



PARLIAMENT OF TASMANIA

PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS

**DISAGGREGATION OF THE HYDRO-
ELECTRIC CORPORATION AND
OTHER RELATED MATTERS**

INTERIM REPORT ON DISAGGREGATION

Laid upon the Table of both Houses of Parliament.

The Committee was appointed under the provisions of section 2 of the Public Accounts Committee Act 1970 (No. 54).

MEMBERS OF THE COMMITTEE

LEGISLATIVE COUNCIL

Hon. G. A. Shaw (Chair)
Hon. D. M. Crean
Hon. P. R. Schulze

HOUSE OF ASSEMBLY

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Ms L. Giddings (until 10 December 1997)
Hon. D. E. Llewellyn (from 10 December 1997)

By Authority: Government Printer, Tasmania

Preface

In presenting this interim report, the Public Accounts Committee has endeavoured to meet its obligation of providing comprehensive information to the Parliament and the people of Tasmania to inform future debate.

The report takes into consideration evidence gathered from 87 documents, many substantial and complex reports, 10 submissions and representation made by 44 witnesses. It provides details of important and relevant background information as context for the reader.

As an interim report, the report focuses on the matter of disaggregation and only deals with the matters of the sale/lease of the transmission and distribution/retail businesses of the HEC and the proposed development of Basslink as they relate directly to the debate about disaggregation. Detailed consideration of sale/lease and Basslink has been reserved for subsequent reports.

Whilst the Committee has drawn out a set of findings and conclusions on the key issues, it has limited its recommendations about the appropriate structure for the disaggregated transmission and distribution/retail businesses because the choice of option hinges on whether the sale/lease of these businesses is appropriate and whether Basslink is viable and appropriate.

The findings, conclusions and recommendations presented in this report must not be considered to pre-empt those that may be made in subsequent reports.

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Summary of Findings

Finding 1 (*Section 4.3.1, p.32*)

The Committee believes at this stage that formation of a single generation business is appropriate, but it has not ruled out consideration of horizontal disaggregation at a later stage.

Finding 2 (*Section 4.3.2, p.32*)

The Committee concluded that formation of a single transmission business is appropriate.

Finding 3 (*Section 4.3.4, p.34*)

The Committee noted:

- the NCP review (the Reeves/Breslin report) recommended separate distribution and retail businesses in Tasmania;
- the Government did not accept the Reeves/Breslin proposal model and suggested a single distribution/retail business;
- the Government's proposal for combined distribution/retail was consistent with business structures observed in NSW and Victoria;
- the NCP review is subject to NCC assessment as to its compliance with NCP and COAG requirements;
- the NCC has not at this stage undertaken its assessment.

The Committee noted the NCC Secretariat's views on the separation of the distribution and retail businesses.

The Committee considered that, provided the Government is able to demonstrate that there is a clear public interest in retaining an integrated distribution/retail entity upon introduction of the retail market, there should be no impediment to doing so.

Finding 4 (*Section 5.1.1, p.43*)

The Committee found that:

- In the view of the NCC, the Tasmanian Government has implicitly agreed to disaggregate the HEC because of its in principle commitment to join the NEM via Basslink and to withdraw equity from the business
- Given the relationship to NCP tranche payments, commitments to COAG agreements relating to joining the NEM and a decision to withdraw equity are key motivators for the disaggregation of the HEC.
- The NCC considers the State to have significant future obligations to reform regardless of whether Basslink proceeds. The extent of these obligations, if Basslink does not proceed, has not been considered.
- The State may have been prematurely committed to meeting obligations under the COAG electricity agreements.

Finding 5 (Section 5.1.2, p.43)

- The Committee concluded that, on the evidence before it, there are three significant options for the disaggregation of the HEC being:
 - a single GBE with a subsidiary structure
 - three separate GBEs or
 - a GBE plus two separate companies formed under Corporations Law.
- With regard to the separation of the Transmission business, the Committee did not consider the option of ring fencing worthy of continued consideration. However, subject to advice from the NCC, ring fencing may be an appropriate mechanism to disaggregate the Distribution and Retail components within a combined Distribution/Retail business.
- The issue of cross-subsidies between Distribution and Retail may not be adequately addressed under the Government's proposal.

Finding 6 (Section 5.1.2, p.44)

The Committee concluded that:

- The implementation of a subsidiary structure in an environment in which Basslink was not occurring would be an option to be considered provided it does not jeopardise future NCP tranche payments.
- If a structure is being established to enable Basslink to be constructed and connection to the NEM to occur, then the use of a subsidiary structure for the transmission company is not a feasible option.

Finding 7 (Section 5.1.3, p.45)

The Committee found that, outside NEM connection, there were no specific obligations under the NCC and COAG Agreements in respect of the timing of disaggregation.

Finding 8 (Section 5.2.1, p.48)

The Committee found that:

- The development of competition has been a strong driver in the disaggregation of vertically integrated monopolies in other states to form multiple generation and distribution/retail businesses and a single transmission business.
- Disaggregation of the HEC would provide a step towards development of competition in the Tasmanian ESI through contestability.
- Based on interstate experience, development of competition in the electricity generation industry in Tasmania without an alternative electricity generator would be very difficult to achieve.
- Based on interstate experience development of competition in the distribution and retail sectors has a very limited application in Tasmania because of the size of the market.

Finding 9 (Section 5.2.2, p.49)

The Committee noted that:

- Tasmania has a different ESI structure to South Australia, thus it is not necessarily appropriate to undertake direct comparison between SA and Tasmania.
- Evidence regarding SA suggests that the use of subsidiaries is not an appropriate long-term option for Tasmania in pursuing the introduction of competition in the Tasmanian ESI.

Finding 10 (Section 5.2.3, p.49)

The Committee found that there was some evidence to suggest that the sooner disaggregation is achieved the sooner some competition can be introduced into elements of the Tasmanian ESI.

Finding 11 (Section 5.3.1, p.51)

The Committee found that the current imperatives to disaggregate the HEC include:

- breaking its single monopoly structure
- improving its business efficiency
- achieving transparency across its operations by removing any cross-subsidies that distort the costing and pricing of services
- providing for improved business focus and the management of the different risk profiles of the different parts of the business, and
- breaking up the "one business" culture.

Finding 12 (Section 5.3.2, p.52)

The Committee found that:

- From an internal perspective, the HEC initially had a firmly held view that the formation of subsidiary companies was preferable to separate companies, particularly in the short term.
- The Government has a clear view, as evidenced in the content of the *Electricity Companies Act 1997*, that formation of separate companies is preferable to subsidiaries.

The Committee formed the view that either structure had the potential to yield efficiency gains in comparison to the current HEC structure but that separate companies had the potential to yield greater gains in this sense than did subsidiaries.

Finding 13 (Section 5.3.3, p.52)

The Committee considers that if the Parliament supports the process of disaggregation then the process of company formation should continue in line with the HEC timetable, which seeks to establish the companies to commence from 1 July 1998.

Finding 14 (Section 5.4.1, p.54)

The Committee found that:

- Entry to the NEM via Basslink requires disaggregation of transmission from generation and this is the only substantial reform not yet in place to prepare for possible interconnection.

Finding 15 (Section 5.4.2, p.55)

The Committee concluded that operators in the NEM are structured as both GBE and privately owned company models. The use of either separate company or separate GBE models for Tasmania is a matter of choice.

Finding 16 (Section 5.4.3, p.55)

Evidence indicated that a reasonable lead-time is necessary to allow entities to prepare for competition in the NEM. It is suggested that around two years prior to connection would be an appropriate period.

Finding 17 (Section 5.5.1, p.56)

The Committee acknowledged the Government's view that investors working on a major investment require certainty on the system in which they would have to work. Failure to disaggregate may be seen by an investor as an obstacle to committing funds.

Finding 18 (Section 5.5.2, p.57)

The Committee concluded in providing certainty for potential Basslink investors that:

- there is a choice of three options for disaggregation - subsidiaries, separate GBEs and separate companies; and
- provided a choice between one of these is made and there is a commitment to comply with COAG agreements, then there is no compelling argument in favour of one option over another.

Finding 19 (Section 5.5.3, p.57)

The Committee considers that the early action to disaggregate would be important to facilitate genuine expressions of interest in the development of the Basslink project.

Finding 20 (Section 5.6.2, p.59)

The Committee found that the disaggregation of electricity assets to form separate businesses was an essential prerequisite to sale.

Finding 21 (Section 5.6.3, p.59)

The Committee found that the Government's current timetable would require prompt action on disaggregation given the plan to introduce legislation to progress the sale or lease later in 1998.

Finding 22 (Section 5.8.1, p.63)

The Committee found that:

- The potential costs of the Government's preferred disaggregation model is likely to be around \$2.9 million annually. This cost arises from the need to separate and duplicate functions that are currently combined in the existing HEC structure including corporate overheads and Board costs.
- If the Reeves/Breslin model to separate the distribution and retail businesses were adopted there would be an additional \$3 million annual cost to disaggregation.

Finding 23 (Section 5.8.2, p.63)

Disaggregation provides for potential efficiency gains and improved business focus leading to cost reductions and new business opportunities that may offset the additional costs.

Finding 24 (Section 5.8.3, p.65)

The Committee concluded that disaggregation is unlikely to have a significant effect on the Consolidated Fund.

Finding 25 (Section 5.9, p.66)

The Committee considers that the Government must ensure that contracts to supply electricity and other services which have anti-competitive components must be transparent and demonstrably in the public interest.

The Committee concluded that, in disaggregation, changes to contractual arrangements will need to be managed to minimise financial risk.

Finding 26 (*Section 5.10, p.68*)

The Committee concluded that the management of the disaggregation process must take significant account of human resource management to minimise skill loss.

The Committee concluded that, following the disaggregation process, efficiency improvement is likely to result in reductions in employment levels. However, it was recognised that the subsequent proposals for sale or lease could have more significant employment impacts.

Finding 27 (*Section 5.11, p.69*)

The process of disaggregation is not likely to create particular consumer impacts. However, in any intermediate phase between disaggregation and sale/lease where a business is being prepared for sale/lease whilst in public ownership, its performance in relation to consumer issues such as disconnections should be monitored to ensure no significant negative impacts occur.

Conclusions and Recommendations

It must be noted that this is an interim report about disaggregation and the Committee has not yet completed its deliberations about the sale/lease of the transmission and distribution/retail businesses and the proposed development of Basslink. As such, the findings, conclusions and recommendations presented must not be considered to pre-empt those that may be made in subsequent reports.

The Committee recommends that the HEC be disaggregated into three separate businesses:

- **generation;**
- **transmission; and**
- **distribution/retail.**

The Committee concluded that disaggregation is unlikely to have a significant effect on the Consolidated Fund.

The Committee concluded that a number of factors indicate that there are significant impediments to the development of competition in both the generation and retail sectors of the Tasmanian electricity supply industry. These include:

- the lack of any significant competition in generation;
- the size and nature of the Tasmanian market;
- the integrated nature of the hydro system;
- the unique nature of the Tasmanian network monopoly;
- the absence of planned separation between distribution and retail as noted by the NCC; and
- the time-lapse before the planned entry of Tasmania to the NEM.

The Committee concluded that these factors would prevail regardless of whether the businesses are operated in public or private ownership.

The Committee concluded, however, that disaggregation is the first step to the introduction of contestability and subsequent competition in the generation and retail sectors.

The Committee, in recommending disaggregation as a first step to the introduction of competition, recommends that significant effort be applied in preparing further strategies to enable the development of competition in the generation and retail sectors of the Tasmanian electricity supply industry.

The Committee concluded that the preferred corporate structure for each business is dependent on the outcome/s sought through disaggregation. The options are summarised in the following table.

OUTCOME SOUGHT: FUTURE DEVELOPMENT OF ELECTRICITY SUPPLY INDUSTRY IN TASMANIA
(in isolation from NEM interconnection and equity withdrawal)

(No. 8)

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
FUTURE DEVELOPMENT OF ELECTRICITY SUPPLY INDUSTRY IN TASMANIA (in isolation from NEM interconnection and equity withdrawal)	Wholly Government owned private companies established under the <i>Electricity Companies Act 1997</i> .	Yes	<ul style="list-style-type: none"> • Consistent with model proposed by Government. • Can be rapidly implemented given legislation already in place. • Provides complete separation of business elements. • Clear capacity to meet NCP obligations. • Accountable to Parliament through the Memorandum and Articles of Association of the companies. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Disaggregation can continue consistent with HEC's current timeframe of 1 July 1998 for start of new businesses.
	Separate GBEs	Yes	<ul style="list-style-type: none"> • Consistent with existing GBE structures. • Provides complete separation of business elements. • Able to comply with all NCP requirements. • Currently accountable to Parliament. 	<ul style="list-style-type: none"> • New legislation required.
	Subsidiaries of existing HEC	Yes	<ul style="list-style-type: none"> • Enables smooth transition to disaggregated structure for HEC. • Does not provide for complete separation of business elements - remaining connection between businesses through HEC Board. • Potentially fulfils COAG/NCP obligations in isolation from NEM but not fully tested. • Simplifies accounting transition for HEC. • Allows maximum flexibility to Government to vary structure in the future. • Originally HEC preferred position but later changed. 	<ul style="list-style-type: none"> • No new legislation required. • Can be implemented for 1 July 1998 start based on previous HEC view

OUTCOME SOUGHT: DEVELOPMENT OF BASSLINK AND NEM INTERCONNECTION

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
<p>DEVELOPMENT OF BASSLINK AND NEM INTERCONNECTION</p>	<p>Wholly Government owned private companies established under <i>the Electricity Companies Act 1997</i>.</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Fully complies with COAG/NCP obligations. • Well recognised corporate structure. • Consistent with models in other States involved in NEM. • Distribution/Retail structure not fully resolved with NCC. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Entry currently proposed for 2001-2002 with lead-time for investor commitment and development. • Disaggregation timing is not critical but consistent with HEC's current timeframe of 1 July 1998.
	<p>Separate GBEs</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Potentially complies with COAG/NCP obligations but not fully tested. • Well established model in Tasmania. • Comparable to models in other states involved in NEM. • Distribution/Retail structure not fully resolved with NCC. 	<ul style="list-style-type: none"> • New legislation required. • Entry currently proposed for 2001-2002 with lead-time for investor commitment and development. • Disaggregation timing is not critical but consistent with HEC's current timeframe of 1 July 1998.
	<p>Subsidiaries of existing HEC</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Does not comply with COAG and NCP obligations for NEM. • Could be considered for interim step. Cannot be recommended in longer term. 	<ul style="list-style-type: none"> • No new legislation required. • Acceptable prior to entry to the NEM.

