17 February 2012

Mr John Pierce
Chairman
Electricity Supply Industry Expert Panel
GPO Box 123
HOBART TAS 7001

Dear Mr Pierce

AURORA ENERGY SUBMISSION RE: DECEMBER 2012 DRAFT REPORT

Aurora Energy (Aurora) welcomes the Expert Panel’s Draft Report. It is a substantial, credible and well-researched piece of work that deserves serious consideration by the public, the energy industry and Parliament. Aurora strongly endorses the Panel’s findings of significant inefficiencies in the structure and operation in the wholesale energy market. Throughout the Review process, it has been Aurora’s consistent position that this is the fundamental reform task facing the Tasmanian Electricity Supply Industry (TESI).

Like the Panel, Aurora believes that the status quo is not sustainable and therefore welcomes the Panel’s proposed reform options for the wholesale energy market. The challenge is the complexity and uncertainties in the options and the reform linkages required to generate the best long-term outcomes for customers, Shareholders and for Tasmania overall. Ensuring that reforms are achieved within an appropriate timeframe, and are durable in a dynamic external environment, are also key considerations.

Aurora broadly supports the analysis and observations regarding the ‘The Past’ and ‘The Present’, as identified in the Draft Report, and the supporting papers. Where necessary, Aurora has made some brief comments as part of this submission.

Aurora makes more detailed comments regarding ‘The Future’ and the Panel’s reform options. In summary:

- Aurora supports reform consistent with reform path 2 – creating competition through disaggregating Hydro Tasmania’s trading rights. This model will clearly address the wholesale market power issues and provide confidence to all retailers and potentially other generators regarding effective energy risk management. It is more likely to be robust in the longer term than regulatory arrangements.

From the Office of the Chief Executive Officer

Aurora Energy Pty Ltd
ABN 85 082 464 602
21 Kidderway Place
GPO Box 193
Hobart Tasmania 7001
Telephone: 03 6227 3501
Facsimile: 03 6227 3596
• Reform path 1 – regulation - could be pursued in the short term to partially address the wholesale market issues and provide improved opportunities for retailers to manage their wholesale risks.

• On face value, reform path 3 – creating competition through a combined Vic-Tas region - may deliver the greatest competition benefits. However, the complexity, challenges, risks and implementation costs appear too high to make this a viable option in the near term on Aurora’s initial assessment.

• Aurora agrees with the Panel that reform paths 1 to 3 become increasingly more complicated and have progressively longer implementation timeframes. Given the pressing need for reform to improve customer outcomes, Aurora continues to support the ‘reform pathway’ or staged delivery model, starting with regulation, potentially alongside the implementation of a disaggregated trader arrangement. However, Aurora agrees with the Panel that there is a risk that commitment to staged delivery may falter after the initial implementation of reform path 1.

• Aurora agrees with the Panel that refinement to the LRMC methodology could deliver price benefits to Tasmanian customers. However, this reform does not address wholesale or retail competition issues and should not be considered in isolation. Instead, it should only be considered alongside the role and financial viability of Tamar Valley Power Station (TVPS) and ultimately the reform of the wholesale market.

• Aurora supports the Panel’s view that TVPS must be placed on a sustainable footing. While the current valuation methodologies for TVPS have been independently audited, a re-assessment is likely to be required following any changes to the wholesale market and regulatory arrangements.

• Aurora continues to support the introduction of Full Retail Competition (FRC) where it provides benefits to customers. Aurora agrees strongly with the Panel that the introduction of FRC in isolation is highly unlikely to deliver these benefits. For FRC to be effective, wholesale market reform is required and the financial viability of TVPS must be addressed. Customer expectations regarding the price benefit of FRC need to also be managed, with price reductions identified by the Panel being driven by changes to the LRMC methodology, not by FRC itself.

• Aurora notes the Panel’s comments regarding network integration. Aurora will continue to work closely with Transend to realise the potential benefits identified from collaboration. Depending on the reform path taken, network integration may be an option and Aurora remains open to further examination of this issue while noting it remains a lesser order issue.
Given the complexities and risks of the reform process, there is significant work still to do by the Panel, the SOEBs and Government in order to articulate the cost/benefit of the various reform options. The implementation of any chosen reform options is also expected to take considerable time and effort by the SOEBs and the Government. Given the likely public expectations of quick action following the conclusion of the Panel’s Review, the timeframes around necessary processes needs to be clearly communicated to the Tasmanian public.

