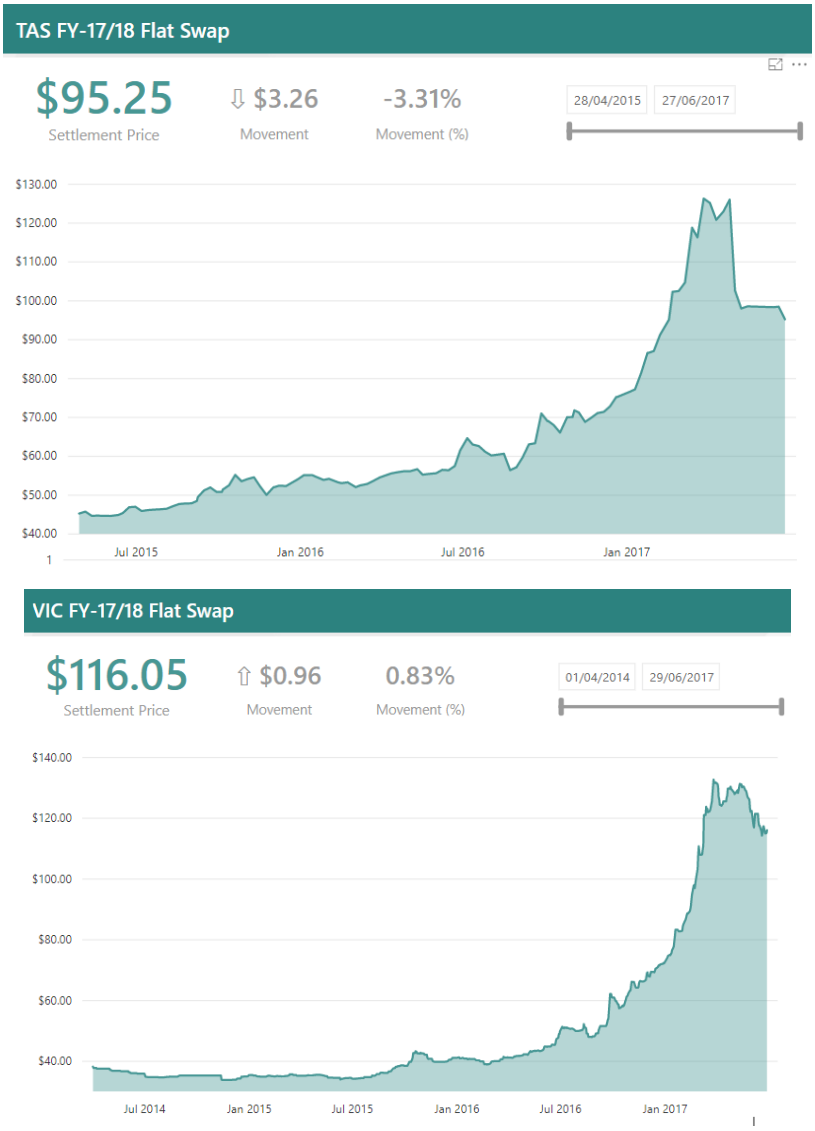
Nevertheless, even at this level, market customers still face substantial increases in prices compared to a year earlier (around $40/MWh based on Victorian Flat Swap contracts for 2017/18). Assuming full pass through, Goanna Energy Consulting (Goanna) estimates that this would increase the electricity bill for a

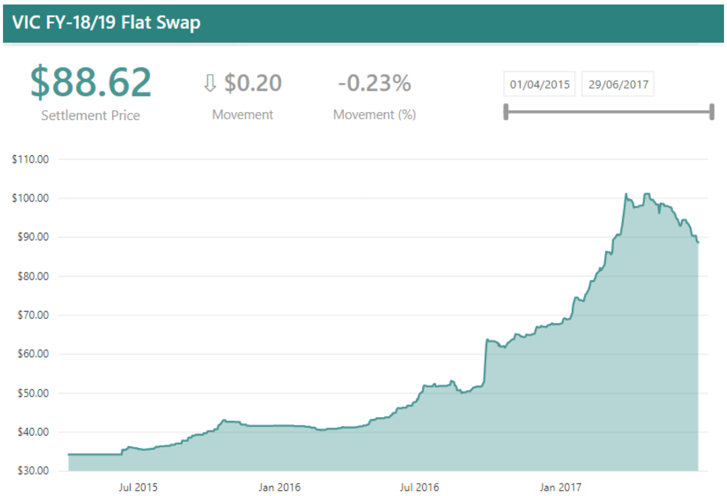
[6] See Hydro Tasmania, *News Release*, 'Hydro Tasmania intervenes to shield Tasmanian businesses', 2 May 2017.

hairdresser on a market contract by $2,100 per annum, for a café or newsagency by $3,300 and a pharmacy by $5,000. Increases of this magnitude would place small businesses under additional operating pressures and impede their ability to employ and serve Tasmanians.