OUTCOME SOUGHT: EQUITY WITHDRAWAL VIA LEASE OR SALE

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
<p>EQUITY WITHDRAWAL VIA LEASE OR SALE</p>	<p>Wholly Government owned private companies established under the <i>Electricity Companies Act 1997</i>.</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Maximises value for sale. • Preferred structure in consultant's work. • Model is well understood in marketplace. • Ensures separation risk is minimised. • Not tested for lease. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Requires a minimum six months' trading results for "due diligence" processes. • Disaggregation can occur consistent with Government's timeframe to achieve new structures from 1 July 1998. • Consistent with the HEC timetable for change.
	<p>Separate GBEs</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Unlikely to affect sale price. • Potentially less acceptable than private company due to more limited familiarity in marketplace. • Not tested for lease. 	<ul style="list-style-type: none"> • New legislation required. • Requires minimum six months' trading results for "due diligence" processes.
	<p>Subsidiaries of existing HEC</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Not preferred for sale as the model increases the separation risk. • Could only be considered as interim position to simplify initial separation. • Not tested for lease. 	<ul style="list-style-type: none"> • No new legislation required. • Would require additional time to move to full separation and have minimum of six months' trading results.

Chapter 1 - Introduction

1.1 Background

The *Public Accounts Committee Act 1970*, provides for the establishment of a joint committee, comprising three members from the Legislative Council and three from the House of Assembly, with the function of inquiring into, considering and reporting to the Parliament on any matter referred to it by either House.¹

The current membership of the Public Accounts Committee (PAC) is as follows:

Mr George Shaw MLC (Chair)
Mr Peter Schulze MLC
Dr David Crean MLC
Mr Robert Mainwaring MHA
Mr David Llewellyn MHA
Mr Michael Foley MHA

The Committee has the power to summon witnesses to appear before it to give evidence and to produce documents (s7(1)) and, except where the Committee considers that there is good and sufficient reason to take it in private, all evidence is taken by the Committee in public (s7(3) as amended).²

On Thursday 9 December 1997, the PAC received a reference from the Legislative Council through the following motion, which was agreed to following debate:

‘That the Legislative Council request the Standing Committee of Public Accounts to assess and report on the revenue implications for the Consolidated Fund on disaggregation of the Hydro Electric Corporation and other related matters.’

1.2 Issues Underpinning the Reference

In moving that the matter be referred to the Public Accounts Committee (PAC) the debate reflected discussion and concern arising from the *Electricity Companies Bill 1997* which had previously been debated and passed by the Parliament.

The *Electricity Companies Bill 1997* provided for the establishment of companies for one or more of the transmission, distribution, and retailing of electricity in Tasmania. It was the view of many members of both Houses of Parliament that there was a dearth of information regarding the motivations behind the Bill and its financial implications.

¹ *Public Accounts Committee Act 1970*, No. 54 of 1970, and subsequent amendments in Act No. 89 of 1997.

² *Public Accounts Committee Act 1970*, Sections 7(1) and 7(3) (as amended).

1.3 The Committee's Terms of Reference

The PAC met on 22 December 1997, reviewed the reference and established a range of matters that were to be considered in the Terms of Reference. The Terms of Reference were then publicly notified in newspapers on 10 January 1998. The Terms of Reference stated:

The Standing Committee of Public Accounts has received a reference from the Legislative Council 'to assess and report on the revenue implications for the Consolidated Fund on disaggregation of the Hydro-Electric Corporation and other related matters'.

The Committee has determined that 'related matters' include Basslink and the sale of equity in the Hydro Electric Corporation.

The following points may also be considered in relation to the Terms of Reference:-

1. The direct and indirect social usefulness of this public asset.
2. The impact on consumers and specific groups in the community and the quality of service to them.
3. The retention value of the enterprise measured against its sale and disaggregation value.
4. The impact on employment, skills training and conditions and the protection of the existing workforce.
5. The existing competing demands on the Tasmanian Public sector and existing budgetary constraints and/or the alternative sources of funds for public sector investment.
6. Current environmental impact and the need to continue and enhance environmental protection.
7. Any administrative economies of scale and coordination that may be facilitated by (public ownership) sale or disaggregation.
8. Appropriate weighting of long term as well as short to medium term considerations.
9. Any other relevant matters.

On 9 March 1998, following developments on the options for the process of equity withdrawal from the HEC, the Committee resolved to explicitly recognise the option of a long-term lease in addition to a sale. The resolution recorded in the Minutes is:

That recognition of a lease option be included by adding "/lease" to the word sale wherever occurring in the description of related matters and points which may also be considered in relation to the Terms of Reference.

1.4 Collection and Evaluation of Evidence

Following the establishment of its Terms of Reference, the Committee advertised publicly on 10 January 1998 seeking submissions from any interested parties. In addition, the Committee sought advice from various individuals including the Hon J Cleary, MHA, on appropriate witnesses to call to give evidence on the matters under consideration.

The Committee received 10 submissions and, as at 16 April 1998, has heard evidence from 44 witnesses (not including return presentations) in Hobart, Melbourne and Sydney.

The Committee has gained a significant volume of material through submissions, witness presentations, committee questioning, the subsequent tabling of reports, additional information on specific questions and independent research of issues. A list of witnesses interviewed and the reports and other information formally taken into evidence are provided as Appendices.

All witnesses were offered the chance to make a general presentation on the Terms of Reference, following which a question and answer model was adopted with Committee members exploring issues as seen necessary. In the case of certain key witnesses, several attendances were necessary to cover all the issues. Copies of all evidence have been provided to each member of the Committee.

In its work the Committee has been supported by the Executive Officer, Ms Heather Thurstans and two officers, Mr Simon Barnsley and Ms Sarah Male, seconded from other agencies to assist in analysis and report development. The Committee is grateful for their positive contribution.

The Committee has met on the following days in the pursuit of its inquiry:

Wednesday 10 December 1997	Wednesday 25 February (Melbourne)	Monday 30 March
Monday 22 December 1997	Monday 9 March	Monday 6 April
Friday 23 January	Tuesday 10 March	Tuesday 7 April
Monday 2 February	Thursday 12 March	Wednesday 8 April
Wednesday 11 February	Friday 13 March	Thursday 9 April
Friday 13 February	Wednesday 18 March (Sydney)	Wednesday 15 April
Monday 23 February (Melbourne)	Thursday 19 March (Sydney)	Thursday 16 April
Tuesday 24 February (Melbourne)	Thursday 26 March	Friday 17 April

Members have invested significant time outside meetings in the reading and consideration of the material presented. Transcripts of all witnesses' sworn evidence (except that taken in camera) have been placed on the Internet and are accessible at <http://www/parliament.tas.gov.au/pacc.htm>

1.5 Interim Report on Disaggregation

Due to the need to address initially the matter of disaggregation of the HEC, consistent with the *Electricity Companies Act 1997*, this report does not consider all matters covered in the Terms of Reference. The PAC accepted the priority of Government to resolve the matter of disaggregation and has thus reported on this area to allow relevant decision making processes to continue. The Committee has concluded most of its evidence gathering on the issue of disaggregation and has chosen to produce this Interim Report.

In preparing the Interim Report the Committee has had regard to the evidence provided through a very intensive program of investigation and analysis. In many cases, submissions and witnesses addressed matters relating to all aspects of the Terms of Reference and were not confined to the issue of disaggregation of the HEC and its impact on the Consolidated Fund.

The Report is confined to the issues arising out of the Government's proposals for disaggregation. Basslink and the sale or lease of HEC assets is touched on in this report but a comprehensive coverage of these two issues will be provided in subsequent reports.

The Interim Report is structured in five Chapters. Chapters 1 to 3 provide background and context to the Report by describing the process of electricity reform that is currently underway in Australia and the rationale behind this reform agenda, including national competition policy and microeconomic reform objectives and a description of the National Electricity Market. Chapters 4 and 5 discuss the matter of disaggregation of the Hydro-Electric Corporation and associated issues and provide the Committee's findings and conclusions in this respect.

Chapter 2 - Overview of Electricity Reform in Australia

During the 1990's an agenda for reform of the Australian electricity sector has emerged to encourage and coordinate the most efficient, economic and environmentally sound development of the electricity industry in eastern and southern Australia through the development of a national grid. The reforms are designed to advance cooperation in the electricity industry, the absence of which has led to excessive generation capacity and inappropriate plant mix and fuel use.

The agenda commenced with the 1991 Special Premiers' Conference (SPC) decision to develop a National Electricity Market (NEM), following a 1991 Industry Commission report which highlighted the potential for significant gains from a competitive electricity market. The SPC decision has been progressively refined through a number of Council of Australian Governments (COAG) agreements from 1992 to 1994, and has been aligned with the development of a package of micro-economic reforms known as National Competition Policy Reform agreed to in April 1995. Under the 1995 Agreement States and Territories agreed to introduce a range of reforms in exchange for a set of financial payments from the Commonwealth.

2.1 COAG's Electricity Reform Agenda

The key objective of the COAG electricity reform agenda is to develop a fully competitive National Electricity Market (NEM) across participating jurisdictions. Participating jurisdictions currently include New South Wales, Victoria, the Australian Capital Territory and South Australia with Queensland intending to participate once the interconnection is built (expected about 2000 to 2001). Tasmania is not required to be a participating jurisdiction until such time as it is connected to the mainland grid, as is proposed through the establishment of Basslink.

The SPC established the National Grid Management Council (NGMC) in 1991 to develop an open market in electricity in the southern and eastern States of Australia. A set of rules and standards to govern trading and pricing arrangements under the NEM to be known as National Electricity Code of Conduct (NEC) has been developed. The NEC was submitted to the ACCC in November 1996 for accreditation and authorisation that was forthcoming in December 1997. Jurisdictions are now in the process of completing the steps required to give the NEC legal effect.

Participating jurisdictions have established two national companies - the National Electricity Market Management Company (NEMMCO) and the National Electricity Code Administrator (NECA) to oversee the operation of the NEM:

- NEMMCO to manage the operation of the wholesale market and security of the interconnected power system, and;
- NECA to manage administration of the Code including dispute resolution, Code development and monitoring.

The trading and management/administration arrangements in the NEM are described in greater detail in Section 2.2, below.

The COAG agenda to introduce a range of benefits into the Electricity Supply Industry (ESI) aims to promote efficiency by increasing competitive pressures within and between State electricity grids. This is expected to deliver:

- **consumer benefits** in greater choice and efficient, low cost electricity;
- **economic benefits** in improved national and international competitiveness of participating jurisdictions; and
- **supply benefits** by ensuring a sustainable and reliable supply of electricity in the long term.

2.2 The National Electricity Market

The National Electricity Market (NEM) has been designed to create competition in the generation and retailing of electricity across all of the participating jurisdictions.

In the past, the generation, transmission, distribution and retailing of electricity was all under the control of single publicly owned monopolies such as the Hydro-Electric Commission and the State Electricity Commission of Victoria (SECV). This model meant everything was planned and controlled centrally without the benefit of market signals to guide decisions. In some cases, this led to significant over-investment and created excess capacity in generation that presently exists in Victoria and New South Wales. There has been very limited electricity trading across state boundaries. South Australia has been purchasing electricity from Victoria and the Snowy Mountains scheme provided electricity to NSW, Vic and ACT.

In the competitive markets established in Victoria and NSW, and progressively in the NEM, generators must compete to supply electricity forcing them to operate as efficiently as they can. Retailers will be able to choose with whom they contract, which will put further pressure for efficiency in generation. The retailers themselves will also face competitive pressure on their price over cost margins and the need to better package services to meet their customers' needs. It is argued by those involved in the development of the NEM that the benefits of competition that will accrue to consumers are lower prices and better choice and quality of services. The market price of electricity will determine whether new capital investment is needed and is economic.

The NEM works through a wholesale spot market or pool in which generators' bids to supply power to the pool (and therefore to be allowed to generate) are matched against retailers' (and potentially end-use customers) bids to buy power. This results in a price every half-hour, which varies depending on the electricity load required. The spot price for each half-hour (trading interval) is set at the average of six dispatch prices for each five-minute period in the trading interval. The highest price bid or offer dispatched in a five-minute period will set the dispatch price for that five minutes.

Retailers, generators, and customers large enough to buy wholesale, can all buy and sell through the pool. It means that the real value of electricity, in terms of what it is worth to customers and what it costs to produce, is determined as a market price. This allows the physical flow of electricity between generators and customers to be balanced by the system operator, NEMMCO.

With the price changing every half-hour, only those professionally skilled to deal in the wholesale market will choose to accept exposure to such a variable market price. To minimise this exposure it will be possible and prudent for most generators, retailers and larger customers in the market to enter into contracts to get a degree of certainty over price. A variety of contractual arrangements may be used for this purpose and will be brokered on behalf of market participants by traders.

While the prices between generators, retailers and large customers are determined under these competitive arrangements, because the transmission and distribution networks are natural monopolies, charges for access to, and use of, these networks are regulated so as to reflect fairly the cost. This price regulation is presently undertaken by each participating jurisdiction. As the market develops, the responsibility for price regulation of the interstate network will move to the ACCC.

As outlined above, the operation of the market is managed by NEMMCO that comprises members from each of the participating jurisdictions. The rules governing the NEM are contained in the National Electricity Code that is intended to ensure that competition is fair and ensures an efficient, secure and safe electricity system.

The ACCC is has commenced a process to develop transmission pricing arrangements for the national grid. In the Tasmanian context, Government Prices Oversight Commission (GPOC) is about to commence a pricing review for the Tasmanian transmission system.