Aurora appreciates the opportunity to respond to the Draft Report. The Panel’s objective in relation to efficiency of electricity price outcomes for customers is aligned with Aurora’s strategic focus to meet customer needs at the lowest sustainable cost. Aurora is undertaking more detailed work on the costs, benefits, risks and challenges of potential reforms. Aurora will continue to work closely with the Panel and the Secretariat to identify reforms that are in the best interest of Tasmania, our customers and our Shareholders.

Yours sincerely

Dr Peter Davis
Chief Executive Officer
AURORA ENERGY SUBMISSION RE: EXPERT PANEL DRAFT REPORT

In this submission, Aurora will make broad comments regarding the ‘The Past’ and ‘The Present’, as identified in the Draft Report, and the supporting papers, before turning to address ‘The Future’ and the Panel’s reform options in more detail. Aurora’s objective in the Review continues to be on delivering better economic and electricity price outcomes for Tasmania in line with Aurora’s strategic focus to meet customer needs at the lowest sustainable cost.

‘The Past’ and ‘The Present’ and Supporting Volumes

Aurora broadly supports the Panel’s analysis regarding the history and operation of the TESI. The Panel presents a comprehensive examination of issues ranging from electricity pricing trends, the technical and financial performance of the Tasmanian energy businesses and the major investment decisions, Basslink and Tamar Valley Power Station (TVPS). While Aurora generally agrees with the Panel’s observations and conclusions, Aurora makes the following comments:

Efficiency and Effectiveness

The Panel’s main focus with regard to the efficiency of the Aurora distribution business was the overspending of regulatory allowances from the period 2004 to 2010, although noting the overspend was to a lesser degree than for Transend.

Operational expenditure exceeded regulatory allowances over the seven year period by a total of four per cent in nominal terms, averaging well under one per cent per annum. Regulatory determinations span five year time horizons and there is difficulty for both regulators and distribution businesses in accurately forecasting a wide range of variables, including emergency repair and weather related response costs. Given this, Aurora would contend that the operational expenditure overspend over the period of review was a not an excessive outcome. As Wilson Cook, the Panel’s consultants, concluded:

“A comparative study of expenditure indicators with other states shows that Aurora compares favourably on all operating cost indicators.”

With regard to capital expenditure, the Panel noted the overspend exceeded Aurora’s regulatory allowance over the period 2004 to 2010 by around 40 per cent in nominal terms. Aurora notes that the great majority of this overspend occurred in the first half of the period, under the 2003 Distribution Regulatory Control Period. This was a time of unexpectedly strong economic growth in Tasmania, with increased commercial activity and higher than forecast electricity demand. About half of the overspend was driven by customer driven work. About a quarter was due to system capacity requirements.

Aurora cannot refuse requests to connect customers to the distribution network and stronger than expected growth has resultant system wide impacts. In order to not
overspend the regulatory allowance in such circumstances, Aurora would need to make capital expenditure cuts in other areas such as reliability and power quality. In the 2007 Determination for Maximum Prices for Distribution Services, the Regulator significantly increased the allowed capital expenditure from the previous period, accepting that the prior expenditure was prudent and efficient.

Aurora has recently seen a reduction in customer-generated work as the Tasmanian economy has slowed and is highly cognisant of the impact that operational and capital expenditure has on electricity prices. In response, Aurora has demonstrated industry leadership in its 2012-2017 Regulatory Proposal currently before the AER, with a focus on minimising price increases for customers through reductions in operating and capital expenditure in real terms, while maintaining a safe and reliable electricity supply. Aurora has already made a number of significant productivity savings in response. This has been particularly challenging with regard to employee redundancies and restructures. Aurora appreciates the Panel’s acknowledgment of the transformation that is currently occurring across the business.