Under normal circumstances, (regulated) standing offer retail tariffs are determined by the TER as part of its Standing Offer Determinations and tariffs are submitted annually by Aurora for approval by the TER. The TER calculates a Wholesale Electricity Price (WEP) using a model developed for Treasury based on regulated load following swap contracts. A load forecast and network loss factors (transmission and distribution) are used to then develop a Wholesale Electricity Cost (WEC) for inclusion in the NMR.

*Figure 2: Wholesale Settlement Prices – Tasmania and Victoria*






Source: SavvyPlus Consulting Pty Ltd

For the majority of Tasmania's small customers, who are on regulated retail tariffs, rather than see their electricity prices increase significantly, the State Government stepped in to cap their electricity prices for 2017/18.[7] It is not clear what will happen after that.

**5. We <u>recommend</u> that the ACCC investigate the operation and regulation of the Tasmanian wholesale electricity market, its interaction with the retail market, its price outcomes, and their impact on small business consumers. This should include an assessment of the impact of the Tasmanian Government's decision to cap regulated retail prices in 2017/18 due to wholesale cost pressures.**

### 2.3.2 Vertical Integration in the NEM and Tasmanian Wholesale Prices

As already mentioned, Tasmanian wholesale prices have a close relationship to Victorian wholesale prices, and the degree of vertical integration in Victoria (and the rest of the NEM) thus has a potentially significant impact on Tasmanian wholesale prices.

The AER has expressed the view that, whilst the emergence of so-called 'gentailers' in the NEM, allows generators and retailers to insure internally against wholesale price risk, reducing their need to participate in hedge (contract) markets, it also reduces participation in contract markets and liquidity in those markets, posing a potential barrier to entry and expansion for generators and retailers that are not vertically integrated.[8] We note that these retailers often provide an important source of additional competition in the NEM.

[7] Matthew Groom, Minister for Energy, *Media Release*, 'Capped power prices a step closer for Tasmanians', 24 May 2017.
[8] AER, *State of the Energy Market*, May 2017, p. 47.

The AER also undertakes frequent analysis of high price events in the NEM that can be attributed to generators, including 'gentailer', increasing prices by withholding capacity.

It is worth noting that competition concerns were raised during the formation of 'gentailers' with large generation portfolios relative to a region's capacity. The ACCC itself proposed to block an acquisition of the large Loy Yang A generator in Victoria by AGL, which had a significant retail market share, on competition grounds but was thwarted in a controversial 2003 Federal Court judgement (although the Court did attach some conditions that were withdrawn in 2012). As a result of that decision, and in the face of opposition from consumers groups, AGL's acquisition of the Torrens Island Power Station in South Australia was subsequently approved by the AER in 2007 despite this providing AGL, already a significant retailer in SA, with ownership of the largest generator in the State.

After more than a decade of vertical integration, three retailers—AGL Energy, Origin Energy and EnergyAustralia—supply 70 per cent of retail electricity customers in the NEM and the same entities expanded their market share in NEM generation capacity from 15 per cent in 2009 to 48 per cent in 2017. In Victoria, these three supply around 70 per cent of customers and hold 64 per cent of generation capacity, though Snowy Hydro and Engie have increased their retail market share to 24 per cent and own 34 per cent of generation capacity.

6. **We <u>recommend</u> that the ACCC thoroughly investigate the issue of vertical integration and its impact on retail markets, including in Tasmania, as part of this Inquiry.**

## 2.4 NETWORK CHARGES

In common with other parts of the NEM, Tasmanian network charges increased significantly from around 2008/09 until 2012/13. This created shortcomings in the regulatory regime that caused network businesses, including the Tasmanian ones, to inflate their expenditure and rate of return proposals. These proposals were largely accepted by the AER. Changes to the National Electricity Rules partially addressed some of these shortcomings.

Subsequently, there has been a moderation in network charges reflecting a combination of:

- Internal decisions by TasNetworks (or its predecessors) not to spend all of its regulatory allowances for opex and capex.
- More moderate expenditure proposals by TasNetworks (or its predecessors) (especially augmentation capex) and acceptance of the AER's rate of return guideline, resulting in more moderate revenue and price increases. (Though TSBC submissions to the AER's most recent Tasmanian Transmission and Distribution Determinations have questioned whether the AER's acceptance of these proposals went far enough.)
- The position of the Tasmanian Government in opposition to further increases in network charges by its own businesses.