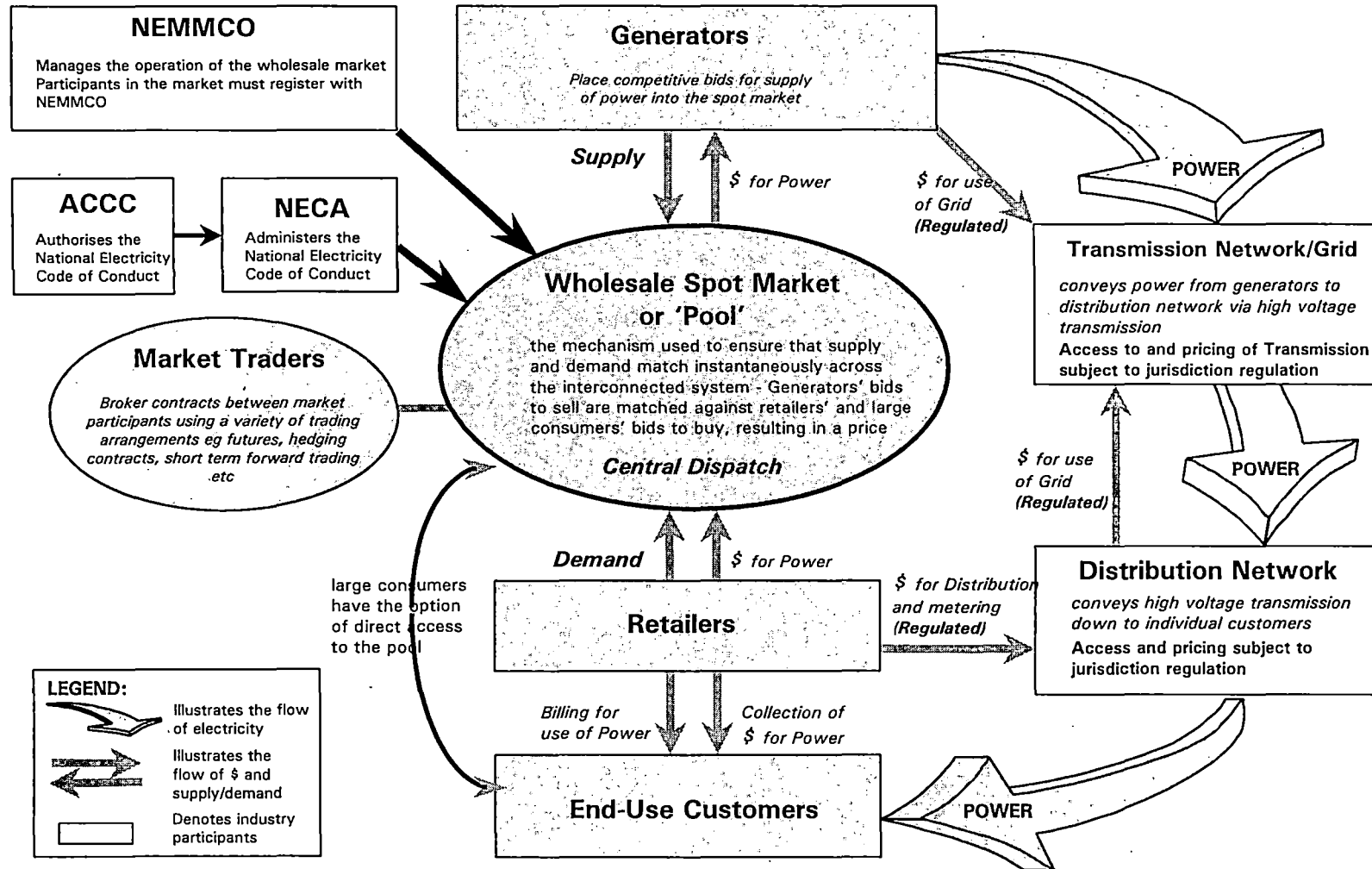
The development of the NEM is seen as a principal component of Australia's ongoing micro-economic reform agenda. The main objectives of the fully competitive NEM, as specified by COAG at a meeting on 19 August 1994 are:

- the ability for customers to choose with which retailers and traders they will trade;
- non-discriminatory access to the interconnected transmission and distribution network;
- no discriminatory legislative or regulatory barriers to entry for new participants in generation or retail supply; and
- no discriminatory legislative or regulatory barriers to interstate and/or intrastate trade.³

The NEM will allow energy supply companies to trade across State and Territory boundaries through a single wholesale power 'pool' with the expectation that consumers will be able to reap the benefits of competition using their power of choice to obtain better deals on price and quality of service.

³ Department of Treasury and Finance, Victoria, *Victoria's Electricity Supply Industry - Towards 2000*, June, 1997, p.31

RELATIONSHIPS WITHIN THE NATIONAL ELECTRICITY MARKET



2.3 National Competition Policy Reform

In 1991 Commonwealth, State and Territory governments agreed to examine a national approach to competition policy. An independent inquiry into national competition policy was commissioned in October 1992 and its report, now known as the Hilmer Report, was subsequently released in August 1993.

The recommendations of the Hilmer report were considered by Commonwealth, State and Territory governments and led to agreement on a competition policy reform package in April 1995. The substance of this reform package is to extend the scope of the Trades Practices Act 1974 and establish a process to identify and remove impediments to competition throughout the economy. It includes the establishment of the Australian Competition and Consumer Commission (ACCC), which assumes the functions of the Prices Surveillance Authority and acts as regulator for many industry access arrangements.

Three inter-governmental agreements were signed at the April 1995 meeting of COAG to support the reform package:

1. the *Competition Principles Agreement* which is the key agreement aimed at removing impediments to competition including legislation, special advantages and disadvantages conferred on some GBEs, restriction on the entry of competitors, monopoly pricing and the structure of some monopolies.
2. the *Conduct Code Agreement* which sets out the basis for extending the application of the Trades Practices Act, including to GBEs; and
3. the *Agreement to Implement the National Competition Policy and Related Reforms* (or the 'Money' Agreement as it has been termed), which provides for redistribution of some of the tax gains, accruing to the Commonwealth as a result of reform, back to the States and Territories which have implemented the reforms.

Under the *Competition Principles Agreement* the National Competition Council (NCC) was established to assess the progress of each State/Territory with their competition policy and related reforms prior to recommending to the Commonwealth whether they should receive payments under the 'Money' Agreement or not. The Reform Requirements and anticipated Competition Payments to Tasmania are set out in the Table below. In addition to the Competition Payments there is an additional per capital Financial Assistance Grant (FAG) Guarantee also associated with the National Competition Policy Agreements. The amount of these FAG payments commences in 1997-98 with a payment of \$7.6 million and rises to \$62.7 million by 2005-06.⁴

⁴ Department of Treasury and Finance, Tasmania, *The Structural Separation of the Hydro-Electric Corporation, National Competition Policy Implications*, February 1998, p.7 and Government of Tasmania, *National Competition Progress Report, April 1995 to 31 July 1997*, August 1997, p.5.

Tranche	NCP Electricity Reform Requirements	Anticipated NCP Payments to Tasmania (1996-97 prices)
First Tranche, commencing 1997-98	<ul style="list-style-type: none"> • Relevant jurisdictions must have taken all measures necessary to implement an interim competitive NEM. • While Tasmania remains not interconnected it is not regarded as a relevant jurisdiction. • NCC assessed Tasmania as having achieved satisfactory progress in the context of being a non-relevant jurisdiction and Tasmania received its first Tranche payment in 1997-98. 	<u>Competition Payment:</u> \$5.5 million annually for 1997-98 and 1998-99 <u>FAG Guarantee:</u> 1997-98 \$7.6 million 1998-99 \$14.4 million
Second Tranche, commencing 1999-00	<ul style="list-style-type: none"> • Relevant jurisdictions must have completed the transition to a fully competitive NEM by 1 July 1999. • Tasmania's position will depend on development of interconnection to join the NEM. 	<u>Competition Payment:</u> Rises to \$11.0 million annually for 1999-00 and 2000-01 <u>FAG Guarantee:</u> 1999-00 \$21.1 million 2000-01 \$28.0 million
Third Tranche, commencing 2001-02	<ul style="list-style-type: none"> • Relevant jurisdictions must have continued their effective observance of the COAG electricity reform requirements. • Tasmania's position will depend on development of interconnection to join the NEM. 	<u>Competition Payment:</u> Rises to \$16.4 million annually from 2001-02 onwards <u>FAG Guarantee:</u> 2001-02 \$34.9 million 2002-03 \$41.9 million 2003-04 \$48.8 million 2004-05 \$55.7 million 2005-06 \$62.7 million

The reforms required for NCP payments include the facilitation of a NEM by participating jurisdictions. The NCC has indicated that Tasmania is not considered a participating jurisdiction while it remains unconnected with the mainland grid but would be required to meet the NEM requirements if interconnected. Tasmania has received its first tranche payment but will need to comply with a number of obligations in relation to electricity reform in order to qualify for its second and third tranche payments. These obligations will exist but differ depending on whether Tasmania interconnects to the mainland grid or not.

The Tasmanian Government has committed to joining the NEM through the proposed development of Basslink subject to its economic viability. In the view of the NCC, this commitment has placed special obligations on Tasmania over time in contrast to other non-participating jurisdictions. This issue is developed at Section 2.5.1.

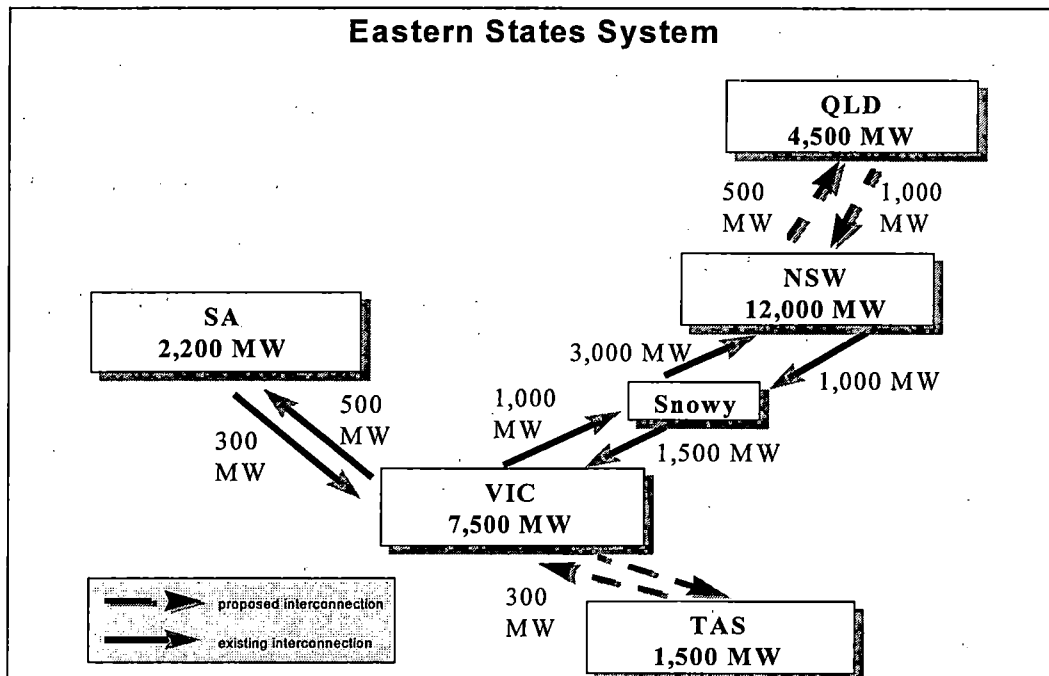
2.4 State and Territory Progress in Reform

2.4.1 Market Development

Victoria has led the development of a wholesale electricity market, one having commenced in July 1994, administered by the Victorian Power Exchange. This, together with the market established in New South Wales in May 1996, has provided the basis for an interim and transitional phase of the NEM known as NEM1, which commenced on 4 May 1997. The ACT is also a participant in NEM1, allowing it to import electricity from Victoria as well as its traditional source in NSW.

South Australia is connected to the Victorian transmission system and is presently undertaking the necessary structural changes prior to officially joining the NEM in 1998. Queensland is in the process of developing an interconnection with NSW to become part of the NEM in 2001.

The commencement NEMMCO's operation of the NEM was due on 28 March 1998 but has now been delayed until mid-May 1998 to allow for full testing of the software and management systems that will integrate the market. The generation and interconnection capacities across the existing and proposed eastern states system are illustrated in the diagram below.⁵



Source: Department of Treasury and Finance, Victoria, *Victoria's Electricity Supply Industry Towards 2000*, June 1997, p.41.

⁵ Department of Treasury and Finance, Victoria, *Victoria's Electricity Supply Industry - Towards 2000*, June 1997, p.41.

2.4.2 Structural Reform

Victoria

The former State Electricity Commission of Victoria (SECV) went through a series of changes commencing in October 1993.

Stage 1 - From monopoly to independent businesses (October 1993)

The disaggregation of the vertically integrated SECV to create three State-owned bodies (equivalent to GBEs) to operate the generation, transmission and distribution/retail components of the former SECV.

Stage 2 - A competitive industry is established (October 1994)

The creation of eight State-owned companies (established under Corporations Law) operating in a competitive framework:

- the Victorian Power Exchange (VPX) - an independent company to administer the wholesale electricity market and to oversee system control;
- Powernet Victoria - a transmission network company;
- Generation Victoria - an interim structure comprising five groups of power stations trading as independent producers; and
- five distribution businesses - regionally based companies formed from the SECV and 11 former municipal electricity bodies involved in distribution.

Stage 3 - Implementation (From October 1994)

Completion of structural changes and implementation of new commercial arrangements so that privatisation of the various businesses could be undertaken.

This comprised:

- five generation businesses formed from the horizontal disaggregation of Generation Victoria;
- five distribution businesses as above which were progressively privatised;
- continued development of VPX, shortly to be subsumed by NEMMCO; and
- a single transmission company (Powernet Victoria), now privatised.

A process of privatisation then occurred in Victoria with all distribution companies privatised during 1995, four generation businesses privatised in the period May 1996 to April 1997 and the transmission business privatised in 1997.

The process has included development of accompanying regulatory structures including the Office of the Regulator General and the Office of the Electricity Ombudsman.

Other States

In other States, the changes have not been as radical as those in Victoria but all demonstrate significant changes as summarised in the Table below.

State/Territory	Progress
New South Wales	<ul style="list-style-type: none"> • Electricity Commission of NSW (Pacific Power) restructured in 1991 into commercially oriented business units, with the Network (transmission) business unit formally established as a separate legal entity in 1994. • Disaggregating Pacific Power into three state-owned corporations (GBE comparable) – Pacific Power, Macquarie Generation and Delta Electricity – from March 1996 created three principal generators. • Transmission is operated by a separate entity Transgrid that has responsibility for implementation of the NSW wholesale electricity market. • 25 distribution authorities amalgamated into six large state-owned corporations operational from March 1996. • Working to a timetable of fully deregulating its retail market by July 1999.
South Australia	<ul style="list-style-type: none"> • In 1995 Electricity Trust of South Australia (ETSA) corporations (GBE comparable) was established as a holding company with four wholly owned subsidiary corporations ETSA Generation, ETSA Transmission, ETSA Power and ETSA Energy • ETSA disaggregated to form two entities in Jan 1997 -- ETSA Corp. and Optima Energy • ETSA Corp. retained ownership of the previous subsidiary companies of ETSA Transmission, ETSA Power (distribution and retail) and ETSA Energy (energy trading) • Optima Energy is the generation corporation • SA is a major importer of electricity from Victoria via connection to the Victorian transmission system
Queensland	<ul style="list-style-type: none"> • Queensland Electricity disaggregated into (a set of GBEs): <ul style="list-style-type: none"> – three state-owned generation businesses; – an engineering services business; – seven distribution businesses; – three state-owned retail businesses; and – an autonomous transmission entity known as Powerlink • Planning to interconnect with NSW and has created an interim competitive wholesale market with the intention to move towards a fully competitive market including retail deregulation by 2001.
Australian Capital Territory	<ul style="list-style-type: none"> • Government owned retailer and distributor has been corporatised • Government has recently indicated intention to deregulate its retail market • Electricity supplied to the ACT is generated in NSW but participation in the NEM will also allow the ACT to source from Victorian generators.
Western Australia, Northern Territory	<ul style="list-style-type: none"> • Although signatories to NCP Agreements, WA and NT have not been party to the COAG national electricity agreements and are not therefore participating jurisdictions in the context of the NEM. • WA has created a GBE, Western Power, which is ring-fenced into five entities although it continues to operate as a vertically integrated monopoly • WA developing its own State-based competitive market and is introducing a third party access system to both transmission and distribution • The NCC has indicated to Western Australia that <i>“it is essential that electricity generation and transmission functions are structurally separate to ensure that the anticipated benefits from a more competitive electricity market are achieved.”</i>⁶ WA has advised the Council that it is currently considering this matter.