With regard to effectiveness, Aurora notes the Panel’s conclusion that the performance of the distribution network was ‘adequate’ over the period 2004 to 2010 but while rural performance was improving, there was a declining trend in service levels for urban areas. Since the release of the Panel’s draft report, the Tasmanian Economic Regulator (TER) has released its draft 2011 Reliability Review. While trends in supply reliability are best measured over several years, Aurora met the supply reliability performance measures across all the five categories - critical infrastructure, high density commercial, urban and regional centres, high density rural and lower density rural - for the first time in 2010-11. The performance of the distribution system also improved within each community category. The number of communities classified as “poor performing”, due to exceeding the Tasmanian Electricity Code limits for either frequency or duration, decreased from 35 in 2009-10 to 16 in 2010-11. If the Panel will be updating its analysis in the Final Report regarding effectiveness, it would be appropriate to reflect this more recent performance information from the TER.

Aurora agrees with the Panel that the retail business has been unable to operate within its regulatory allowance but as also acknowledged by the Panel, Aurora’s retail cost to serve per customer is impacted by economies of scale when compared to larger, mainland competitors. This is a focus of the efficiency and productivity measures also being implemented in the Aurora Energy Business, with an aim to bring cost to serve towards regulatory benchmarks.

Financial Position of the State Owned Electricity Businesses

The Panel’s observations on the Financial Position of the State Owned Electricity Businesses cover the period 2004 to 2010. Aurora has no significant issues with the report. However,
in line with the Panel’s expectations that Aurora’s efficiency focus will improve its financial performance, 2010/11 did see a significant turnaround in Aurora’s results (with changes to wholesale energy arrangements also a major factor).

- Profit Before Tax was $39.5 M in 2010/11, compared with a $19.6 M loss in 2009/10;
- Operating costs ex- restructuring were $21.5 M below Budget in 2010/11;
- Capital expenditure savings of $33 M were achieved;
- Return on equity increased from -2.5% in 2009/10 to 5.9% in 2010/11; and
- Dividend recommendation for 2010/11 is $11.9 M, the highest since 2004/05.

As observed by the Panel, Aurora continues to have high debt levels, with TVPS being highly geared. This affects Aurora’s credit rating and reduces returns to Government.

**Governance**

With regard to governance, Aurora believes it already broadly meets the strengthened governance recommendations proposed by the Panel. Aurora also strongly supports the reforms the Government is currently pursuing to improve governance, many of which align with the Panel’s recommendations, and is working closely with the Government on these.

As the Panel describes, the current governance arrangements are good practice and there is no need for radical change but a process of continuous improvement. This includes matters such as improving clarity around the legal status of governance documents/business requirements and their implications for Directors and Officers duties under current legislative arrangements.

Aurora supports the Panel’s view that interactions between the Shareholders and the State-owned energy business (SOEB) Boards should be at the broader strategic level in order to preserve management autonomy and facilitate accountability. The Government’s process to appoint the Boards of the SOEBs is robust. Given this, Boards should be empowered to run the businesses in line with the Shareholders’ high level strategic oversight.

**‘The Future’**

The Panel has made a strong case that significant inefficiencies exist in the structure and operation in the wholesale energy market. Aurora has consistently held this position. The challenge is what to do about it. This is a highly complex problem with many risks and uncertainties but also opportunities for better outcomes for Tasmanian electricity customers.

Doing nothing, in Aurora’s view, is not an option. The Panel’s report highlights the dynamic efficiency losses arising under the current market structure and presents modelling on
potential economic impacts of moving to an efficient market. Aurora therefore welcomes the Panel’s proposed reform options. Reform to the wholesale energy market has the greatest potential to positively impact on customer electricity prices. As the Panel makes clear, benefits that may accrue from full retail competition (FRC) are heavily dependent on wholesale market reform. Aurora discusses each reform path in detail below.

Reform Path 1 - Regulation

Aurora believes reform path 1, a regulatory approach to addressing the wholesale energy market issues, could improve on the status quo. However, the model as proposed by the Panel – auction of standard contracts over a three year time horizon with an independently set reserve price – would, in Aurora’s opinion, fail to achieve the primary objective of allowing retailers to appropriately manage wholesale market risk.