This has had the effect of moderating the increases in Tasmanian network tariffs from 2013 onwards and we welcome this.

The outcome of the AER's most recent Tasmanian Distribution Determination has been positive for small business. Through a combination of more moderate revenue proposals and tariff re-structuring, TasNetworks' main small business tariff (TAS22) will fall significantly from 1 July 2017. According to TasNetworks' analysis, an average small business on TAS22 can expect a reduction of $1,826 (-31.7 per cent) in its network charges from 2016 to 2019. Moreover, an average small business moving from TAS22 to a new time-of-use network tariff[9] can expect its annual electricity bill to fall from $5,579 to $3,172, a reduction of $2,407 (-43 per cent), based on certain assumption about usage and excluding the additional costs of advanced meters. In terms of Aurora's NMR, network charges increased from $253.9 million in 2008/09 to peak at $291.6 million in 2012/13 and have since fallen to $254 million in 2016/17. They are forecast at $212 million in 2017/18.

The reductions in network charges are the main reason for the decreases in small business retail prices in 2017/18 as they more than offset the higher wholesale energy costs. The estimated decrease in an annual bill for typical small business customers on T22 (which account for the majority of small business customers) is expected to range between 4.1% and 5.7%, depending on their usage profile.

[9] These tariffs are available on an opt-in basis for the time being, with the aim of ultimately being compulsory.

These are welcome changes and will help Tasmanian small businesses overcome the impacts of increases in recent wholesale electricity prices. However, lower network charges which small businesses were expecting to result in significant reductions in their electricity bills for 2017/18 have been severely eroded by higher wholesale costs.

**7. We recommend that the AER consider the impacts on the Tasmanian retail electricity market of the issues we have raised above in relation to Tasmanian network charges for small business.**

## 2.5 Renewable Energy Target Costs

The Renewable Energy Target (RET) adds directly to retail costs in Tasmania. For small businesses on market contracts, it is passed through to them by their retailer (who carries the obligation). For those on regulated standing offer tariffs, it is passed through as part of the TER's standing offer Determinations. RET costs of $27.5 million are forecast for 2017/18. This compares to a RET pass through of only $5.1 million for 2008/09. Hence, RET costs have increased more than fivefold in that time.

Although the consumer costs of the SRES appear to have been declining as the number of Small Renewable Certificates (STC) decline, the price of certificates is sticky, at or near the clearing house price ($40). Moreover, the price of Large Generation Certificates (LGC) under the LRET have increased significantly to the extent that prices have approached the $90 cap applied under the scheme as the need to create certificates has ramped up in line with the Renewable Power Percentage (RPP). Although LGC prices have softened somewhat in recent months, they remain at very high levels (in the vicinity of $80). Hence, the consumer cost of the scheme is increasing even though electricity consumption in Tasmania is flat and the RET now accounts for over 5 per cent of small business bills.

It has been argued that the subsidy cost of the LRET is compensated for by the impact of wind generation in keeping wholesale prices lower than would be the case in its absence. This may be true in the short term, but it is problematic in the longer term as the market adjusts the supply of generation, as has already happened in the NEM with the removal of large amounts of thermal generation. In Tasmania, there is the added complication that all wind generation is wholly or partly owned by Hydro Tasmania, and bid into the market by it, compromising any competition from wind generation.

The increasing cost of the RET, especially the LRET, is of significant concern to the TSBC. The high price of STCs is also of concern, as are the uncapped nature of the SRES and the lack of transparency in its forward market.

**8. We recommend that the ACCC examine the impacts of the RET on retail prices for small business in Tasmania.**

## 2.6 Metering Costs

Metering costs have increased substantially from $1 million in 2008/09 to $13.2 million in 2016/17 and are forecast at $12 million in Aurora's 2017/18 pricing proposal.

With the adoption of new time-of-use distribution tariffs by TasNetworks and their application at the retail level by Aurora, there will be a need to install advanced meters with communications when customers adopt these tariffs. Although they will commence on an opt-in basis, eventually it is intended that the old consumption based tariffs will disappear and all Tasmanian consumers will be assigned to the new tariffs. However, these meters are an additional (still unknown) cost that will offset to some extend any benefits that customers gain from the new tariffs. It is to be hoped that the new rules aimed at facilitating competition in metering will help to keep costs down but the ultimate outcome of the introduction of new tariffs and meters on customers, including small business, remains uncertain.

The rising costs of metering and the still unknown costs of advanced metering are of concern to the TSBS.

