21st February 2012

Mr John Pierce
Chairman
Electricity Supply Industry Expert Panel
Review of Tasmania’s Electricity Industry
2 Salamanca Square
HOBART 7000

Dear Chairman,

The Property Council of Australia (Tasmania) welcomes the opportunity to make a submission to the Electricity Supply Industry Expert Panel regarding the Tasmanian Electricity Supply Industry (TESI) Report.

The Property Council represents the $600 billion property industry in Australia and the biggest private sector industry in Tasmania.

The property industry employs some 40,000 Tasmanians directly and indirectly and contributed in 2009 – 10 some 10.9 per cent or $2.5 billion to Gross State Product (GSP), with a further $3.07 billion in flow on activity. Members include the majority of major property investors in Tasmania.

Property Council members engage in the entire property investment universe, which includes all:

- Dimensions of property activity (financing, funds management, development, ownership and assets management);
- Major property types (offices, shopping centres, residential development, industrial, tourism and leisure and infrastructure); and
- Four quadrants of investment (public, private, equity and debt).

The issues discussed in this TESI Report are important to the property industry and to Property Council members in general. Therefore the Property Council’s submission aims to draw the Panel’s attention to other opportunities available to deliver true reform to the industry and cost savings to customers. In addition to providing a critical analysis of the Panel’s draft Report, this submission raises important questions that must be considered before any sweeping reforms are approved.
It is our members’ opinion that to truly introduce a competitive retail market, the industry must ‘get back to basics’ and assess whether the motivators of the original reform remain relevant in the current market. There are other opportunities available to facilitate a truly low cost and efficient electricity market for Tasmanian customers.

**AMALGAMATION NOT EXPANSION**

While the exploration of deregulation of the electricity market is certainly a step in the right direction, the Property Council feels that there are other opportunities to consider before any changes to the wholesale market are enacted.

The first consideration is whether in fact Tasmania even requires the current three bodies administering the generation, distribution and sale of energy.

The original reasoning behind dismantling the original Hydro Electric Corporation and aligning the Tasmanian market with the broader National Electricity Market (NEM) was to mitigate hydrological risk and secure alternative sources of energy.

These concerns have largely been addressed by the purchase of the gas fired Tamar Valley Power Station and the question really needs to be asked – is it necessary for Tasmania to remain a part of the NEM? By its own admission, the electricity reform since 1997 has not delivered the outcomes originally expected. Perhaps now it is time to review whether it is appropriate to amalgamate Hydro, Transend and Aurora. Clearly, the disaggregation of the Tasmanian Electricity Supply Industry (TESI) has resulted in a more complex cost structure, job duplication and reduced economies of scale.

The difficulties and resistance encountered during the creation of the Tasmanian water and sewerage corporations clearly point towards the fact that the Tasmanian public demand less bureaucratic layers and a more transparent utility provider. While the Panel’s assertions regarding the creation of additional wholesale retailers is good in theory, the concern is that it could be detrimental to the interests of Tasmanians as it could potentially simply add further cost layers to the TESI, further complexity and increased barriers to establishing a fair market for all participants.

**BASSLINK**

A similar question needs to be asked about the future of Basslink. Tasmania has the generation capacity to be self-sufficient. The cable is not being used as it was intended; it is enabling Hydro to moderate its generation capacity in accordance with spot price fluctuations. It also brings Tasmania’s ‘clean, green’ reputation into question as Tasmanians are unknowingly buying coal-generated power in accordance with Hydro’s supply whims. Importantly it also remains to be resolved how the additional costs associated with the carbon tax will be passed onto Tasmanians.

It may be time to ask whether a permanent Basslink connection is warranted or whether the infrastructure may be best served remaining as a back-up in case of a supply shortfall from prolonged drought or infrastructure failure.
TWO-PART PRICING

The current two-part pricing structure adopted for the calculation of a customer’s account provides very little scope for a given customer to control their electricity expenditure. As with the proposed water and sewerage pricing model, it is difficult to accept that the breakdown of fixed and variable cost truly reflects the actual cost of production and distribution.

The Property Council asks that the Tasmanian Economic Regulator (TER) review the price setting framework component of electricity charges and employs a fixed cost model that reflects the cost of production and distribution.

The current model, as identified by the Panel, exhibits an inherit flaw, the tariffs are calculated on the assumption that there will be an undersupply of electricity in the near future and the long range marginal cost is accordingly higher.