Risk management is a fundamental aspect of business operations. However, the structure of the Tasmanian market is unique in the NEM and standard risk management frameworks have significant problems. As the Panel itself highlights:

‘It is incontrovertible that Hydro Tasmania possesses significant latent market power. Its periodic signalling of that power through spot and contract market outcomes is a serious barrier to entry into the retail market by efficient, large scale, mainland retailers.’

The fundamental problem with the model as proposed is that Hydro Tasmania would still have significant market power and would still control the spot market. Retailers need to minimise risk at reasonable cost, given electricity retailing is a low margin, high volume business. Under this model, retailers are likely to have unbalanced load/contract positions given customer churn, load flex, differing customer load profiles, and the periodic nature of the auctions. Unless retailers over-hedge (as Aurora has been obliged to do in the current market), there remains enormous risk from high spot price events. As the Panel itself has identified, these can and have occurred in the Tasmanian market for reasons unrelated to demand or supply and can occur at ‘virtually any and all times’.

The major benefit of the proposed model is that it would provide retailers with some assurance that the prices for standard swaps and caps are in line with a competitive market. This assumes that the price discovery process is robust, there is participation by retailers in the auctions and that the reserve price setting mechanism is credible. It also provides assurance that Hydro will continue to offer contracts, which under the present market structure Hydro is under no compulsion to provide. However, an auction process as proposed does not greatly reduce the risk to retailers that is currently present in the market.

Further risks and challenges include the following:
• concerns over the long-term durability of reform path one. Regulatory risk, gaming risk and sovereign risk will be of concern to retailers in what is a relatively small market. The fundamental problem of wholesale market dominance will remain;

• auctions involve not insignificant costs, especially if they need to be more frequent or complex in nature to address risks to retailers. The Panel has proposed that these costs would be around $0.5 million per annum and would be funded by Hydro Tasmania. Aurora suggests costs may be higher under suggested alternative reform proposals discussed below;

• further analysis of the process for setting of the reserve price is required. There will be tension between undervaluing hydro energy versus retailer perceptions prices are too high or having little confidence in the transparency and robustness of the price setting process;

• general uncertainty over participation from retailers given the size of market if regulatory reform does not go far enough; and

• the challenge of reserve prices being linked to the dynamic supply/demand balance. In times of drought this may see considerable increases in wholesale energy prices for extended periods. While this sends appropriate price signals, this may be considered unacceptable to Tasmanian electricity consumers and the Government and may raise concerns about the durability of this reform.

Aurora has previously outlined to the Panel that a similar model was adopted in New Zealand in 1996 to address the market power of the Electricity Corporation of New Zealand (ECNZ), a predominantly hydro generator that controlled about 70 per cent of total NZ capacity. The mechanism was abandoned two years later due to low participation, with limited volumes traded. The major issues seem to have been that purchasers found that standard contracts did not meet their needs, there lacked a tradable market and there were concerns about the reserve price setting mechanism. The NZ Government ultimately decided to physically disaggregate ECNZ into three competing entities.

Aurora would suggest that the Panel consider modified regulatory mechanisms with a primary focus on minimising, if not removing, wholesale market risk for retailers. This is inconsistent with NEM norms but the Tasmanian market, in the absence of structural change, is a highly risky market. Light-handed regulatory intervention, in Aurora’s view, is unlikely to achieve the Panel’s outcomes.

Alternative considerations could include:

• Auctions of profiled or load following hedge products to reduce risk for retailers. The challenge would be in valuing these products and setting a reserve price;
• An alternative to an auction would be a requirement for Hydro to sell profiled or load following hedges at Regulator-determined prices, which would be expected to change over time.