9. **We <u>recommend</u> that the ACCC examine rising metering costs and the impacts of advanced metering charges to help determine their impacts on smaller customers in Tasmania and what they can expect to pay for these in the future.**

## 2.7 Cross-Subsidies and Time-of-Use Tariffs

There are a range of historical cross-subsidies in Tasmanian electricity tariffs (distribution and retail). Of particular concern to the TSBC is that small business tariffs, especially the most common tariffs for distribution (TAS22) and retail (T22) contain a hefty element of cross subsidy from small business to other tariffs, especially the very low-cost heating tariffs (TAS41 and T41). This reflects a desire by Governments to provide Tasmanian residential consumers with low electricity rates for heating given the reliance of Tasmanians on electricity for heating in winter. One impact of this is that it has made gas residential heating, which is commonly used in other cooler parts of Australia, less competitive and dampened gas demand and market growth in Tasmania.

In common with other cross-subsidies, the small business cross-subsidy is economically inefficient and imposes added costs on small business as electricity consumers. This has adverse flow on economic impacts on Tasmania. The cross-subsidy also lacks transparency, making it more difficult for small business to advocate for its removal. As a result, the TSBC commissioned Goanna Energy Consulting (Goanna) to undertake a study of the costs of the small-business cross-subsidy.[10]

This study found that small business in Tasmania was the source of a cross-subsidy and that this imposed inefficiencies and distortions on the Tasmanian electricity and gas markets, on the small business sector and on the State's economy. Due to this cross-subsidy, in 2016/17 annual electricity costs for small business were $400 higher at typical (medium) small business consumption levels and over $700 more for high consumption levels, with a total annual cost to the small business sector of over $10 million.

[10] Goanna Energy Consulting Pty Ltd, *Cross-subsidies in the Tasmanian electricity sector – there impacts on small business*, A Report for the TSBC, August 2016 at http://www.tsbc.org.au/index.php/2016/11/16/tsbc-charged-up-over-electricity-cross-subsidies/.

Following AEMC rule changes to network tariff setting in the NEM, there has been a process undertaken by the AER and distribution businesses aimed at tariff reform including the removal of tariff cross-subsidies. In Tasmania, tariff reform has included the gradual removal of the cross-subsidy in T22/TAS22, which the TSBC very much welcomes. As a result, small business distribution tariffs will fall significantly on 1 July 2017 (see Section 2.4.

However, removal is over a long-time period of up to 15 years (from 2014/15) due to the political impacts of the subsidy on heating and hot water tariffs. In our view this is far too long, especially as some of the cross-subsidy will continue to impact small business.

On the retail side, Aurora is adjusting retail tariffs in line with the changes in TasNetworks' distribution tariffs. We welcome this as a retail tariff response is needed for small business to benefit from the removal of cross-subsidies in network tariffs.

However, Goanna noted in their study that Aurora's T22 small business tariff contains a two-step consumption component with the first block of use levied at a higher rate than remaining consumption and higher than the single consumption rate residential tariff (T31). This imposes additional costs on small business. Aurora says that the higher rate reflects the costs of serving small business but, as far as we are aware, has provided no evidence to support this or to show why consumption under T22 is treated differently to TAS22. We have advocated for the removal of the additional consumption block in Aurora's T22.

In relation to time-of-use tariffs, TasNetworks is now offering small businesses access to time-of-use demand based tariffs on an opt-in basis. The TSBC has supported tariff reform, although not without qualifications. However, in its 2017/18 Pricing Proposal, Aurora did not offer time-of-use retail tariffs, citing insufficient data to both support their development and understand their potential impacts on customers. It says it will reconsider this in next year's Pricing Proposal. This decision makes the time-of-use tariffs of little use to standing offer customers (i.e., the bulk of small businesses).

10. **Cross-subsidy issues are of concern to the TSBS and we recommend that the ACCC examine them in this Inquiry, especially the very long transition to remove the small business cross-subsidy and the two block retail tariff applied by Aurora to small business.**
11. **We further recommend that Aurora's decision not to extend time-of-use network tariffs to the retail level in 2017/18 should be examined by the ACCC.**

3

# Issue 2:

# Market Structure & the nature of Competition

- Competition between electricity retailers
- How retailers compete
- Impediments to retail competition

# 3 Market structure and the nature of competition

In this section, we discuss market structure and competition issues in the context of the Tasmanian retail electricity market and small business. We consider this in relation to the questions and matters for comment outlined in the ACCC Issues Paper.

## 3.1 Competition between Electricity Retailers in Tasmania

There is very little competition between retailers in Tasmania, including for small business customers. This is a source of considerable disappointment and frustration to the TSBC. We have consistently advocated for more competition over many years.