⁶ National Competition Council, *Annual Report, 1996-97*, p. 122

2.5 Tasmania's Progress in Reform

When considering reform in Tasmania in comparison to other States, the Committee considers that it is necessary to give recognition to the unique features of the Tasmania ESI. Whilst there are many common elements to the process and elements of reform in several Australian States, particularly those already forming a part of the NEM, it is not axiomatic that these features are in the best long term interest of Tasmania.

Several unique issues to consider for Tasmania are:

- its integrated hydro-electric generation system;
- the scope to which a fully competitive electricity supply industry can be established if Basslink is not viable;
- the small size of the Tasmanian retail market; and
- the significance of the MI contracts in generation capacity and sales; and
- the required timetable and sequence of events for reform.

2.5.1 Commitments under NCP and COAG Agreements

Structural Review

The NCP *Competition Principles Agreement* requires the Tasmanian Government to undertake a structural review of a public monopoly before it introduces competition to the market traditionally supplied by the public monopoly, or before it privatises the public monopoly or any part of it.

The NCP Structural Reform Principles, as contained in Treasury's supporting information, state:⁷

Box 1: National Competition Policy Structural Reform Principles

Clause 4 of the *Competition Principles Agreement* states that:

1. Each party is free to determine its own agenda for the reform of public monopolies.
2. Before a party introduces competition to a sector traditionally supplied by a monopoly, it will remove from the public monopoly any responsibilities for industry regulation. The party will re-locate industry regulation functions so as to prevent the former monopolist enjoying a regulatory advantage over its (existing and potential) rivals.
3. Before a party introduces competition to a market traditionally supplied by a public monopoly, and before a party privatises a public monopoly, it will undertake a review into:
 - a) the appropriate commercial objectives for the public monopoly;

⁷ Department of Treasury and Finance, Tasmania, *The Structural Separation of the Hydro-Electric Corporation*, February 1998.

- b) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly;
 - c) the merits of separating potentially competitive elements of the public monopoly;
 - d) the most effective means of separating the regulatory functions from the commercial functions of the public monopoly;
 - e) the most effective means of implementing the competitive neutrality principles set out in the CPA;
 - f) the merits of any community service obligations undertaken by the public monopoly and the best means of funding and delivering any mandated community service obligations;
 - g) the price and service regulations to be applied to the industry; and
 - h) the appropriate financial relationships between the owner of the public monopoly and the public monopoly, including the rate of return targets, dividends and capital structure.
4. A party may seek assistance with the review from the (National Competition) Council. The Council may provide such assistance in accordance with the Council's work program.

A structural review of the HEC's distribution and retail businesses has been conducted in accordance with Clause 4(3) of the *Competition Principles Agreement* because of the Government's intention to privatise these businesses. This was documented in *National Competition Policy, Review of the Structure of the Hydro-Electric Corporation's Distribution and Retail Businesses*, December 1997 (the Reeves-Breslin Report).

In the context of the Government's proposal, the NCC has indicated that a structural review of the HEC's transmission business is not required as it is a natural monopoly and is to be separated out into a stand-alone entity and regulated in a manner fully consistent with NEC. The NCC is of the view that such reviews already undertaken in other States are sufficient to meet this commitment.

A structural review of the HEC generation business is to be conducted prior to Tasmania joining the NEM. The State has confirmed with NCC its intention to pursue interconnection with the mainland grid via Basslink and therefore to enter the NEM at which time it will be considered a participating jurisdiction and as such be bound by the terms of the NCP Agreements.

It is important to note that the role of the NCC is to review proposals that are put before it, rather than to recommend a particular course of action, which is considered to be the role of the individual jurisdiction. Because of this, although it can be argued that the NCC has been satisfied with the Government's proposal to date, it has not been presented with any alternative propositions so it can not be argued that the NCC has selected the Government's position in preference to others.

Structural Separation

The NEM and COAG Agreements require structural separation of the generation, transmission and distribution elements of the electricity supply industry to ensure that the anticipated benefits from a more competitive electricity market are achieved. The NCC has indicated a strong view that ring-fencing these operations is insufficient.

As a condition of the State's commitment to join the NEM, structural reform through the disaggregation of the HEC will be necessary with a minimum requirement that the transmission business be separated out by the time of entry.

The Tasmanian Government has participated in a series of Agreements at Special Premiers' Conferences and COAG meetings that have successively committed the State to reform of its electricity sector. These are set out in the Table below:

Meeting	Relevant Agreements
SPC, Brisbane 30-31 Oct 1990	Premiers agreed to set up a working group to assess benefits from an extension of, and/or organisational changes to, the electricity grid covering NSW, Vic, Qld, SA, Tas and the ACT
SPC, Sydney 30 Jul 1991	Premiers <ul style="list-style-type: none"> • agreed to establish the NGMC including representatives from NSW, Vic, Qld, SA, Tas and the ACT. • requested more detailed technical appraisals of the proposed links to Tas and Qld for results to be made available at the Nov meeting.
Premiers' and Chief Ministers Meeting, Adelaide 21-22 Nov 1991	SECV and HEC reported that there are significant potential gains from a link between the two States.
Heads of Government, Canberra 11 May 1992	Heads of Government: <ul style="list-style-type: none"> • agreed to develop an interstate transmission network across eastern States, and, to achieve agreed to the principles of separate generation and transmission elements in the electricity sector • Tasmania's participation in the national grid was noted to be dependent on the development of the Basslink proposal.
COAG , Perth 7 Dec 1992	Heads of Government: <ul style="list-style-type: none"> • noted work on the development of an interstate transmission network • reaffirmed their commitment to the principle of separate generation and transmission elements

COAG, Melbourne 8-9 Jun 1993	<p>Relevant Heads of Government:</p> <ul style="list-style-type: none"> • announced a firm commitment to have the necessary structural changes in place to allow a competitive electricity market to commence from 1 July 1995 • confirmed their commitment to the establishment of an interstate transmission network, separate from generation and distribution interests • Tasmania reserved its position pending the outcome of its current review of the structure of its electricity supply industry
COAG, Hobart 25 Feb 1994	<p>Relevant Heads of Government agreed to the principles for a NEM of a uniform approach to network pricing and regulation, and a form of vesting contracts for managing the transition to a competitive market</p>
COAG , Darwin 19 Aug 1994	<p>Relevant Heads of Government noted substantial progress in structural reform to achieve a competitive market and that review of the ESI in both Tas and SA are underway with a view to structural reform consistent with the national model</p>
COAG, Canberra April 11 1995	<p>All Australian Governments reached agreement on NCP and signed the three inter-governmental agreements underpinning it (see Section 2.3, above)</p> <p>Related reforms to the electricity industry established in previous SPC and COAG meetings formed part of the NCP package.</p>
Leaders' Forum Adelaide 12 Apr 1996	<p>Leaders discussed the creation of a NEM and reaffirmed their commitment to implementing the COAG agreements</p>

2.5.2 *Legislative Reform*

A package of legislation, principally the *Electricity Supply Industry Act 1995* has been passed through the Tasmanian Parliament creating a framework for increased competition in the Tasmanian ESI. This Act removed the HEC's statutory monopoly on electricity generation and transferred its regulatory and advisory responsibilities to Government Agencies, primarily the Office of Energy Planning and Conservation (OEPC).⁸

At the same time the Government introduced the *Government Prices Oversight Act 1995* to establish the GPOC to independently assess the costing and pricing policies of public monopolies (including the HEC) to ensure that monopoly power is not being abused.

GPOC makes recommendations to the relevant Ministers on the pricing of government monopoly services. Under the Act, the Minister for Energy is required to set maximum prices for electricity tariffs to retail customers for a three-year period, taking into account the recommendations from GPOC. In the context of the structure of the NEM discussed in Section 2.2, above, GPOC holds the jurisdiction responsibility in Tasmania for the regulation of transmission and distribution pricing.

2.5.3 *Disaggregation of the HEC*

In accordance with the requirements of the Competition Principles Agreement, the Minister for Finance commissioned a structural review of the HEC's distribution and retail businesses, the Reeves-Breslin Report, which was completed in December 1997.⁹ This report recommended that "the distribution and retail businesses of the HEC should be carried out by separate legal entities in a competitive Tasmanian electricity market" and that "full separation be implemented prior to the introduction of competition in the Tasmania electricity market."(pxiii) This recommendation was based on the view that "... a single distributor/retailer with ring fenced functions would clearly not provide the same level of open access and retail competition and substantially lessens the chances that competitive gains in the generation sector would be passed through to consumers."¹⁰

⁸ Other Acts in the package included the *Energy Co-ordination and Planning Act 1995* and the *Hydro-Electric Corporation Act 1995* with the latter establishing the HEC as a Government Business Enterprise under the *Government Business Enterprises Act 1995* with a more commercial focus than its predecessor.

⁹ A Reeves and P Breslin, *National Competition Policy. Review of the Structure of the Hydro-Electric Corporation's Distribution and Retail Businesses*, December 1997.

¹⁰ A Reeves and P Breslin, *National Competition Policy, Review of the Structure of the HEC's Distribution and Retail Businesses*, December 1997.

The Government rejected the Reeves/Breslin recommendation to split distribution and retail and has indicated its intention to disaggregate the HEC into generation (including system control), transmission and combined distribution/retail businesses. The Government's decision to reject the Reeves/Breslin recommendation was based on the following views:

- the recommendation was not consistent with what is happening in other States;
- the separation would result in the businesses being very small relative to mainland firms and thus leave the Tasmanian firms at a disadvantage;
- the scope for the distribution business being able to obtain a retail licence in another state and operate in Tasmania in conjunction with its distribution business;
- the additional costs which could lead to a lower sale price for the businesses; and
- satisfaction that existing ring fencing arrangements for retailer/distributors being adequate to protect consumers.¹¹

The Government subsequently introduced the *Electricity Companies Bill 1997* into Parliament to provide for the establishment of one or more companies (limited by shares and incorporated under the Corporations Law) for the transmission, distribution and retailing of electricity in Tasmania.

... with each such company having as its primary purposes one or more of the following activities:

- (a) the transmission of electricity;
- (b) the distribution of electricity;
- (c) the retailing of electricity;
- (d) any other activity, other than the generation of electricity, related to or associated with the transmission, distribution or retailing of electricity.[s5(1)]

If the Government proposes to form such a company, Section 5(2) of the Act requires the Minister for Energy to lay before both Houses of Parliament a statement specifying –

- (a) the intention to so form or participate in the formation of such a company; and
- (b) the primary purposes of the company; and
- (c) any other information the Minister considers appropriate.

Both Houses of Parliament must approve the Minister's proposal before a company can be formed.

The *Electricity Companies Act 1997* was passed by both Houses of Parliament and received Royal Assent on 22 December 1997.

¹¹ Paraphrased from Department of Treasury and Finance, Tasmania, *The Structural Separation of the Hydro-Electric Corporation, National Competition Policy Implications*, February 1998, p.18.

2.5.4 *The Government's Plans for Further Reform*

The Government has also outlined proposals to part privatise the HEC through the sale or lease of the transmission and distribution/retail businesses and to participate in the NEM through an undersea interconnector called Basslink between Tasmania and the mainland grid in Victoria.

There is a range of factors driving further reform in Tasmania from national competition policy and industry reform, including the intention for Tasmania to participate in the emerging NEM, to local drivers such as the new vision for the HEC developed by its Board. The rationale for reform in the context of disaggregation is discussed further in Chapter 5, below.

Chapter 3 - The Rationale for Electricity Reform in Tasmania

When considering how best to approach its complex terms of reference, the PAC developed an agreed framework that analyses the rationale behind the Government's proposed electricity reform agenda. This links the problems and issues the Government is trying to address, the means by which it is trying to address them, and the ultimate outcomes that it is seeking to achieve. This framework is illustrated and described in this Chapter.

3.1 The Problems and Reform Issues

There are broadly four sets of problems or reform issues facing the State that the proposed reforms to the State's electricity supply industry are designed to address. These are discussed in Sections 3.1.1 to 3.1.4, below.

3.1.1 Obligations under the NCP and COAG Agreements

The State has obligations through NCP commitments and the COAG reform agenda to introduce regulation and competition into its electricity market as discussed in Chapter 2, above.

In summary these include:

- **structural review** requirements under the NCP if the Government intends to introduce competition into a market traditionally supplied by a public monopoly or it intends to privatise a public monopoly; and
- COAG requirements for entry into the NEM including **structural separation** of HEC transmission from generation, the ability of customers to choose their supplier, the removal of any barriers to new entry and the establishment of an appropriate regulatory regime.

Other States are moving to reform in readiness for their participation in the NEM and in order to meet their commitments under these Agreements. Tasmania's obligations under NCP are very clear if Basslink proceeds. If Basslink does not proceed these obligations, and therefore the imperatives for associated reform, are less clear. This issue is discussed in more detail in Section 5.1, below.

3.1.2 Business Imperatives for the Hydro-Electric Corporation

Evidence provided to the Committee by many witnesses indicated that there has been a compelling need to improve the efficiency of electricity supply authorities around Australia. Some held the view that there would be significant productivity and efficiency gains to be made through the disaggregation and a consequent improved business focus of the HEC.

The best argument we have in those sorts of terms at the moment is the business focus argument that, if in fact you disaggregate the units into areas of activity that have got fairly clear focus to them, rather than having to be concerned about all the integration elements, that is one of the ways of removing under-performance in those terms.¹²

Several witnesses acknowledged that there is a cycle to organisational change with “disaggregation and aggregation occurring from time to time, and probably at any one time some industries or some businesses are going one way and some are going the other way” it was also argued that it is change itself that is required to yield efficiency gains rather than the nature of the change.¹³

Evidence from the HEC highlighted that, as a consequence of the changing electricity industry, nationally and internationally, and the need to improve the organisation’s business focus, change is inevitable for the HEC.

Central to the Board’s strategy for positioning the business in the changing electricity environment is the indisputable fact that the status quo is not an option for the HEC.

The end of the hydro-industrialisation era in the early 1990s and the introduction of reforms to the electricity market Australia wide in 1995 heralded a period of immense change for the HEC and its business.

Following a series of strategic planning workshops in 1996 and early in 1997, the HEC Board advised the Tasmanian government that a failure to embrace change would not just result in stagnation for the HEC as a business but in its serious decline and loss in its total value. In this environment, to stand still, or to refuse to change, is to go backwards.¹⁴

The HEC further argued that there are potential efficiency gains from disaggregation that come from breaking up the “culture of one business” and by “concentrating the efforts of management ... to make sure the decisions that they are making are decisions which fit that business” suggesting that a “one-size-fits-all-approach” is not appropriate when different parts of the entity have different risk profiles.¹⁵

3.1.3 The State’s Economic and Fiscal Position¹⁶

The public sector finance problems facing Tasmania are considered to require greater access to revenue for the Consolidated Fund. In economic terms, Tasmania has relatively high unemployment and low growth. There is also a significant debate on the level of state debt and the State’s capacity to service this debt. These issues will be considered in detail in subsequent reports.