• Requiring Hydro to both offer and purchase standard forward contracts (with a regulated difference between bids and offers) to increase liquidity and provide a disincentive for Hydro to push prices to extreme levels in the absence of supply constraints;

• Re-examination of the reasons for the failure of the Basslink Inter-regional Revenue (IRR) auctions and possible alternatives. Basslink’s import capacity is sufficient to meet around 30 per cent of Tasmanian load and ways to maximise Basslink’s potential to increase competition could be further considered by the Panel. Numerous retailers own generation assets in Victoria, yet have no retail presence in Tasmania despite theoretical access to their generation via Basslink. Similarly, Aurora would like the option to source generation from Victoria but is uncomfortable with the risk of trading across Basslink; and

• Indirect or direct regulation of Hydro’s spot market behaviour in an attempt to limit opportunistic bidding behaviour and short run price volatility. Tasmania is energy, not capacity constrained, and will have no energy supply issues for perhaps two decades. Yet Hydro Tasmania has an ability to move spot prices to $12,500 MW/h at any time (and has in practice), irrespective of demand and supply conditions. This is a significant risk to retailers. As previously outlined to the Panel in previous correspondence, the Market Price Cap (MPC), Cumulative Price Threshold (CPT) and Administered Price Cap (APC) framework that applies in the NEM can have perverse outcomes in the hydro-dominated system in Tasmania (and negative consequences on the value of the TVPS). However, Aurora recognises there are a number of drawbacks with indirect/direct regulation, in particular the degree of judgement required by the regulator and implications for market efficiency. However, methods that may limit opportunistic bidding behaviour and short run price volatility could be further considered to reduce risks to retailers.

In summary, Aurora supports the concept of reform path 1 as an improvement on the status quo but considerably more work needs to be done regarding the type of products available to retailers to manage risk for this reform path to be effective. However, Aurora strongly believes that more fundamental structural reform is required to fully address the market issues identified by the Panel and to deliver robust market arrangements that are likely to provide the greatest benefits to Tasmanian customers.

Potentially, the regulatory model could be pursued as a short-term solution while more robust but complex structural solutions are evaluated and implemented. Aurora believes that the success of this initial pathway will be highly dependant on the confidence that
participants have that more robust reforms will be introduced at a later date. It is likely that retailers will perceive there is a risk that commitment to a staged reform delivery process may falter after the initial implementation of reform path 1.

Reform Path 2 – Creating Competition in the Trading of Energy Produced by Hydro Tasmania

Aurora believes that structural reform through the creation of wholesale trading competition will be the most effective reform and deliver the most significant benefits to Tasmanian customers. Its primary advantages are:

- It more effectively addresses wholesale market power issues than reform path 1. Both spot and contract markets will be subject to true competition as no single entity will be 'pivotal' in capacity terms;
- It will be a more durable solution than the regulatory approach with its associated regulatory and sovereign risks;
- It will undoubtedly be the most attractive option for new entrant retailers and will therefore best meet competition objectives; and
- It will give the Government the greatest potential to maximise the value of the state’s generation and retail assets.

As previously outlined to the Panel in previous correspondence, a wide range of mechanisms have been used internationally to allow for disaggregated control of dispatch rights in hydro dominated systems. These range from simple ownership transfers to sophisticated arrangements where parties share rights to hydro catchments or even to specific hydro stations.

Aurora, nor any other party, has been privy to the arguments put forward by Hydro Tasmania regarding their issues over reservoir coordination losses and optimisation of reservoir management. The draft report is largely silent on this, despite the fact the Tasmanian hydro system is comprised of six distinct catchment systems. The Panel’s view is that the integrated operation and water management can be retained by Hydro Tasmania while three traders would have contractual trading rights to Hydro capacity and energy. Aurora supports the Panel’s view that trading rights only are required for this reform path and that physical break-up of Hydro assets are not necessary to deliver wholesale competition.

The drawback of this reform path is that it is a complex model with a number of risks and will take time to ensure it can be successfully implemented. These risks and challenges include:

---

1 If a supplier is pivotal during a given period, then aggregate demand cannot be met without some supply from the participant.
• Contracts will likely need to be in the form of a complex option with associated risks regarding the critical parameters, terms and conditions. Sophisticated modelling and hydro trading capability will be required by both the buyer and seller to value the option;

• Management of hydrological risk (in aggregate storage terms, not short term dispatch decisions) will become the responsibility of the traders. Accounting for hydro storage when defining traders’ dispatch rights will be an important consideration. The potential for perverse incentives under the MPC/CPT/APC framework during a severe drought must also be considered;

• If retained under Government ownership, the Panel’s model of three traders increases the risks and the costs, although ultimately these traders could be transferred to the private sector. The Panel’s initial estimate is that trader establishment costs would be $1 million each, with annual operating costs of $4 million each; and

• Disaggregation means a loss of economies of scale and scope. There are also possibly issues over the balance sheet strength required by each trading entity to operate effectively in the NEM and to be seen as robust and credit-worthy counterparts by retailers.