It is in fact noted that the long-range marginal cost (LRMC) model adopted by the TER to set the tariffs, is in the order of 11-12 per cent higher than adopting a true market based pricing approach. It is unfathomable for the TESI to even consider any wholesale changes before demanding a review of these tariff structures. In fact, without doing so, any changes made to the wholesale market will be made redundant.

The Property Council challenges the TER to revise their model and more closely align it with Tasmanian market conditions. It is of particular interest that notwithstanding any other changes to the TESI, the Panel believes that simply aligning the model employed for the next market determination with the prevailing market, it is estimated that retail prices would become in the order of 5 and 10 per cent cheaper.

Failure to address this fundamental underpinning of the TESI will lead to similar consternation and controversy as experienced during the implementation of the water and sewerage reform. The current investigation into the deficiencies of the TESI provides the TER with a unique opportunity to assess the key considerations and failings in the current pricing structure. Our members will see a failure to capitalise on this opportunity as an indictment of an industry out of touch with their customers and society as a whole.

THE PANEL’S ASSESSMENT

As noted in the Panel’s report, a truly competitive retail market in Tasmania has not eventuated as expected following the reform to date. The Panel has identified the cause of this as being the lack of competition in the wholesale retail market and the perceived power of the sole generator, Hydro. Furthermore, the Panel has concluded that until wholesale competition is introduced, there are far too many barriers preventing new retail market participants from entering the TESI.
The three reform paths are squarely focussed on the need to introduce new retailers to the market. However, it is questionable as to whether this is the best outcome for Tasmanian consumers. While it is noted that retail competition in other NEM markets such as Victoria has resulted in savings to the end consumer, the Tasmanian market dynamics are substantially different.  

Tasmania does not have the oversupply of generators like other NEM regions, quite the opposite in fact. Given the market, it cannot be expected that there will be deep discounting from the spot market participants simply because Tasmania’s supply will always closely mirror demand. There are no significant troughs or latent power supply. This is reflected in the spread of the peak and off peak tariffs, particularly for contestable customers. An example identified during the preparation of this Report noted a particular contracted off peak price representing a discount of only 20 per cent of the corresponding contracted peak price.  

The Report’s findings indicate that new retailers are required but fail to provide any insight as to why they are in fact required and why the expansion of the market is preferable to the contraction and rationalisation of the market.  

The Property Council cannot support any such expansion until projections are tabled which identify real cost savings to the customer.  

In a larger market the Panel’s recommendations and indeed justification for the introduction of further market participants may be applicable, but it really remains to be seen whether the Tasmanian market is large enough for retailers to engage in aggressive market behaviour.  

This is particularly relevant when considering the ageing Tasmanian population and limited population growth projections. The net result will be retailers potentially fighting over pieces of a ‘small pie’ with limited economies of scale and limited customer portfolios. Excluding large industry, there is a limited customer base to target and limited profit margin on these smaller customers which will surely be just another barrier to entry into the Tasmanian market. Smaller customer bases also correspond to a lack of economy of scale as any savings gleaned from competitive market behaviour will be absorbed by the higher fixed cost of operating in the TESI. These fixed costs will inevitably be passed on to the customer.  

The fundamentals of the market need to be addressed before introducing added layers of complexity. The further disaggregation of a malfunctioning market can only introduce further costs and inefficiencies, harming rather than assisting TESI customers.  

**RECOMMENDATIONS**

With consideration of the Panel’s findings, the Property Council recommends the following actions:
1. The TER is held to account with regard to the long range marginal cost model used in the tariff price determinations. Their model must more closely reflect the Tasmanian market conditions and provide a fairer price to customers.

2. The two-part pricing model be restructured to ensure the cost to any given customer is reflective of the actual cost of generation, transmission and use. This is critical to ensure customers have the sufficient ability to control their cost of living.

3. A feasibility study be conducted into the merit of maintaining a permanent connection with Basslink, taking into account its impact on pricing, generation influence, the impact of future carbon tax legislation and Tasmania’s future demand requirements.

4. The Panel’s scope be expanded to consider the merits of amalgamating Hydro, Transend and Aurora as opposed to the introduction of further market participants.

5. If the Panel deems that the introduction of new wholesale competition is appropriate, the Property Council expects evidence be provided which identifies the true cost savings to customers. These findings must be made public and available for comment and scrutiny.

The Property Council is happy to discuss any part of this Submission with the Panel.

Regards,

Mary Massina
Executive Director (Tasmania)