¹² Dr M Vertigan, 23 February, Melbourne, p.4.

¹³ Dr D Norton, 12 March 1998, p.26 and Dr M Vertigan, 23 February, Melbourne, pp 4-5.

¹⁴ HEC Submission, p.2

¹⁵ Dr D Norton, 12 March 1998, p.26

¹⁶ Department of Treasury and Finance, Tasmania, *Tasmania’s Debt Burden*, February 1998, *The Tasmanian Budget: Competing Demands and Budgetary Constraints*. February, 1998 and Mr D Challen, 12 February 1998.

3.1.4 Future energy supply and risk management¹⁷

Current energy demand forecasts, if correct, indicate that within three years, the total electricity load required will exceed the hydro system capability and that after nine years (the year 2005-06) this gap would grow to 100MW_{average} (approximately 9% of system capability). While this could be met in the short term through a combination of demand-side management and running down the water storages, it is not a sustainable long term position, particularly in the event of lower than average rainfall or drought.

The Committee has not concluded its investigations of future energy requirements. This issue will be considered in detail in subsequent reports.

3.2 The Proposed Solutions

3.2.1 The Government's Position

In April 1997 the Premier, the Hon Tony Rundle MHA, launched the State Government's *Directions* Statement which contained a package of initiatives. These include:

- the intention to structurally separate the transmission and distribution/retail businesses of the HEC;
- the intention for the State to fully comply with its NCP obligations;
- the intention to withdraw equity from the HEC by selling or leasing the transmission and distribution/retail businesses and using the proceeds to retire Consolidated Fund debt and to fund new initiatives;
- the proposed development of Basslink within the next four years as the means of accessing Tasmania's next electricity source, with Basslink to be funded by the private sector;
- the intention to integrate Tasmania into the NEM through Basslink;
- the requirement that the HEC Board prepares the HEC for participation in the NEM and explores opportunities to build on its sustainable competitive advantages to achieve growth in value;
- encouragement of the private sector to determine the gas potential of the Yolla gas field and encouraging the development of a major new industry which would justify the expense of bringing gas ashore; and
- the introduction of full retail competition to the State's electricity market as soon as practicable to improve customer choice and introduce pressure for lower prices for households and small businesses.

¹⁷ Office of Energy Planning and Conservation, Tasmania, *Electricity in Tasmania*. A position paper on the current market situation and future prospects. April 1997, Sections 2 and 3 and *Hydro-Electric Corporation. Demand Forecasts*. (No. 14)

3.2.2 *The Outcomes Sought*

In pursuing its strategies for economic and fiscal recovery and integrated energy development the Government put forward evidence to the Committee that it is seeking to achieve a range of outcomes.¹⁸ These are listed on the right-hand side of the diagram.

3.2.3 *Alternative Solutions Proposed*

During the course of its inquiry, the Committee has identified alternative views to those of the Government about the solutions to the problems that Tasmania faces. These views will be discussed in subsequent reports.

In the context of this interim report, there is an alternative view that structural separation of the HEC can occur by ring-fenced business units, subsidiary companies or GBEs as opposed to the fully separated companies proposed by Government. Underpinning this view is the belief that it would be more appropriate to work towards an alternative time frame which addresses the need to reform the ESI in the absence of equity withdrawal and/or Basslink.

The following diagram illustrates the discussion above including both the options proposed by Government and a range of alternative views.

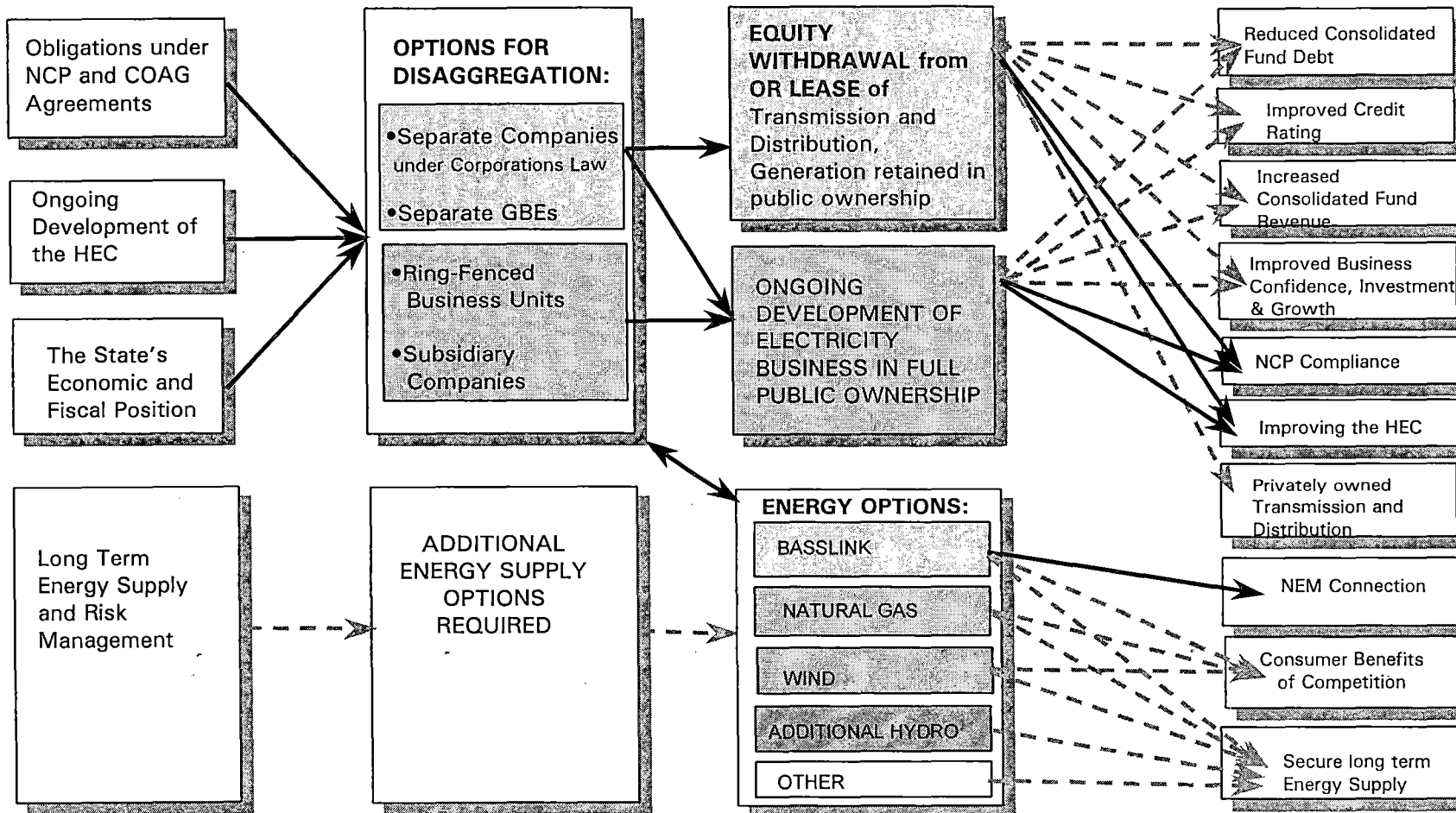
¹⁸ Submission from Department of Treasury and Finance, Tasmania, and Mr D Challen, 12/2/98.

COMPONENTS OF ELECTRICITY REFORM

PROBLEMS TO BE ADDRESSED

—————> Denotes matter considered in this report
 - - - - -> Denotes matter NOT considered in this report

OUTCOME SOUGHT



3.3 The Relationship Between Disaggregation, Sale/Lease and New Supply Options

The rationale for the disaggregation of the HEC's generation, transmission and distribution/retail businesses on its own (ie without considerations of the sale/lease, new energy supply options including entry to the NEM via Basslink) arises from:

- the need for the HEC to evolve in its current business and industry environment,
- the need to develop competition and appropriate regulation for the State's electricity market and
- the State's obligations under NCP.

When the issue of the sale or lease is brought into the picture then a further argument for disaggregation emerges in that the entities to be sold or leased must be structurally separated beforehand.

When the development of new energy options such as Basslink are also brought into the picture then it is argued that disaggregation is necessary because it allows for both the development of competition in generation and the State's obligations under the COAG reform agenda to be fully met.

A full analysis of the reasons to disaggregate is provided in Chapters 4 and 5 below.

Chapter 4 - Structural Approaches to Disaggregation

4.1 The Current Structure of the HEC and its Operation as a Vertically Integrated Monopoly

The HEC is a state owned corporation structured under the *Government Businesses Enterprise Act 1995*. It is a vertically integrated monopoly in the electricity supply industry in Tasmania. A single Government appointed Board manages the HEC.

Vertical integration has in the past been the norm in the operation of electricity supply authorities in Australia. Vertical integration offers the benefit of allowing a business to maximise its economies of scale in production and overheads, thus reducing its overall costs. Indeed, in August 1993 a report submitted by Cresap Langton to a joint HEC/Tasmanian Government team examining selected aspects of a future ESI in Tasmania, proposed that:

... the most effective longer-term structure for HEC within the Tasmanian ESI is the first option, namely a vertically integrated company. This has been selected for the following reasons:

- It provides the most easily regulated pricing environment. ...
- It clearly allocates the obligation to supply. ...
- It produces more sustainable competition. ...
- It is the lowest cost option. ...
- It is the option that best supports HEC's improvement of efficiency. ...
- It is the option that provides the best non-price benefits to Tasmania.¹⁹

The opposing view is, however, that vertical integration can allow significant distortion of a business's cost structure, exploitation of its market power and reduced efficiency. It allows for the operation of cross subsidies that distort both costing and pricing of services. It is also argued that, if competition is absent, there is no external pressure (in the absence of regulation) to adopt efficient cost structures and market based pricing, as the goal of the organisation will be overall profit maximisation.

The Industry Commission in their review of ETSA made a comprehensive study of this matter. They drew attention to a 1991 study of 74 privately owned electricity utilities in the USA that "demonstrated costs would rise by almost 12 per cent if vertically integrated firms were to be separated into generation and network enterprises". That study also noted that competition at the generation stage may also lead to gains that offset efficiency gains from vertical divestiture. In summary, the Commission accepted that "vertical separation in the ESI will mean some trade-off exists between integration economies and the benefits of competition".²⁰

Tasmania currently only has one Generation, one Transmission, one Distribution and one Retail business. Because the Transmission and Distribution businesses are natural monopolies and, in the current HEC integrated structure, generation and retail are not contestable, the development of competition in the ESI as the means of breaking

¹⁹ Cresap Langton, *Corporatisation and Private Equity Options*, 9 August 1993, Executive Summary, pp10-11.

²⁰ Industry Commission, Canberra, *The Electricity Industry in South Australia*, p.95

monopoly power is difficult. The alternative to the introduction of competition is the introduction of a network access regime and the regulation of prices. Regulation of prices has been recently introduced in Tasmania through *the Government Prices Oversight Act 1995* (see Section 2.5.2, above).

Evidence from the Government, based on advice received from Ernst and Young in March 1998, claimed that benefits through the elimination of cross-subsidies and other distortions would result from the disaggregation of the HEC:

Formal separation of monopoly transmission and distribution activities from the contestable activities [generation and retail] allows the identification and removal of cross-subsidisation that may exist. Without full disaggregation an incentive exists to attribute costs to monopoly business activities away from contestable activities where costs can be recovered through regulated tariffs.

Formal disaggregation will allow for cost reflective tariffs to be developed by the regulator. This may result in lower tariffs and/or tariffs which provide more economically efficient pricing signals to customers.²¹

However, specific examples of cross-subsidy were not presented to the Committee.

Evidence from Professor Hilmer also argued the benefits of disaggregation in this context:

... you can see competition working in generation, and there are many other areas in which it is more difficult – such as transmission - to see competition working. What you do not want is the monopoly profit in the non-competitive area being used to help one competitor or to otherwise distort what happens, say, in the competitive area – generation. If you can cleanly separate these it is going to be easiest to make sure that that does not happen and therefore there is a presumption in favour of it.²²

Professor Hilmer placed a caveat on this comment by acknowledging that Australia has many quite different parts and that what you might do in Tasmania may be different.

I think the real issue ... is going to be the question of, will you have a contestable generation market in Tasmania, because if you do not, then you start to have different forms of organising a monopoly. But the competition of electricity starts with generation. If you do not produce competitive electricity through a variety of potential sources then the rest of it does not make nearly as much sense in terms of a competitive model.²³

Structural change has occurred in the HEC to improve the overall efficiency and effectiveness of the organisation and cost reductions of 4% annually have been achieved in recent years.

The 1997 Annual Report of the HEC outlined briefly its structure and response to the requirements of the NCP. The transmission business of the HEC has been ring fenced. Four operational divisions have been put in place - Generation, Network, Systems and

²¹ Correspondence from Ernst and Young to Department of Treasury and Finance, Tasmania, dated 11 March 1998, p.4, (parentheses added).

²² Professor Fred Hilmer, Sydney 19 March 1998, p.5

²³ Professor Fred Hilmer, Sydney 19 March 1998, pp 5-6.

Energy Services. The office of the Chief Executive Officer (CEO) and a Consulting Business Unit supports the four divisions.

The changeover transition began in March 1997 with the new divisional structure taking effect from the beginning of the 1997-98 financial year. The new Divisions are to act as independent business units, reporting their financial performance in separate profit and loss accounts and balance sheets, all of which will be consolidated into a corporate report for the HEC as a whole.

The HEC's future strategy, had it been implemented, would have provided for disaggregation into subsidiaries by April 1998.

4.2 What is Disaggregation?

Disaggregation herein refers to the structural separation of formerly vertically integrated electricity entities. The breaking up of vertically integrated monopolies in the electricity industry is a fundamental element of the national reform of the ESI.

The proposed process of disaggregation in Tasmania is to involve the organisational and legal separation of the existing business of the HEC to form independent entities. The Government, through the *Electricity Companies Act 1997*, has clearly indicated its intention to disaggregate the HEC through the formation of separate companies, under the Companies Code, to own and operate one or more of:

- transmission;
- distribution;
- retail; or
- any other activity, other than generation, related to transmission, distribution or retailing. (Refer Section 2.5.2 and 2.5.3, above)

The remaining organisation would thus become a GBE solely responsible for the generation business.

4.2.1 Vertical and Horizontal Disaggregation

In proposing disaggregation consideration must be given to:

- **vertical disaggregation** (the separation of dissimilar activities to separate units – generation, transmission, distribution, retail) which has occurred in all states entering the NEM; and
- **horizontal disaggregation** (the separation of one business into several smaller businesses providing the same services, for example creation of multiple distribution/retail businesses or generation businesses) which has occurred in most states and has been the initial basis of creating competition in generation and retail/distribution in NSW and Victoria.