Aurora is strongly of the view that the traders should be in Government ownership, at least initially. This will ensure contracts can be fine-tuned and issues resolved under the one owner. This will minimise the financial risk to the Government of selling the trading rights immediately to the private sector with associated uncertainties over their value and efficient operation.

Government ownership could also utilise the trading capabilities, people and systems currently resident in Hydro Tasmania and Aurora. Given the small size of the Tasmanian market and its unique hydrological and market characteristics, the availability of skilled personnel should not be underestimated. Aurora is also unconvinced that the establishment of three traders is necessary at the outset. Advisers to Aurora found that two equal sized parties would materially reduce the extent to which any energy supplier was pivotal in the Tasmanian market and that the incremental gain of a third trader over two traders was modest. The Panel’s consultants drew a similar conclusion. A structure with three traders could be envisaged at a later date once the reform has been proven to be working effectively.

Aurora expects that the timeframe for establishment, testing and sale of the traders could be in the vicinity of three years. This timeframe will provide greater certainty over the value of the dispatch rights, given the current uncertainty over carbon pricing nationally and internationally. It will also allow for consideration of the optimal duration of the contractual
dispatch rights - balancing more certain short term revenues against more ambiguous long
term revenue expectations, particularly with value of carbon-free generation expected to
increase over time.

Reform path 2 as proposed by the Panel also raises a number of unanswered questions. In
particular:

- The Panel is silent about the role and management of TVPS;
- the operation of Basslink and its interaction with Hydro Tasmania, traders and the
  market is not clear; and
- more work is required to understand the operation of the Special Protection Scheme
  (SPS), ancillary services and the IRR process under this reform path.

As the Panel has recognised, these are highly complex and technical issues. While Aurora
has views on these matters, many are outside of our area of expertise. Further work and
consultation with subject matter experts will be required.

While challenging, none of the above issues are insurmountable and issues of similar
complexity have been dealt with nationally and internationally. They will, however, take
time to work through. Notwithstanding this, Aurora supports the Panel’s view that reform
consistent with reform path 2 is the preferred option. It will create a durable solution that
maximises the likelihood of effective wholesale and retail competition and maximises the
value of the State’s electricity assets.

Reform Path 3 – Creating Competition by Combining the Victorian and Tasmanian Regions

The third reform path proposed by the Panel is the creation of a combined region with a
single regional reference price, determined at the current Victorian regional reference node.
The objective of this reform would be to remove Hydro Tasmania’s ability to exercise
market power in the spot market, increase the level of competition between Victorian and
Tasmanian generators in wholesale contract trading and increase the options for retailers to
manage wholesale market risk.

At face value, reform path 3 may be the option most likely to maximise competition and
dynamic efficiency. It could be described as the most ‘elegant’ of the three options.

However, Aurora agrees with the Panel that this would be a highly complex reform to
achieve. There are a large number of operational and legislative challenges and a number of
parties across the NEM would need to be involved. The conversion of Basslink to a
regulated link would have benefits for both generators and retailers and conversion has
occurred twice in the past in the NEM. However, there are significant technical issues to be
addressed and the cost of keeping the signatories to the Basslink Services Agreement whole
would be a major challenge.
On Aurora’s initial assessment, these factors would mean that reform path 3 would not be a viable option in the near term. The Panel has suggested this reform path could take 4-5 years to achieve. However, as previously outlined, the reform options are not mutually exclusive and reform path 3 could be analysed over time in conjunction with the implementation of other reforms.

*Wholesale Energy Allowance for Non-Contestable Customers and Sustainability of TVPS*

Aurora notes the Panel’s recommendation regarding the regulatory framework for the determination of the wholesale energy allowance for non-contestable customers. Aurora agrees that refinement to the LRMC methodology could deliver price benefits to Tasmanians but this is a matter for Government as it has a range of consequences for the profitability and returns of the SOEBs.

