A personal submission to the Legislative Council inquiry into Energy Prices in Tasmania

Jack Gilding, 11 October 2023

Summary

No one likes price rises and it does appear that the price of electricity in particular has become a highly politicised issue. This is the case even in Tasmania, despite the fact that prices rises have been significantly lower than in some mainland states and electricity is not a particularly large proportion of household expenses or the cause of the largest cost of living increases.

The dynamics of electricity prices in Tasmania are quite different to those on the mainland both because the state government owns the major generator (Hydro Tasmania), the monopoly transmission and distribution entity (TasNetworks) and the largest retailer (Aurora Energy) and also because it is a small market with relatively little competition.

Despite the major role of government-owned entities, the extent of national regulation of the electricity market means that the government does not have total control of prices.

Government ownership also means trade-offs between costs to consumers and benefits to the government as the owner of assets.

This submission makes two major arguments:

- Although the state government can mandate lower wholesale electricity prices, this involves trade-offs and it is by no means certain that such a policy would be of overall benefit to Tasmanians, and may in fact lead to disadvantaging the most vulnerable consumers.
- This inquiry could contribute substantially to public debate and understanding by highlighting the complexity of electricity pricing and putting on the record some of the facts needed to facilitate informed debate.

Context

Although the Terms of Reference for this Inquiry talk about 'energy prices' we assume that the Inquiry is focussed just on electricity, and in particular to the regulated prices for electricity for residential and small business customers in Tasmania.

In order for this inquiry to provide meaningful recommendations it is important that the Inquiry recognises the particular circumstances of the regulation of the electricity prices in Tasmania.

The components of a typical residential electricity bill in Tasmania are as follows (the percentages are 2018-2019 estimates taken from OTTER):

- **Wholesale electricity prices** (34.75%): While wholesale prices in the National Electricity Market (NEM) are highly variable by both region and time of day, there are regulated wholesale contracts which set the prices charged by Hydro Tasmania to Tasmanian retailers.
- **Network charges** (40.98%): These are charged by TasNetworks to Aurora and other retailers. The total revenue that TasNetworks is able to receive is set by the Australian Energy Regulator (AER). The collection of this revenue is split into network tariffs. While these are set individually by TasNetworks, the overall framework for this (the TasNetworks Tariff Structure Statement) is also subject to review and approval by the AER.

- **NEM charges and renewable energy schemes** (10.74%): These are set by national processes (AEMO and Australian law respectively).
- **Retail charges** (13.54%): The charges added by Aurora on top of the above components is reviewed each year by the Office of the Tasmanian Economic Regulator (OTTER).

Are electricity prices a problem for Tasmanians?

Electricity prices for residential customers in Tasmania are at or among the lowest in Australia[1]. The OTTER report {OTTER 2022, p.i} finds that:

> "*For residential customers in Tasmania who consume electricity around the median level for each tariff:*
>
> - *The annual bill under Aurora Energy's regulated time-of-use tariff is the lowest, compared to the bills under equivalent regulated tariffs in all mainland jurisdictions.*
> - *The annual bill under Aurora Energy's regulated general usage and heating (controlled load) tariffs is among the lowest of equivalent regulated tariffs in all mainland jurisdictions.*
> - *The annual bills under the time-of-use tariffs offered by Aurora Energy and 1st Energy are lower than the bills under all residential time-of-use tariffs included in this report, including in market contracts, in almost all mainland jurisdictions.*"

Tasmania also offers a generous level of concessions to vulnerable customers, only the Northern Territory has more substantial concessions.

How much can Tasmania influence electricity prices

Options for Tasmanian agencies (state government, OTTER and GBEs) to directly influence the price paid by electricity users within existing regulatory arrangements include:

- Decreeing a regulated wholesale price via a Treasurer's WEP Order
- Changing concession arrangements which are a cost on the state budget

Another significant but indirect point of influence is decisions made by the state government about project Marinus (see below).

This assumes that Tasmania remains a part of the NEM market and regulatory arrangements. While there has been political discussion about 'NEM exit', no one in reality is proposing this solution and the costs and benefits have not been publicly modelled. Complete separation from the NEM would involve great costs in setting up Tasmanian regulatory structures to carry out the functions carried out by the AER and AEMO.

[1] Comparing electricity prices between jurisdictions has a number of methodological challenges. These include:

- Most Tasmanians are on standing offer tariffs from Aurora Energy. In other states there is much more competition between retailers and a bigger range of tariffs on offer.
- The total cost of electricity for a household depends on the tariff structure, the time of use and amount of electricity used. Assumptions need to be made about typical consumption patterns.
- Relatively little gas is used in Tasmanian households for water and space heating so electricity usage is higher.
- Tasmania has overall colder weather than the mainland requiring a greater heating load in winter.

These factors are discussed in more detail on p.2 and Appendix 1 of {OTTER 2022}.

Physical separation from the NEM (ie not using Basslink and not building Marinus) would have major implications for system security and would prevent Hydro Tasmania from accessing the financial benefits of arbitrage between Tasmanian and Victorian prices.

It is possible to conceive of Tasmania operating outside the NEM market and regulatory structures but with a physical connection to Victoria via Basslink, but this has not been publicly proposed or investigated.

The impact of project Marinus

Recent announcements suggest that the direct cost of project Marinus is now in the order of $3-$3.3 billion for a single 750 MW link {Bowen 2023}.

In addition to this cost, TasNetworks currently has planned a range of on-island transmission development projects (including the North West Transmission Developments – NWTD) that are largely or totally necessary to support Marinus, the anticipated additional wind powered generation which is expected to go ahead if Marinus is built and new load sources (particularly in Bell Bay). These projects (the contingent projects listed on page 9 of the TasNetworks Combined Proposal {TasNetworks 2023}) total $905m in addition to the cost of NWTD and project Marinus.