4.2.2 *The Corporate Structures for Disaggregated Units*

In addition to determining the units that are to be structurally separate, it is necessary to determine the corporate structures to be applied in operating the business units.

The alternative approaches considered by the Committee have been:

1. ring-fencing
2. the creation of subsidiary companies
3. the creation of separate GBEs
4. the creation of separate companies under Corporations Law

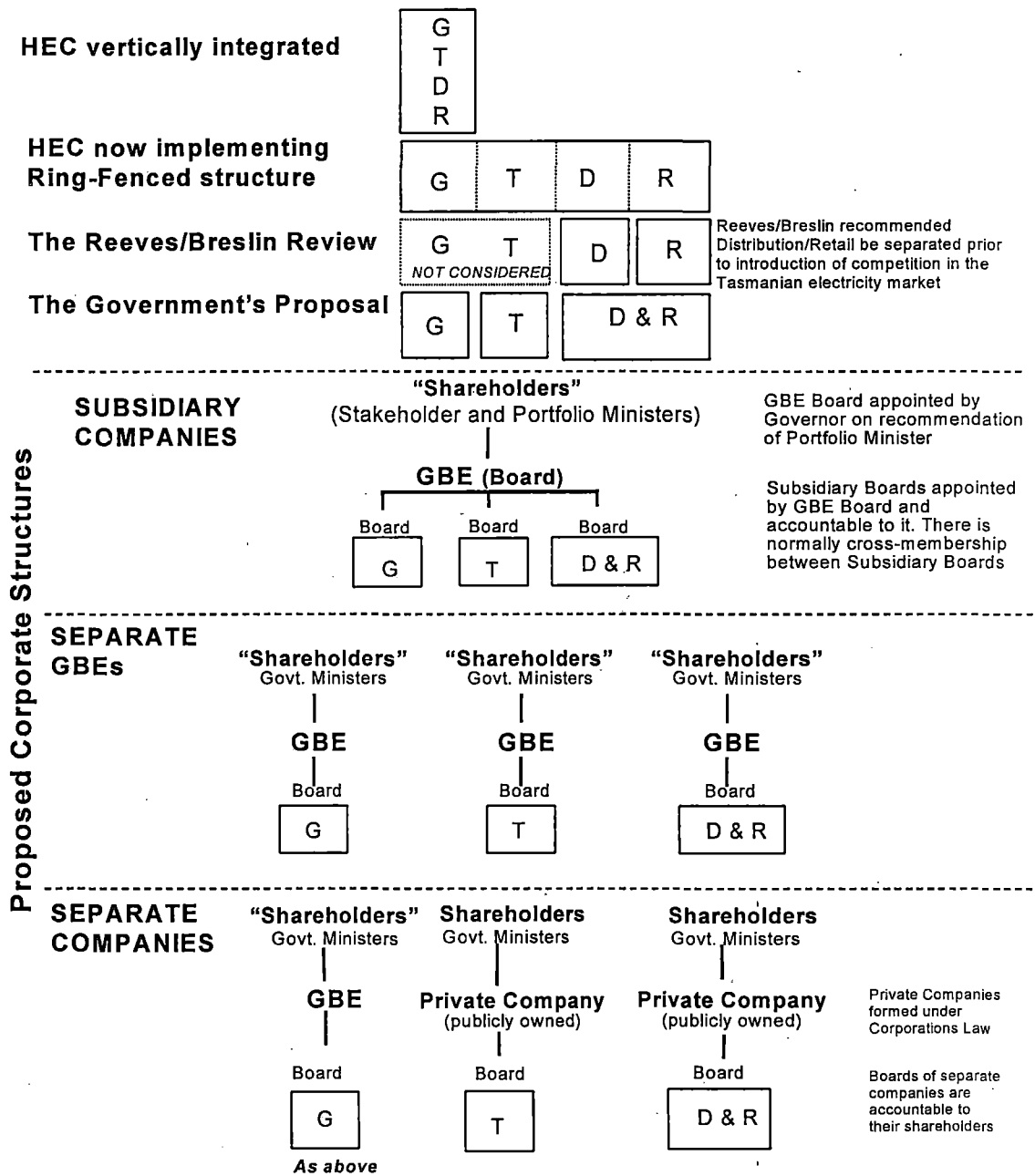
Ring fencing is the simplest approach to achieving separation, as it is solely an administrative arrangement. Ring-fencing entails the establishment of separate accounting and management structures to allow the identification of specific operations within the overall business. This addresses the need for separate accounting and financial information on certain key elements of the electricity businesses for the purposes of monopoly regulation. Currently the HEC is a fully ring-fenced organisation.

The creation of subsidiary companies is an option involving creation of separate legal entities, which are owned and controlled by the Board of the parent company. Each subsidiary has its own Board. Board members are appointed by the Board of the parent company and are accountable to it.

The creation of separate GBEs would involve the disaggregation of the three businesses and creation of Transmission and Distribution/Retail as separate GBEs under the GBE Act each with its own Board. This would require new Portfolio legislation for two new GBEs as well as enabling legislation to allow rearrangement of assets and liabilities.

Creation of separate companies under Corporations Law entails total separation of each business and formation of separate Boards and operating arrangements. Separate companies under Corporations Law achieve the maximum degree of separation. The Boards of separate companies are accountable to their shareholders.

The diagram below illustrates the current structure of the HEC and the alternative corporate structures possible through disaggregation where G = Generation, T = Transmission, D = Distribution and R = Retail. It also illustrates the Government's disaggregation proposal, which is discussed further in Chapter 5.



Section 4.4 provides a detailed comparison of the operational characteristics and other aspects of the three corporate structures illustrated above.

4.3 The Scope of Disaggregation

The HEC is currently a single vertically integrated GBE, which has recently ring-fenced its generation, transmission, distribution and retail businesses. This Section considers the extent to which these four component businesses should be further horizontally or vertically disaggregated.

4.3.1 Generation

As highlighted briefly in Section 4.1, above, the Committee has heard much evidence to suggest that it is the generation business that is the business in which competition can, and should, be introduced. This issue will be considered in depth in subsequent reports.

Evidence presented to date indicates that there is difficulty in splitting generation into smaller units due to the loss of system performance and conflict between storage and run of river systems. The issue for Tasmania is the fully integrated nature of the hydro system that makes it difficult to split up the system.

In contrast, the Nixon Report recommended that consideration be given to splitting HEC's generation business into five competing firms, with the basis of such a split to be the five major catchment areas of the current system.²⁴ Nixon acknowledged, however, that objections to arranging such a split would include loss of coordination, loss of supply security, loss of critical mass and the possibility of the two businesses which dominate storage capacity to ratchet up the price in situations of low rainfall.

Finding 1

The Committee believes at this stage that formation of a single generation business is appropriate, but it has not ruled out consideration of horizontal disaggregation at a later stage.

4.3.2 Transmission

Transmission is seen to be a natural monopoly thus not suited to any horizontal disaggregation. This was confirmed by all other states reviewed. In addition, the NCC has considered the issue of structural separation of the transmission business from generation in other states and recognises the merit of a single transmission business. There is not seen to be any requirement for a structural review prior to separation. This conclusion by the NCC is based on the efficacy of the model in other states where it has already been applied.

Finding 2

The Committee concluded that formation of a single transmission business is appropriate.

²⁴ Hon Peter Nixon AO, Commonwealth State Inquiry into the Tasmanian Economy, *The Nixon Report - Tasmania into the 21st Century*, July 1997, pp 23-27.

4.3.3 *Distribution and Retail*

The structure of the distribution and retail business was considered in the Reeves/Breslin report, which found that there was no scope to horizontally disaggregate the retail business due to loss of scale. However, as outlined in Section 2.5, the Reeves/Breslin report did recommend the structural separation of distribution and retail at the time of entry to the NEM. The reasons for this recommendation related to the small size of the Tasmanian market.

The Committee had evidence from several distribution/retail businesses which all indicated that there were substantial economies of scale in the retail business. It was suggested that the ideal scale was around 1.5 million customers. In this setting, the long-term viability of many retail/distribution companies currently operating would be in doubt.

In evidence, the NCC advised that it would not be formally assessing its level of satisfaction with the structural review of distribution and retail until it receives a report from Tasmania in the next month. However, on 6 April the Committee requested the Government to seek urgent advice from the NCC on the proposed structure of the retail and distribution businesses in Tasmania to assist in the preparation of its interim report.

The President of the NCC, Mr Graeme Samuel advised the Government in correspondence dated 8 April that, although he could not provide comments endorsed by the Council, he had sought and provided the views of the NCC Secretariat on the matters raised. In relation to retail/distribution separation, these views were:

- The Secretariat notes the Reeves/Breslin report to recommend structural separation of distribution and retail once retail competition is introduced.
- The review was conducted in the context of the Tasmanian Government's obligations under clause 4 of the Competition Principles Agreement. The Government is not required to accept the findings of the review. However, the Government is required to demonstrate that there is a clear public interest in retaining an integrated entity upon introduction of the retail market.
- The Secretariat is concerned that the Tasmanian Government's decision to retain an integrated wires and retail business that owns 100 per cent of the network and has 100 per cent share of the retail market will thwart competition in the retail market. Notwithstanding the powers of the regulator, this can be achieved by shifting costs from the retail function to the wires function.
- The risks in this respect are particularly marked for Tasmania given the review's finding that horizontal separation for distribution is not viable – thus distinguishing it from NSW and Victoria.
- The Council will assess the review process and the Government's response in its assessment of progress with implementation of the agreed reforms.²⁵

²⁵ Correspondence from Graeme Samuel, NCC President, to Department of Treasury and Finance, Tasmania, 9 April 1998.

A formal response from the Council is expected to be forthcoming before the end of April. If the NCC is not satisfied with the Government's proposal for some of the reasons set out in the Reeves/Breslin Report then the Government will have to consider alternatives such as establishing separate retail and distribution businesses or further consider the options within the Reeves/Breslin report.

Finding 3

The Committee noted:

- the NCP review (the Reeves/Breslin report) recommended separate distribution and retail businesses in Tasmania;
- the Government did not accept the Reeves/Breslin proposal model and suggested a single distribution/retail business;
- the Government's proposal for combined distribution/retail was consistent with business structures observed in NSW and Victoria;
- the NCP review is subject to NCC assessment as to its compliance with NCP and COAG requirements;
- the NCC has not at this stage undertaken its assessment.

The Committee noted the NCC Secretariat's views on the separation of the distribution and retail businesses.

The Committee considered that, provided the Government is able to demonstrate that there is a clear public interest in retaining an integrated distribution/retail entity upon introduction of the retail market, there should be no impediment to doing so.

4.3.4 Other Observations

The transmission business has a regulated financial return. It is focussed on asset management, which is considered to be low risk. It is sophisticated in terms of technology and it is subject to a major \$500 million reinvestment program over the next ten years.²⁶ This investment is major in national terms, relative to the network size. The Committee, in gathering and considering evidence, expressed concern about the need for this investment. The projected annual investment was, in broad terms, equivalent to the current total annual revenue of the business. The Committee will report on this issue in greater detail in subsequent reports.

The generation business also has a focus on asset management but has significant risks to manage. The risk exposure of this business in entering the NEM or another competitive environment is high. Evidence from witnesses associated with the generation businesses in both NSW and Victoria pointed out the risks inherent in the generation business with a movement to participation in the NEM. The Hogg Report addressed the issue of risk in some depth at Section 5.6.²⁷ The evidence on the new risks is strong and would require significant change and new skills on the part of the HEC to effectively manage in the new competitive environment.

²⁶ Hydro-Electric Commission, *Annual Report 1996-97*

²⁷ *Report of the Committee of Inquiry into Sale of the NSW Electricity Assets* pp 64-65

The distribution/retail business is significantly different to the previous two. Entry to the NEM will bring the need to introduce contestability for retail customers (see Section 5.2, below). The timetable for this change is yet to be established in Tasmania. Other States have set various timetables, which would see all customers as being contestable from July 1999 to January 2001.

On the basis of evidence from other states, the introduction of retail customer contestability in Tasmania will require major change on the part of the existing HEC retail business.

Existing private and public sector operators already in place in Victoria and NSW are likely to be better equipped and more experienced in competitive markets than is the existing HEC business unit. It is evident from other retail companies that there would be some interest in entering the Tasmanian market. This risk is likely to be better managed through ensuring a longer lead-time for preparation on the part of the HEC.

Evidence from existing retail/distribution businesses in Victoria suggested that the market size of Tasmania would preclude any major new retailer entering. However, there is risk of interstate retail businesses "cherry picking" larger customers which can be serviced at low cost. Powercor (a Victorian retailer) has made major inroads in the NSW electricity industry, building its market share of contestable business to around 16% in a short period of time.²⁸ Thus there are market threats to the present business which will emerge with the introduction of contestability.

²⁸ Mr A Walker, Sydney 19 March 1998.

4.4 Comparison of Corporate Structures

4.4.1 Operational Characteristics

	GBE OWNED SUBSIDIARIES FORMED UNDER CORPORATIONS LAW	GBE	WHOLLY GOVERNMENT OWNED PRIVATE COMPANY UNDER <i>ELECTRICITY COMPANIES ACT 1997</i>
Current examples of structure	Nil	HEC and all other GBEs	Nil under Act at present. TT-Line and four ports Corporations are all private companies in similar situation to the proposed businesses
Appointment of directors	HEC Board	Governor on recommendation of Portfolio Minister	Shareholders (currently two Ministers)
Duties of Directors	Boards of subsidiaries are accountable to the Board of the GBE The duties of the GBE Board are prescribed by <i>GBE Act</i> . Similar to Corporations Law	Prescribed by <i>GBE Act</i> . Similar to Corporations Law	Corporations Law provisions - subject to ASC scrutiny
Capacity for policy direction from Minister/Shareholder	As for GBEs – the provisions for a Ministerial Charter and Ministerial directions extend to the subsidiary through the Board of the Parent GBE. The use of powers of direction is tempered by the capacity for all or some of the Directors of a Board to resign if the direction is not seen to be in the interests of the GBE. The corollary is that the Minister (through the GBE Board) can seek to remove the members of a subsidiary Board if that Board fails to comply.	Act provides for Ministerial Charter giving broad policy expectation of GBE [<i>GBE Act S36-38</i>] Act provides capacity for Minister to give direction to Board on long term objective for GBE and on any issue where draft corporate plan is inconsistent with Ministerial Charter to the extent of the inconsistency [<i>GBE Act S40(2)</i>]	Within the limits of the legislation, the shareholders can give direction to the Board by a special resolution at a general meeting of the Company. Potentially greater control over direction than GBE due to scope for explicit direction The use of powers of direction is tempered by the capacity for all or some of the Directors of the company to resign if the direction is not seen to be in the best interests of the company.