Aurora stresses that this reform does not address wholesale or retail competition issues and should not be considered in isolation. Instead, it should only be considered alongside reform of the wholesale market, including the role and financial viability of TVPS.

The viability of TVPS and the Aurora Energy Business will be impacted by a change to the LRMC methodology. Aurora’s cost to supply the non-contestable load through a combination of TVPS output and Hydro Tasmania contractual arrangements is broadly consistent with the revenue received under the current methodology. In addition, the current valuation for TVPS has been independently audited but a re-assessment is likely to be required if there are changes to wholesale and regulatory arrangements, as these could materially impact on the expected future revenues for TVPS.

While still a lower cost alternative than wind powered generation, gas fired generation is a complement to, not a competitor for, hydro generation in Tasmania. TVPS will never be a pivotal supplier in the Tasmanian market given the capacity of the existing hydro plant. Aurora therefore strongly supports the Panel’s view that TVPS must be placed on a sustainable footing. Aurora also supports the transparent disclosure of the valuation of the drought support and energy security provided by TVPS. However, Aurora notes that there is uncertainty over such a valuation. It is also likely to be dynamic given continually changing parameters around hydro storages, carbon pricing, interest rates, gas prices, ownership strategies and market and regulatory frameworks.

*Full Retail Competition*

Aurora continues to support the introduction of Full Retail Competition (FRC) where it provides benefits to customers. Aurora has outlined a number of issues in earlier submissions for consideration by the Panel and included: significant IT systems costs; the potential reduction in demand side participation benefits given Aurora’s synergies in being Tasmania’s retailer and distributor for non-contestable customers; the possibility that high income customers will be the primary target of new entrant retailers; and the impact of
higher standing offer tariffs on low income customers given the expected higher retail margins and implementation costs.

Aurora emphasises that it does not oppose FRC but seeks to highlight that its implementation needs to be carefully assessed.

The Panel has considered these and other related matters in its draft report. It is clear that the Panel has a strongly held view that FRC will deliver benefits to customers overall, largely through dynamic efficiency gains. As such, the implementation of FRC through organic or proactive forms is present in all three of the Panel's reform paths.

Aurora agrees strongly with the Panel that the introduction of FRC in isolation is highly unlikely to deliver benefits to customers. For FRC to be effective, it is essential that there is wholesale market reform and the financial viability of TVPS must also be addressed.

Aurora believes there is a need to manage customer expectations regarding the price benefit of FRC. Indeed, the Panel notes that a higher risk margin under FRC may have an upward impact on prices. The Panel's analysis also shows that the retail component of electricity bills is only about 8 per cent and has been the smallest contributor to electricity price increases since 2000.

By far, the biggest benefit to customer prices will come from changing the market and regulatory arrangements for wholesale energy. The price reductions identified by the Panel for non-contestable customers (5-10 per cent) are driven by changes to the LRMC energy allowance calculation, not by FRC itself. Further, while customers may be relatively better off, they may see no headline pricing benefit with potential benefits offset by carbon costs, renewable energy certificates and other factors.

Aurora notes the Panel's commentary regarding the challenges for the Aurora Energy business around competing with mainland retailers given Aurora's small scale and vulnerability to a loss of market share. Aurora agrees that this is a significant challenge and is the focus of the current transformation underway in Aurora's Energy Business.

Network Integration

Aurora has previously communicated with the Panel regarding the various costs, benefits and challenges regarding network integration. The reform path chosen will have an impact on these variables and, depending on that path, network integration may be worthwhile pursuing. However, it is a second order issue compared to the pressing need for wholesale energy market reform.
Aurora remains open to further examination of the benefits of network integration in the longer term, noting the Panel identified financial benefits of $2.4 to $5.6 million per annum. Aurora believes operational and asset management benefits may also be possible. Aurora also notes the recent decision by the NSW Government to merge key elements of the three state owned electricity distribution companies into a single entity. In the interim, Aurora will continue to work closely with Transend to maximise collaboration benefits.

Ends