The small business market is served by only two active retailers – Aurora (the incumbent), plus ERM who have a very small and diminishing market share.[11] ERM sometimes provide competitive offers to small business customers but their participation is sporadic. Their share of the small business market remains tiny and they have made little impact on the market since the introduction of FRC on 1 July 2015 (as can be seen from Table 1 below). The only part of the Tasmanian electricity retail market where the market share of retailers other than Aurora is above 10 per cent is the large business segment.

[11] Progressive Green is also listed as a licensed retailer but we understand that they are not presently active.

*Table 1: Number of Tasmanian Electricity Customers by Type*

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
|---|---|---|---|---|---|
| Total Tasmanian Electricity Customers (Excluding BSI) | 265 364 | 267 103 | 268 373 | 272 528 | 274 649 |
| Other retailer market share (other than Aurora Energy) | 0.2% | 0.3% | 0.1% | 0.1% | 0.1% |
| Total small business customers | 36 964 | 36 363 | 35 990 | 35 944 | 36 177 |
| Other retailer small business market share | 0.0% | 0.0% | 0.0% | 0.2% | 0.3% |
| Total large business customers | 2 345 | 2 681 | 2 256 | 2 036 | 2 047 |
| Other retailer large business market share | 27% | 32% | 10% | 14% | 14% |

Source: TER, *Energy in Tasmania Report, 2015/16*, Table 1.2, p. 10.

The great majority of small business (and residential) consumers remain on regulated standing offer tariffs (see Table 2 below). Only 15 per cent of small business customers are on a market offer. The vast majority of those on market offers remain customers of Aurora with only about 110 of the 5,479 small businesses on market offers having a retailer other than Aurora.

This places Tasmanian small businesses at a disadvantage compared to their peers in most other parts of the NEM, where retailers compete and have captured more market share, and where competitive benefits, such as price discounting, are common.

*Table 2: Breakdown of Tasmanian Standing Offer and Market Offer Customers*

| | 2011-12 | 2012-13 | 2013-14 | 2014-15 | 2015-16 |
|---|---|---|---|---|---|
| Standing Offer | | | | | |
| Residential customers | 190 494 | 194 901 | 199 487 | 204 936 | 209 762 |
| Residential customers with a concession (excluding APAYG customers)[25] | | 72 030 | 74 177 | 76 325 | 77 581 |
| Small business customers | 33 467 | 32 813 | 32 315 | 32 885 | 30 579 |
| Market Offer | | | | | |
| Residential customers (APAYG) | 35 561 | 33 158 | 30 640 | 29 612 | 26 670 |
| APAYG Customers with a concession[26] | | 15 751 | 14 253 | 14 701 | 13 829 |
| Small business customers | 3 497 | 3 550 | 3 671 | 2 996 | 5 479 |
| Large business customers | 1 723 | 1 816 | 2 036 | 1 761 | 1 753 |

Source: TER, *Energy in Tasmania Report, 2015/16*, Table 7.1, p. 37.

It should be noted that standing offer prices in Tasmania appear to contain limited headroom with which to encourage new entry and price competition. On the one hand, this keeps retail prices lower but, on the other hand, the lack of competition also precludes active discounting of electricity prices for small business and residential consumers.

The TSBC is mindful that competitive retail markets in the NEM have not always worked wholly in the interests of customers, as evidenced in a recent report by the Grattan Institute.[12] However, we believe that the best overall outcome for customers is still for competition rather than price regulation. The shortcomings in competitive retail markets appear to be surmountable and attention to these would improve market outcomes for customers. We anticipate that the ACCC Inquiry will address these issues.

The point has been made that the introduction of time-of-use pricing and advanced metering in Tasmania will encourage new service providers to enter the market and offer competing services. Whilst this is yet to be proven, it would be a welcome development. Nevertheless, we believe that the availability of such competing services is not a substitute for head-to-head competition by retailers and needs to go together with retail competition in Tasmania to be fully effective.

**12. We recommend that the ACCC examine the lack of retail competition in Tasmania and how this has impacted on smaller consumers, including small business.**

## 3.2 How Retailers compete in Tasmania

The overwhelming interest of small business customers in Tasmania in competition appears to be to get a better price, although price differences between retailers are quite marginal. Price competition is also sporadic, with Aurora tending to provide price leadership most times with an occasional outbreak of competitive price offers from ERM.

Aggressive marketing of price offers is rare and with few small businesses on market offers (almost all of them with Aurora), marketing costs are minimal.

In the past, new entrants have tended to rely heavily on third parties, such as consultants or brokers, to compete as this helped them to keep their operational costs low. Aurora has also made use of third parties for market offer customers, but this has reduced over time.