	GBE OWNED SUBSIDIARIES FORMED UNDER CORPORATIONS LAW	GBE	WHOLLY GOVERNMENT OWNED PRIVATE COMPANY UNDER <i>ELECTRICITY COMPANIES ACT 1997</i>
		<p>Act provides for joint directions from Stakeholder and Portfolio Ministers on financial performance objectives. [GBE Act S40(3)]</p> <p>Act provides for directions relating to performance of CSOs [GBE Act S65]</p> <p>The use of powers of direction is tempered by the capacity for all or some of the Directors of a Board to resign if the direction is not seen to be in the interests of the GBE.</p> <p>The corollary is that the Minister can seek to remove the members of a Board if the Board fails to comply.</p> <p>These powers can be seen as a less explicit control than private company. The Portfolio Act can prescribe further conditions.</p>	<p>The corollary is that the shareholders can remove the Directors of the company if the Directors fail to comply.</p>
Requirement to inform Minister/Shareholder and reporting	As for <i>GBE Act</i>	<p>Fully addressed in <i>GBE Act</i> – wide ranging coverage.</p> <p>Annual report to be tabled within five months of end of financial year and must include prescribed information and be subject to Parliamentary scrutiny [GBE Act S55-56] Can also be subject to the provisions of the Freedom of Information (FOI) Act</p>	<p><i>Schedule 1 Part 2(6)</i> requires company to provide information on request and is incorporated in Memorandum and Articles of Association.</p> <p>Reporting obligations can be established in Memorandum and Articles of Association, which then binds the Company. Also covered by Corporations Law</p>

	GBE OWNED SUBSIDIARIES FORMED UNDER CORPORATIONS LAW	GBE	WHOLLY GOVERNMENT OWNED PRIVATE COMPANY UNDER <i>ELECTRICITY COMPANIES ACT 1997</i>
Payment of tax equivalents	Covered by <i>GBE Act</i> through consolidation of HEC	Covered by <i>GBE Act</i>	<i>GBE Act</i> provisions applied by operation of S14 of the <i>Electricity Companies Act 1997</i>
Payment of dividends	Covered by <i>GBE Act</i> through consolidation of HEC	Covered by <i>GBE Act</i> . Dividend can be up to 100% of after tax profit without reference to Parliament. Special dividend in excess of after tax profit can be directed but subject to Parliamentary motion.	Corporations Law provisions apply. Dividends must be paid out of profits. To go beyond this would involve a reduction of capital, which is limited by Corporations Law to very specific situations requiring Supreme Court approval. Memorandum and Articles of Association can prescribe the process for setting dividends and limit the level of dividends that can be paid.
Capacity to borrow	Controlled by provisions of <i>GBE Act</i>	Controlled by provisions of <i>GBE Act</i>	Controlled by provisions of <i>Electricity Companies Act 1997</i> and can only borrow through Tascorp unless Special Resolution of Parliament varies this.
Loan Guarantee Fees	Controlled by provisions of <i>GBE Act</i>	Controlled by provisions of <i>GBE Act</i>	Same as provisions of <i>GBE Act</i> applied by virtue of S13 of <i>Electricity Companies Act 1997</i>
Community Service Obligations	As for GBE	Provisions of <i>GBE Act</i> set the framework for funding CSOs but there is no obligation for Government to explicitly fund these. CSOs are usually absorbed by the GBE within its operational costs.	S19 of the <i>Electricity Companies Act 1997</i> provides for agreements with the Minister (with approval of Board and Treasurer) to perform activities. Explicit contract for services and payment would be required.
Accountability to Parliament	As for GBE	Must not dispose of main undertaking without consent of Parliament [<i>GBE Act S10(7)-(9)</i>]	Company cannot be formed without consent of Parliament and Parliament can seek to obtain information through the

	GBE OWNED SUBSIDIARIES FORMED UNDER CORPORATIONS LAW	GBE	WHOLLY GOVERNMENT OWNED PRIVATE COMPANY UNDER <i>ELECTRICITY COMPANIES ACT 1997</i>
		<p>Charter must be tabled [GBE Act S36]</p> <p>Audit provisions [GBE Act S54]</p> <p>Annual reporting provisions [GBE Act S55-56] including information on any directions given to board by Minister.</p> <p>Objection by GBE on Ministerial direction to perform CSOs to be tabled if direction is not withdrawn following the objection [GBE Act S65(7)]</p> <p>Direction for payment of special dividends to be approved by Parliament [GBE Act S86]</p> <p>HEC also bound not to deal with electricity generating assets or associated land without Parliament's consent under HEC Act 1995.</p>	<p>Ministerial statement of information under S5(2) of the <i>Electricity Companies Act 1997</i>.</p> <p>No capacity to sell shares or assets as prescribed under <i>Electricity Companies Act 1997</i>.</p> <p>Obligations relating to reporting and provision of information depend on the provisions of the Memorandum and Articles of Association.</p> <p>Special resolution requiring Parliament's approval required to borrow from source other than Tascorp</p> <p>Once established Memorandum and Articles of Association cannot be varied without the consent of Parliament as covered in <i>Electricity Companies Act 1997 Schedule 1, Part 1 (1)</i></p>

4.4.2 Issues Relating to the Disposal of assets/businesses

	GBE OWNED SUBSIDIARIES FORMED UNDER CORPORATIONS LAW	GBE	WHOLLY GOVERNMENT OWNED PRIVATE COMPANY UNDER <i>ELECTRICITY COMPANIES ACT 1997</i>
Capacity to sell/allot or offer shares	No limitation unless the subsidiary operates a main undertaking in which case the approval of Ministers and Parliament required <i>[GBE Act S10(7)-(9)]</i>	Not applicable	Not permitted <i>Electricity Companies Act 1997 S20(1)</i> <i>Electricity Companies Act 1997 S20(2)(a)-(c)</i>
Capacity to sell assets	No limitation unless main undertaking which requires Parliamentary approval <i>[GBE Act S10(7)-(9)]</i>	No limitation unless main undertaking which requires Parliamentary approval <i>[GBE Act S10(7)-(9)]</i>	Not permitted <i>Electricity Companies Act 1997 S20(3)(c)</i>

4.4.3 Establishment phase for structure with existing assets in HEC

	FROM GBE TO SUBSIDIARY	FROM HEC TO OTHER GBE	FROM GBE TO PRIVATE COMPANY
Transfer of Major Assets	Within power of Board subject to approval of Minister and agreement of subsidiary <i>[GBE Act S10(1)]</i> except for electricity generating plant, dams and associated works for hydro power generation and associated land which require Ministerial approval and consent of Parliament. <i>[HEC Act 1995 S7]</i> Restriction on dealing with powerlines removed in 1997 amendment Act	Requires new Portfolio Act and other enabling legislation	Requires Treasurer's approval following consultation with HEC Board No authority exists to create private company to undertake activities other than transmission, distribution and retail. Restriction on dealing with powerlines removed in <i>HEC Amendment Act, 1997</i>
Transfer of Other Assets/Liabilities	Within power of Board subject to approval of Minister and agreement of subsidiary <i>[GBE Act S10(1)]</i>	Requires new Portfolio Act and other enabling legislation	Requires Treasurer's approval following consultation with HEC Board.
Allocation of Debt	No limitation	Requires new Portfolio Act and other enabling legislation	Requires Treasurer's approval following consultation with HEC Board.

Chapter 5 - Rationale for the Disaggregation of the HEC

Six sets of reasons for the disaggregation of the HEC have been presented in evidence to the Committee. These are:

1. The obligations of NCP and COAG agreements
2. The development of competition in the ESI
3. The business imperatives for the HEC
4. The proposed entry of Tasmania to the NEM
5. The need for certainty on the part of Basslink investors
6. Sale/Lease of the transmission and retail/distribution businesses

The rationale and validity of each of these reasons is discussed in Sections 5.1 to 5.6, below under three separate headings:

- *The Need to Disaggregate*, which discusses whether there are grounds for disaggregation in any form or not;
- *The Appropriate Corporate Structure*, which discusses the relative benefits of the different corporate structures; and
- *Timing Issues*, which highlights any time imperatives that may or may not exist.

5.1 The obligations of NCP and COAG agreements

5.1.1 *The Need to Disaggregate*

The State's obligations under the NCP and COAG agreements were discussed in some detail in Chapter 2, above.

In its First Tranche Assessment, the NCC noted that no specific reforms were required by Tasmania to meet the COAG electricity agreements, as Tasmania was a "non-participating jurisdiction".²⁹ Tasmania received a positive assessment on its overall program for NCP reform. The NCC stated in its summary:

Tasmania has given strong commitment to the NCP reform process, developing comprehensive programs for the application of competitive neutrality policies and the review and reform of anti-competitive legislation. It has introduced competitive neutrality principles in all of its significant government business enterprises and has gone further than most other governments in stating that it will extend application of competitive neutrality reform to all business enterprises, regardless of their size, and to significant government business activities.³⁰

The NCC also advised, in evidence from its Chairman, Graeme Samuel, that while Tasmania is not interconnected to the mainland grid, it has participated in the relevant COAG agreements in contemplation of joining the NEM. Therefore, if Basslink does not subsequently emerge as a viable alternative, Tasmania may still be bound to the reform processes established and there would be pressure to continue the process of disaggregation. In evidence to the Committee, the Executive Director of the NCC stated:

The Council has not yet looked closely at exactly what Tasmania's obligations are if Basslink does not proceed. Certainly its view is that once Tasmania is interconnected, Tasmania is obliged to meet all the obligations in the electricity agreement. Its obligations if Basslink does not proceed are somewhat more ambiguous. As I say, Council has not looked at it but there is an argument there that Tasmania, nonetheless, has made a commitment to structural reform in line with the national model.³¹

In its review of the sequence of COAG agreements, the Committee found that Tasmania has been an active participant in meetings since 1990 relating to formation of a NEM. (See Section 2.5, above) The potential for an interconnection, now known as Basslink, has been signalled since 1991.³² The level of Tasmania's commitment has been maintained in the course of those discussions, subject to various review processes.

Because of the accumulating effect of these commitments, the Committee formed the view that successive Governments may have prematurely and unnecessarily committed the State to these electricity agreements.

²⁹ National Competition Council, First Tranche Assessment Report p110

³⁰ National Competition Council, First Tranche Assessment Report p104

³¹ Mr E Willett, Sydney 19 March 1998, p.29

³² NCC Compendium of NCP Agreements

Finding 4

The Committee found that:

- In the view of the NCC, the Tasmanian Government has implicitly agreed to disaggregate the HEC because of its in principle commitment to join the NEM via Basslink and to withdraw equity from the business.
- Given the relationship to NCP tranche payments, commitments to COAG agreements relating to joining the NEM and a decision to withdraw equity are key motivators for the disaggregation of the HEC.
- The NCC considers the State to have significant future obligations to reform regardless of whether Basslink proceeds. The extent of these obligations, if Basslink does not proceed, has not been considered.
- The State may have been prematurely committed to meeting obligations under the COAG electricity agreements.

5.1.2 The Appropriate Corporate Structure

Neither the Government nor the HEC sees ring fencing as a viable choice to achieve structural separation of the various business units. This approach is presently being used in WA, and has received severe criticism from the NCC as it is not seen as adequately compliant with NCP commitments. In its recent assessment of Tasmania the NCC stated that:

... the Council considers that it is essential that electricity generation and transmission functions be structurally separated to ensure that the anticipated benefits from a more competitive electricity market are achieved. The Council's strong view is that ring-fencing these operations is insufficient.³³

Finding 5

- The Committee concluded that, on the evidence before it, there are three significant options for the disaggregation of the HEC being:
 - a single GBE with a subsidiary structure
 - three separate GBEs or
 - a GBE plus two separate companies formed under Corporations Law.
- With regard to the separation of the Transmission business, the Committee did not consider the option of ring fencing worthy of continued consideration. However, subject to advice from the NCC, ring fencing may be an appropriate mechanism to disaggregate the Distribution and Retail components within a combined Distribution/Retail business.
- The issue of cross-subsidies between Distribution and Retail may not be adequately addressed under the Government's proposal.

South Australia elected to create several subsidiaries in disaggregating its vertically integrated authority in 1995. The Industry Commission in its report to the SA Government closely examined this structure.

³³ National Competition Council, First Tranche Assessment – Tasmania

The Industry Commission commented in its conclusions in relation to the use of subsidiaries in South Australia:

... the Commission is not convinced that the current structure is sufficient to promote competition or that regulation can be an effective alternative. The Commission believes it is not possible for ETSA's subsidiaries to act independently whilst at the same time availing themselves of the economies of scale and scope of a vertically integrated structure. As long as the holding corporation is responsible for the whole business and conflicts of interest exist between the subsidiaries, the current structure contains the incentive and the scope for anti competitive conduct while aggravating the problems of regulating transmission and distribution.³⁴

The NCC, in assessing the use of subsidiaries in South Australia concluded that the structure was not considered satisfactory in meeting the goals of structural separation for the NCP electricity agreements on the NEM. In this light, use of subsidiaries may give rise to threats to future NCC assessments of reform in the Tasmanian ESI once it enters the NEM and threaten tranche payments. This issue has arisen recently in relation to the perceived slow process of reform in the Western Australian ESI.

In evidence from the Chairman and CEO of the NCC the question was put as to the NCC's attitude to complete structural separation of transmission, whilst leaving the remaining elements (distribution and retail) as a subsidiary of the former vertically integrated authority. The NCC Secretariat indicated this structure is not appropriate in the NEM environment. (See Section 5.4.2 for further detail).

Finding 6

The Committee concluded that:

- The implementation of a subsidiary structure in an environment in which Basslink was not occurring would be an option to be considered provided it does not jeopardise future NCP tranche payments.
- If a structure is being established to enable Basslink to be constructed and connection to the NEM to occur, then the use of a subsidiary structure for the transmission company is not a feasible option.

³⁴ Industry Commission, Canberra *The Electricity Industry in South Australia*, March 1996 (p104)

5.1.3 *Timing Issues*

Evidence from Mr Ed Willett, Executive Director of the NCC stated that:

Tasmania has said that it is going to be part of the NEM and it is going to build Basslink. In that context it has also said it is going to meet its obligations under the electricity agreement. The Council says, 'Yes, that's consistent with your obligations'. The Council would really see it as a matter purely for Tasmania to determine what the timing of that structural reform would be. Now if you are suggesting that may not be appropriate if Tasmania does not become involved in the NEM, well that is not a question the Council has addressed and the Council sees no need to address it.³⁵

Finding 7

The Committee found that, outside NEM connection, there were no specific obligations under the NCC and COAG Agreements in respect of the timing of disaggregation.

³⁵ Mr E Willett, 19 March 1998, p33.

5.2 The Development of Competition in the ESI

In this report, significant reference has been made to competition. In the ESI, it is necessary that there is competition in both the generation and retail sectors to achieve a fully competitive market.

The Reeves/Breslin report provided a comprehensive view of the issue of competition in the distribution/retail sector. The conclusions of that report were discussed in Section 2.5.3. A principal conclusion was that the small size of the Tasmanian market did not make it feasible to create retail competition in the same manner as has occurred in other States. It has been noted in Chapter 4 that development of competition in generation is extremely difficult within the constraints of the existing hydro generation system.