Recent announcements also anticipate that capital at concessional rather than market rates will be made available and this will reduce the servicing costs of the project. National rule changes currently under negotiation are intended to ensure that this benefit is passed to consumers.

There is still no resolution to the issue of how the cost of Marinus is attributed to different regions of the NEM, and without new arrangements the default situation for a regulated interconnector would be that the costs would be split equally between Victoria and Tasmania. This is despite that fact that the populations of these two regions are very different, and that the modelled benefit of Marinus flows mainly to mainland NEM regions.

If Marinus proceeds the total cost of contingent projects, the cost of the NWTD and as much as half of the capital cost of Marinus (a total of possibly more than $2.5bn) will be added to TasNetworks RAB and the cost of servicing this capital will be passed on the Tasmanian consumers. The current TasNetworks RAB is $3.13bn {TasNetworks 2022, p.69}.

If there is significant load growth in Tasmania, the additional network charges for new customers (eg hydrogen projects) may offset some of this cost. However if the main result of Marinus is greater electricity export to the mainland, the additional cost will be paid by Tasmanian consumers.

It is difficult to model the price impact of Marinus and associated projects on electricity prices for standing offer customers until we know if the project will proceed and how the costs will be attributed. However if these projects proceed it is likely to have a significant impact on the transmission component of network charges.

Wholesale electricity prices

While the methodology for calculating the regulated wholesale price set by OTTER is complex, it is largely based on the Victorian forward contract prices with adjustments. While this methodology has been used most years, there is provision for the Tasmanian Treasurer to set the wholesale price by what is known as a 'WEP Order'. This was done in several years in which the Victorian prices was expected to rise significantly and the Tasmanian government wished to avoid these costs being passed on to regulated electricity prices.

The Tasmanian Labor party has proposed "legislation to cap electricity prices increases at 2.5% for all households and businesses" but I am not aware of any detailed analysis of what the implications of this would be in the current regulatory environment.

In 2022 Dean Winter introduced the Electricity Supply Industry Amendment (Price Cap) Bill 2022 which proposed amending the Electricity Supply Industry Act 1995 so that OTTER could not approve an increase in a standing offer price that increased by more than the lower of the CPI or 2.5% (for the same tariff).

The existing precedent for setting a wholesale electricity price via a WEP Order (rather than by reference to the Victorian price) appears to be the simplest way for Tasmania to minimise price increases for regulated tariffs within the current regulatory arrangements.

A lower wholesale prices set by a WEP Order could reduce regulated prices, although these only make up 35% of the total cost to consumers. A WEP Order that substantially reduced regulated prices would significantly reduce Hydro Tasmania's income, and presumably the dividends it could pay to the state government.

Whatever mechanism is used the question arises of whether this is sound policy.

In the Tasmanian context in which the government owns the major generator (Hydro Tasmania), and sets the legislative framework for regulation, and pays for concessions, there are trade-offs in relation to costs and benefits.

Effects of lower wholesale prices

Without major changes to the regulatory environment, it is difficult to see how regulated electricity prices could be reduced other than by regulating a lower wholesale price. Who would be the winners and losers from such a change?

- Regulated prices would reduce. The benefit would be greatest for those who used the most electricity.
- Hydro Tasmania would make less money.
- Hydro would presumably pay less in dividends to the State Government.

Such an outcome would have several undesirable effects:

- Lower kWh charges would benefit the biggest users of electricity, this is likely to be increase inequality.
- Consumers would have less motivation to use less electricity. This would undermine energy efficiency and ultimately lead to increased consumption. Because adding addition generation is likely to be more expensive than generation from existing depreciated assets this will eventually lead to higher electricity costs.

Options for reducing cost of living pressures

The state government currently spends about $44m a year on electricity concessions {Parliament 2022, p.89}. The most significant concession is the Annual electricity concession, which currently provides a benefit of $1.72/day to holders of a Pensioner Concession Card, a Services Australia Health Care Card or an ImmiCard. The advantage of a fixed daily concession is that it is of most relative benefit to people who use the least electricity. Also because it does not impact the cost/kWh of energy use, it does not undermine the case for using less electricity or investing in energy efficiency.

If the intention of public policy is to ease the burden of increases in electricity prices for those most in need, it would probably make more sense to increase concessions (either in terms of amount or in the eligibility criteria) rather than simply reducing the regulated wholesale price.

What can the Legislative Council inquiry achieve?

It is unlikely that this inquiry could make any recommendations that would be accepted by the current state government. However there are several important outcomes the inquiry could achieve:

- Providing a factual basis for putting the cost of electricity (and electricity price rises) in the context of electricity prices in other states and the context of other costs for Tasmanian households and businesses.
- Educating the public about the complexity of electricity pricing in Tasmania and dispelling the impression that costs can be reduced without negative impacts.
- Seeking out and publicising the facts that need to be made public to facilitate an informed debate about options for reducing the impact of electricity prices on the cost of living.

Getting access to the facts necessary to inform decisions on the best policy options is difficult for those outside the government and the government business enterprises (in this case specifically Hydro Tasmania, TasNetworks and Aurora Energy).

To inform public debate on the best way of addressing the impact of electricity price rises the inquiry could usefully seek out and publicise information on:

- The revenue that Hydro currently makes from selling electricity at a regulated wholesale price to retailers, and the impact any reduction in the regulated wholesale price would have on dividends to the state government.
- The revenue that TasNetworks earns from transmission and distribution charges to regulated customers (separate from the revenue from other customers, ie larger users and major industrial customers).
- The likely impact on TasNetworks charges to regulated customers if Tasmanian customers bear half the cost of project Marinus and the total cost of the associated contingent projects.

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