Broking services tend to be more heavily utilised at the lower consumption end of the small business segment, as this potentially provides a low cost option for consumers exercising choice and can lower the information and search costs associated with choosing a retailer. However, fees and commissions can reduce the price benefits of using a broker, especially in a market with as little competition as in Tasmania. Small business customers seeking a market offer appear to have limited information on or knowledge of this.

The use of third parties may also give customers access to offers not publicly available or included on sites such as the AER's *Energy Made Easy.*

[12] Wood, Tony and Blowers, David, *Price Shock: Is the retail electricity market failing consumers?,* Grattan Institute Report, March 2017.

We undertook a limited search of the *Energy Made Easy* online comparator for this submission to determine the extent of discounting to small businesses. The outcomes are summarised in Table 3 below. As reported, there is an absence of standing offer discounts. Hence, market offers are either at or above the standing offer, removing any incentive for to switch to a market offer. In fact, currently small businesses are being advised to retreat to the safety net of standing offers.

Other subordinate ways in which retailers may compete for small business customers are:

- Fixed price offers for a pre-set period of time;
- Simple to understand prices and terms;
- Slight differences in fees and charges;
- Better billing services (accuracy, timeliness, access to data, ease of understanding);
- Access to value added services, such as energy efficiency advice;
- Opportunity to move away from the incumbent, especially if a customer is unhappy;
- Opportunity to support competition;
- Supporting a local Tasmanian company (in the case of Aurora); and
- Dual fuel offers (electricity and gas) in the case of Aurora.

*Table 3: Summary of Small Business Market Offers in Tasmania*

- Only two retailers, Aurora and ERM, posted small business offers on the *Energy Made Easy* website;
- For single rate offers, that is, offers with a single consumption rate plus supply charge, there were no discounts posted by either retailer below the standing offer;
- ERM did offer a 2-year fixed rate at a very small premium on usage and supply charges;
- Aurora’s standing offer was fixed for a year, as was ERM’s single rate;
- Aurora and ERM also offered small business customers access to time-of-use tariffs. In the case of Aurora, we calculated a reduction of approximately 23 per cent on its standing offer tariff for a typical (median) small business consumption level. For ERM, the discount on its single rate offer was around 8 per cent;
- Aurora’s time-of-use offer was therefore about 16 per cent below ERM’s
- This suggests that time-of-use tariffs are providing small business consumers with access to lower costs, although this clearly depends on the customer’s load profile and ability to shift consumption to cheaper times of the day (not always possible for small businesses);
- With time-of-use pricing, the extra costs of installing an advanced meter also need to be factored in;
- Aurora offered a 5.5 cents/day discount for direct debit
- A range of other fees applied, including: connection and disconnection, late payment and interest on overdue accounts in the case of Aurora; and credit card processing fees, cheque dishonour fees and direct debit dishonour fees in the case of ERM;
- Feed-in tariffs at the regulated rate (6.671 cents/kWh) were offered in all cases;
- Aurora also offered Green Power at a premium for all its offers;
- ERM offered monthly or quarterly billing (meter dependent).

**13. We recommend that this Inquiry consider the comments the TSBC has made above and further examine the ways in which retailers compete for small business customers in Tasmania, bearing in mind the very limited extent of retail competition.**

## 3.3 Impediments to Retail Competition in Tasmania

The impediments to small business retail competition in Tasmania include:

- The small size of the market. With just 275,000 electricity customers, the total market is around the same size as the minimum scale for NEM electricity retailers. Nevertheless, with access to other parts of the NEM also determining scale for retailers, provided there are no other unnecessary barriers to entry, it could be argued that Tasmania offers the opportunity to grow their businesses. Moreover, second tier retailers do operate successfully with customer numbers lower than the total Tasmanian market.
- Electricity retailers in other parts of the NEM have sought to begin competing with one another through a process of decision makers creating 'headroom' for competition to emerge below a standing offer price. It can be argued that there is insufficient headroom in Tasmanian standing offers to incentivise new entrant retailers. As argued elsewhere in Section 2.3 of this submission, the TER has allowed Aurora to increase its retail margin and provided it with a CARC allowance as if Aurora is competing or faces a realistic threat of competition (which it does not at present), meaning that small business and residential consumers are left in the worst possible situation of paying these costs but having little access to competitive offers.
- The delay in introducing FRC may have also deterred new entrant retailers and diminished their interest in the Tasmanian mass consumer market.
- Aurora's position as a dominant government owned retail also acts as a deterrent to new entry, plus it has a well-known local brand and access to virtually all the smaller end market, including their consumption data.
- The dominant position of Hydro Tasmania as a government owned generator and virtual monopolist counterparty in hedging is also likely to be a significant deterrent to new entrant retailers, who would be concerned about their ability to hedge effectively and manage the risks of retailing in Tasmania. This lead the independent Tasmanian Electricity Supply Industry Expert Panel (Expert Panel) to favour the separation of Hydro Tasmania into three 'gentraders'.[13] However, the then Tasmanian Government rejected this option but, facing the market power and hedging dominance of Hydro Tasmania as a major deterrent to new retailers, in 2013 opted instead for regulation of Hydro Tasmania's wholesale contracts by the TER, including the use of a load following swap instrument based on the Victorian market. Whilst intended to provide regulated wholesale contracts similar to the NEM wholesale market and more certainty to new entrant retailers, unfortunately this approach has so far failed to entice any new retailers into the Tasmanian market. It must therefore be judged to have failed in its main objectives.[14]
- Arguably, the transfer of ownership of the Tamar Valley Power Station (TVPS) from Aurora to Hydro Tasmania in 2013 is an added barrier to entry, as Aurora had used the TVPS as a hedge and to limit its exposure to Hydro Tasmania's considerable market power. Following its transfer, Hydro Tasmania placed the station in mothballs and was proposing to sell its combined cycle unit, which provides base load power and accounts for the majority of the TVPS's capacity. The sale was

[13] Electricity Supply Industry Expert Panel, *Final Report*, Vol I, March 2012.
[14] It should be noted that the TSBC has commissioned a report on the Tasmanian wholesale electricity market, which will be made available to the ACCC once completed.

abandoned in early 2016 following the unprecedented low dam levels and extended failure of Basslink, with the TVPS now used solely as a standby facility. It is presently of no competitive value in the Tasmanian electricity market.

- In the past, there was a need for retailers to obtain a separate Tasmanian license to operate in the State. Whilst this in no longer the case with national licensing adopted, this requirement may have deterred some potential new entrants from operating in Tasmania in the past.
- On the consumer side, there is a lack of knowledge and consumer sophistication, and a degree of consumer inertia, which makes it more difficult for smaller consumers to take advantage of any competition that is present. Search costs, the time needed to search, the small number of offers and limited price benefits available after this effort has been made are also likely impediments to competition.
- The small size of the Tasmanian gas market (which is far smaller than the electricity market), its retail duopoly, with only Aurora operating as a retailer of both electricity and gas, its unregulated high transportation charges and a lack of appetite for gas policy reform also act a deterrent to competition in electricity. For example, growth in the gas market could provide a further inducement to entry into energy retailing in Tasmania given that many mainland retailers offer both electricity and gas. Uncertainties about the future of gas supply across eastern Australia and future gas price uncertainty may well also contribute. Within Tasmania, the currently unresolved matter of Hydro Tasmania's future gas contract for the TVPS after 2017 is a dark cloud hanging over the gas market given the large amount of gas contracted by the TVPS and its take-or-pay nature. If this contract is not renewed, or substantially amended, the impacts on gas prices in Tasmania could be considerable and the future of the Tasmanian gas market could be plunged into the unknown.[15]

Mainland retailers have indicated an interest in competing in the Tasmanian retail electricity market for small business and residential customers. A number of them indicated such an interest to the Expert Panel and supported its recommendations for the introduction of a 'gentrader' arrangement as a means of introducing a greater element of competition into the Tasmanian market; and dealing with the liquidity and hedging issues mentioned above.[16] However, to activate their interest most wanted the Government to take the extra step of privatising the 'gentraders' as they saw the Panel's recommendation for three government owned 'gentraders' as insufficient to alleviate their concerns about entry.

In 2013, we commissioned Goanna Energy to undertake a study of the introduction of FRC into Tasmania.[17] Included in this study were the results of interviews with six retailers who could potentially enter the Tasmanian electricity market (see Table 4 below).

[15] For more information on the Tasmanian gas market and its impacts on small business see Goanna Energy Consulting Pty Ltd, *The Tasmanian Gas Market: Building the pipeline to opportunities*, A Report for the TSBC, August 2016 at http://www.tsbc.org.au/wp-content/uploads/2016/08/TSBC-Report-Tasmanian-Gas-Market-August-2016-Final-v3.1.pdf .

[16] Electricity Supply Industry Expert Panel, *Final Report*, Vol I, March 2012.

[17] Goanna Energy Consulting Pty Ltd, *The Final Step: Moving to full retail contestability in the Tasmanian Electricity Market*, A Report of the TSBC, January 2013.

Three of the six retailers interviewed said that, at the time, they were either actively interested in or seriously assessing Tasmanian entry, while the other three qualified their interest based on the need for serious reform, wholesale market reform, the small market and a need for multi-jurisdictional customers. Two were interested in the small business segment and two were interested in participating in the sale of Aurora's retail operation whilst another two qualified their interest.

Retailers mentioned the following as impediments to entry into the Tasmanian market:

*Table 4: Retailer Views on Tasmania Retail Electricity*

- Limited wholesale market liquidity and hedging difficulties (the biggest drawback)
- Small market size
- Difficulty in managing spot market volatility
- Difficulty in accessing OTC swaps and caps to manage risks
- Lack of wholesale market counterparties to trade risk management products
- Ownership structures (i.e. government ownership of both generation and retail)
- Regulatory obstacles and uncertainty (e.g., wholesale price regulation, standing offer regulation, contractual arrangements for the operation of Basslink)
- Threat of Hydro Tasmania competing in the market (e.g. via Momentum Energy)
- Low level of customer knowledge and experience with market products

On the other hand, there were also factors that increased the appetite of retailers for entry such as the introduction of FRC, a partial sale and breakup of Hydro Tasmania, wholesale arrangements on a par with Victoria, the existence of few retail competitors, adoption of the national retail framework and Tasmanians' acceptance of online shopping.

**14. We recommend that this Inquiry further examine the TSBC and retailer views on impediments to retail competition in Tasmania and their impacts on small business.**

4

# Issue 3: Customers & their Interaction with the Market

- Impediments to small business choice
- Choice improvements

# 4 Customers and their interaction with the market

In this section, we discuss consumer choice issues raised in the Issues Paper in the context of the Tasmanian retail electricity market and small business.

## 4.1 Impediments to Small Business Choice in Tasmania

The single biggest impediment to small business choice of electricity provider in Tasmania is the lack of retail competition. All the factors listed as impediments to retail competition in Section 3.3 impact the difficulty Tasmanian small businesses have in exercising retail choice.

Regarding the matters listed on page 14 under Questions 8 and 9 of the Issues Paper we provide the following thoughts:

- We do not believe that small business retail offers are any more complex in Tasmania than elsewhere in the NEM, but they are certainly fewer in number and less competitive. This not to say that it is easy for small businesses to grasp and understand offers or that they could not be better presented and easier to understand. Complex (for small customers) terms and conditions is one concern.
- The structure and content of small business electricity bills is similar in Tasmania to other part of the NEM. Again, this is not to suggest that bills could not be improved.
- As mentioned earlier in this submission, small business is price sensitive above all else. Non-price factors such as billing, fees and charges, relationship issues and value-added services tend to play a secondary role to prices. Non-price issues may assume additional importance after an initial contract with a retailer. If the retailer does not perform up to expectations, small business customers may be more likely to switch (if that option is available) after a contract finishes.
- We are not aware of any time-limited discounts on offer in Tasmania at the moment.
- Small business customer switching is very low in Tasmania principally due to the lack of competing retailers and competitive offers. Small businesses may also be reluctant to switch due to familiarity with Aurora (and the unknown of newcomers), a lack of experience with market offers, a lack of understanding and knowledge, search costs, search time, limited price benefits, a lack of internal resources with which to search (or a lack of access to external expertise) or simple inertia.
- As mentioned earlier, there is limited bundling of electricity with other offers in Tasmania, apart from Aurora’s dual electricity and gas offers. Other possibilities might include bundling of electricity with telecommunications, insurance, finance or the like. Provided the price is attractive, bundling can be useful to small businesses due to efficiencies in cost, search or administration.

- We are not aware of any misleading or deceptive conduct or unfair trading practices in relation to the provision of electricity to Tasmanian small businesses.
- We believe that the *Energy Made Easy* price comparator tool is potentially useful to small business, but this is limited by the lack of competition, and the small number and price compression of Tasmanian market offers. We believe that many small businesses are unaware of the site.
- The introduction of time-of-use tariffs in Tasmania coupled with comms enabled advanced meters may well assist some small business in saving on electricity costs, although some will have difficulty in accessing these benefits due to their inflexible operations and additional metering costs need to be added. However, the lack of competing retailers limits these benefits.

## 4.2 How the Ability to Choose can be Improved

In our view, the best single way that choice of electricity provider and electricity price offers would be improved for Tasmanian small businesses is for a genuinely competitive electricity market to exists – this applies to both retail and wholesale. This involves addressing the impediments to competition and customer choice outlined in Sections 3.3 and 4.1 above.

**15. We recommend that this Inquiry further examine the TSBC's views on impediments to retail choice in Tasmania, how choice can be improved and the impacts on Tasmanian small business.**