It is evident that, given Tasmania's generation industry structure and small market size, there are significant barriers to the establishment of a fully competitive market for electricity. At this stage the principal objective of Government is to establish a new electricity supply source (proposed to be Basslink) as the initial step in developing competition.

The reality in Tasmania for the next four years, and quite possibly much longer, is that the State will not be connected to the NEM and therefore cannot benefit from the competitive forces of that market. As Professor Hilmer indicated to the Committee (quoted in Section 4.1) jurisdictions can have different circumstances and the driving force behind strong competition is at the generation level.

The Tasmanian ESI is not currently subject to competition in either generation or supply although there is limited competition among energy sources such as electricity, wood, bottled gas and oil for various domestic and industrial uses. Potential sources of competition at the generation level in Tasmania exist with offshore gas, wind, new hydro generation, and splitting the existing hydro generation structure, although as previously discussed, the latter option would be very difficult.

Given the limited likelihood of any of these alternative generation sources coming to fruition in the immediate future, it is clear that the benefits of competition to Tasmania are limited relative to the rest of Australia.

There is, however, scope to create the conditions for contestability or the threat of competition as opposed to the actual existence of competition. The work undertaken in past reforms, outlined at Section 2.5.2, creates the conditions for contestability and further disaggregation of the vertically integrated HEC will improve the conditions for contestability due to greater transparency in pricing and costing.

5.2.1 The Need to Disaggregate

In both NSW and Victoria a major process of disaggregation of the formerly vertically integrated electricity supply businesses was undertaken to create competition and endeavour to provide benefits to the community. Queensland and SA are going through the process of developing competitive markets at present.

Evidence to the Committee suggested that, in Victoria, the existence of significant over capacity in generation has resulted in prices being driven down through competition amongst generators. Privatisation and the accompanying development of a wholesale pool and complementary trading arrangements have improved generator utilisation.

Efficiencies were realised in the retail and distribution systems, but not of the magnitude emerging from generation.

At present, wholesale prices are so low that it was the view of some witnesses that at some point one generator may drop out of the market. In discussion on future energy prices, Dr Vertigan commented:

We are now in the very early days of a national marketplace. We have got some very perverse prices that are being generated by the operation of the structure in its very early days.³⁶

It was the view of most witnesses that power prices were presently low due to oversupply and, over time, prices would rise as surplus capacity was utilised. However, it was the view that the price would settle at the price for new entry generation capacity.

In submissions to the Inquiry, industry participants emphasised the benefits of competition and urged that the Government address the need for competition immediately.

For development of competition, industry witnesses saw that either Basslink or an alternative electricity generation source such as gas was necessary.

In order to introduce competition in Tasmania without Basslink, it would appear that further disaggregation of the HEC would be necessary. However, it is doubtful that, given the industry structure, the nature of the hydro system operations and the size of the market, effective competition in generation or retail could be developed. Breaking up the system for the benefits of a competitive market could create high transaction and operating costs, potentially offsetting any economic benefits from competition.

On the matter of the need to disaggregate Dr Vertigan argued:

³⁶ Dr M Vertigan, Melbourne 23 February 1998 p.30.

... if we believed everything that the companies told us in this industry we would not know where we would quite end up. There is a very interesting gaming situation going on, many of them would prefer to have less competitors – and you mounted the argument in terms of economies of scale, but let me tell you that most of them will give you an economies of scale argument but what they really want is less competition because in fact that gives them the capacity to keep prices up. So we are intent on maintaining a high level of competition because in fact that will drive both costs down and keep prices down. There is a very good reason for that.³⁷

Finding 8

The Committee found that:

- The development of competition has been a strong driver in the disaggregation of vertically integrated monopolies in other states to form multiple generation and distribution/retail businesses and a single transmission business.
- disaggregation of the HEC would provide a step towards development of competition in the Tasmanian ESI through contestability.
- Based on interstate experience, development of competition in the electricity generation industry in Tasmania without an alternative electricity generator would be very difficult to achieve.
- Based on interstate experience development of competition in the distribution and retail sectors has a very limited application in Tasmania because of the size of the market.

5.2.2 The Appropriate Corporate Structure

The rationale under 5.1, above also applies to the development of competition in the ESI. The Industry Commission (IC) and NCC assessments of South Australia's disaggregation into subsidiaries implied that subsidiaries were not appropriate to the development of competition because of the potential lack of transparency between the subsidiaries which could lead to conflict of interest and the scope for anti-competitive conduct.

The IC report on South Australia questioned the independence of subsidiary structures and commented that "The current subsidiary structure [of ETSA] involves significant conflicts of interest."³⁸ The principal issues emerging were the existence of conflicting objectives within a subsidiary structure and reduced business focus. The IC argued as follows:

As a holding company, by definition ETSA Corporation has some powers of direction over the subsidiaries and hence could influence their actions. The interaction between the ETSA boards is strengthened by the high degree of cross membership between them. The practical reality is that as long as ETSA Corporation has residual powers, including the ability to approve investment, the subsidiaries cannot be said to be independent. ETSA Corporation owns the subsidiaries, hence legal separation cannot mean operational and financial independence.

³⁷ Dr M Vertigan, Melbourne 23 February 1998 p.4.

³⁸ Industry Commission, Canberra *The Electricity Industry in South Australia*, March 1996, p.98

The cross membership between the ETSA Corporation board and the subsidiaries means a high degree of shared knowledge about each other's business plans and operations. For instance, the CEO of ETSA Corporation sits on all boards, and could be in a position of knowing beforehand about potentially competing investment proposals in generation or retail. This represents a possible conflict of interest.³⁹

Finding 9

The Committee noted that:

- Tasmania has a different ESI structure to South Australia, thus it is not necessarily appropriate to undertake direct comparison between SA and Tasmania.
- Evidence regarding SA suggests that the use of subsidiaries is not an appropriate long-term option for Tasmania in pursuing the introduction of competition in the Tasmanian ESI.

5.2.3 Timing Issues

Further evidence presented by Professor Hilmer noted that the process of disaggregation would in itself be a sound first step in Tasmania to create potential for competition. If the State waits for the right time to disaggregate to achieve competition, the mere fact of waiting will delay ideas for competition.

Finding 10

The Committee found that there was some evidence to suggest that the sooner disaggregation is achieved the sooner some competition can be introduced into elements of the Tasmanian ESI.

³⁹ Industry Commission, Canberra *The Electricity Industry in South Australia*, March 1996, p.99-100

5.3 Business Imperatives for the Hydro-Electric Corporation

5.3.1 *The Need to Disaggregate*

The HEC, in presenting its submission to the Committee, summarised its case by emphasising that disaggregation is an essential step towards the following business objectives:⁴⁰

- providing for a publicly owned generation business geared to continuing its work in managing Tasmania's water storage facilities and power stations;
- the structural separation of the transmission function of the business as a consequence of the national agreements on electricity industry reform; and
- preparing the retail/distribution sector in readiness for competition in the retail market.

In evidence presented to the Committee Dr Norton, CEO of the HEC, presented the following arguments on the business reasons for disaggregation:⁴¹

- it is seen to be a process of transforming the business, not splitting it;
- it is a process of strategic change driven by the need to ensure sustainable businesses in a competitive environment; and
- differing market opportunities require a different business focus, different cultures and are subject to different risks.

The Committee also heard evidence to suggest that disaggregation of the HEC would allow its single business culture to be dismantled thereby improving efficiency and allowing for transparency in the costing and pricing of services. Mr Stephen Blanch of Eastern Energy argued:

I am strongly of the view that there is [an advantage of separating out the transmission and distribution businesses], because one of the things I have recognised is that they are quite different businesses. We are talking about manufacturing – which is the generation – we are talking about basically highways, if you like, and then we are talking about streets, and they are very different. Vertically integrated, I worked in one [SECV] for 30 years, we never had a core focus. We never knew that we were in five or six or eight different businesses. We struggled for years to try to work out where the priorities were, how you allocate management attention, how you do the things you have to do, and they are different demands. Transmission is a bit in the middle. It certainly does not fit generation. Generation is a wildly different business to distribution and customer service. It does not matter how hard you try, there is no affinity between a power station or a manufacturer and a retail customer, and they are quite radical.⁴²

This issue was further discussed in Sections 3.1.2 and 4.3.3, above

⁴⁰ HEC Submission, p 11

⁴¹ Dr D Norton, 12 March 1998, p.5

⁴² Mr S Blanch, Melbourne 24 February 1998, p.42. parentheses added

Finding 11

The Committee found that the current imperatives to disaggregate the HEC include:

- breaking its single monopoly structure
- improving its business efficiency
- achieving transparency across its operations by removing any cross-subsidies that distort the costing and pricing of services
- providing for improved business focus and the management of the different risk profiles of the different parts of the business, and
- breaking up the "one business" culture.

5.3.2 The Appropriate Corporate Structure

The HEC, in its initial advice to government in September 1997, proposed three subsidiaries be formed to cover the three major businesses identified above. In making this choice, the HEC argued that, through the Board's vision, there was a sense of urgency to achieving separation in the short term (ie by March/April 1998). In this setting subsidiary companies were the most appropriate transition to achieve within the time frame. The HEC also commented that organisational development issues, in particular the need for cultural change, were factors considered at the time with the view that this would be phased in through a subsidiary approach.

Minutes from the HEC Board meeting on 17 September 1997 list the advantages of a subsidiary approach as follows:

This option has the significant advantage over alternatives in limiting the serious risks arising from a number of important implementation issues relating to matters including:-

- industrial relations;
- the availability, integrity and operation of systems and processes;
- the smooth transfer of assets, liabilities and obligations;
- the capacity of the Boards of the new companies to understand the nuances of the businesses in the short timeframe available;
- the ability to successfully implement cultural change;
- the need to limit management disruption and dislocation; and
- maximise financial returns from the total business during restructuring and after.⁴³

In evidence to the Committee in March 1998, the HEC advised that it had changed its view on the preferred model from the subsidiary structure to that of the separate companies. In making this change, it was indicated that the long-term view of the HEC was to move from vertically integrated through subsidiary to separate companies. Due to lapse of time, the intermediate step of subsidiary was no longer seen as valid.

The Committee felt that the HEC's change of view was strongly influenced by the Government's electricity reform agenda and intention to proceed with equity withdrawal from the Transmission and Distribution/Retail businesses.

⁴³ Minutes of HEC Board meeting, 17 September 1997 attached to letter from the Chairman, to the Government dated 26 September 1997.

Finding 12

The Committee found that:

- From an internal perspective, the HEC initially had a firmly held view that the formation of subsidiary companies was preferable to separate companies, particularly in the short term.
- The Government has a clear view, as evidenced in the content of the *Electricity Companies Act 1997*, that formation of separate companies is preferable to subsidiaries.

The Committee formed the view that either structure had the potential to yield efficiency gains in comparison to the current HEC structure but that separate companies had the potential to yield greater gains in this sense than did subsidiaries.

5.3.3 Timing Issues

It is the view of the HEC that, had its original strategy for subsidiaries been implemented in mid 1997, the new companies would be operating by March/April 1998. Due to the delay in determining the Government's position on this issue, the HEC argued that the subsidiary phase was no longer appropriate and action should be taken to enable the start of the new companies by 1 July 1998. In establishing this position, emphasis was placed on the work already in train to create the new entities and the major staff commitment to the change. The failure to continue on the current path was seen to be a major risk for the organisation and contains the potential to result in the loss of key staff.⁴⁴

The Government wishes to see the new structures established as soon as possible.

Finding 13

The Committee considers that if the Parliament supports the process of disaggregation then the process of company formation should continue in line with the HEC timetable, which seeks to establish the companies to commence from 1 July 1998.

⁴⁴ Dr D Norton, 12 March 1998, p.35

5.4 The proposed entry of Tasmania to the NEM

The viability and appropriateness of the proposed Basslink development is to be fully explored in subsequent reports. As noted previously, the Committee has not yet had sufficient evidence to draw any conclusions on the viability of Basslink. Therefore, for the purpose of this section of the report, the discussion is limited to whether the proposed development of Basslink requires disaggregation to occur.

5.4.1 The Need to Disaggregate

The construction of Basslink and the consequent entry to the NEM was addressed in a paper prepared by the Department of Treasury and Finance, Tasmania entitled "*The Structural Separation of the Hydro Electric Corporation – National Competition Policy Implications*".

In that paper, four issues underpinning the need for disaggregation were set out, all of which are contingent on the decision to enter the NEM via Basslink.

- the need to comply with COAG requirements for Tasmania's entry to the NEM;
- the need to ensure that the disaggregated businesses of the HEC (generation, transmission, distribution and retail) are well placed to effectively compete in the NEM environment;
- the need to give potential Basslink investors some certainty regarding the ESI structural arrangements in Tasmania; and
- the need to comply with the NCP structural reform principles.

In order to satisfy the requirements of COAG agreements on the NEM the Tasmanian Government must ensure that:

- *There is structural separation of the HEC.* The structural changes required to enter the NEM were detailed in a COAG agreement in Melbourne on 8-9 June 1993. (See Section 2.5.1, above)
- *There is non-discriminatory access to the network.* Action is currently underway by the HEC on this matter as is evidenced by its ring-fencing of transmission and distribution. It is relevant to note that the NCC has very recently indicated to WA that it is not satisfied that ring fencing will be an adequate means to ensure non-discriminatory access.⁴⁵
- *Customers must have choice of suppliers in generation and retail.* The *ESI Act 1995* establishes the framework for contestable customers and a threshold below which customers are restricted to sourcing electricity from franchise retailers. The thresholds in which this occurs have not yet been established for Tasmania. All other NEM participants are establishing these thresholds and moving to contestability at present.

⁴⁵ Mr G Samuel, Sydney 18 March 1998

- *There are no discriminatory legislative and regulatory barriers to new entrants in generation, retail supply and/or inter/intra state trade.* The ESI Act 1995 has largely satisfied this objective, but further work would be required prior to interconnection to ensure full compliance.

These points were assessed by the Treasury and contained in its NCP Progress Report for the period April 1995 to July 1997.⁴⁶

In considering entry to the NEM and the opportunity for competition in the ESI within Tasmania, the information on change in other States (detailed in Section 2.2 and 2.4, above) shows that sophisticated market structures are being established. The process of development in Victoria shows that a lead-time is necessary to prepare participants for operating in a competitive market.

The HEC in its evidence placed emphasis upon the need to prepare for competition. Evidence from Professor Hilmer supported the need to create signals for competition such as disaggregation as this gave the appropriate indications of the emergence of a competitive industry.

Finding 14

The Committee found that:

- Entry to the NEM via Basslink requires disaggregation of transmission from generation and this is the only substantial reform not yet in place to prepare for possible interconnection.

5.4.2 The Appropriate Corporate Structure

The evidence from other States and the NCC indicates that the use of a separate company for transmission is essential for entry to the NEM if there is to be compliance with COAG agreements.

The NCC was asked by the Committee to provide advice on various corporate structures and the extent to which these satisfied COAG agreements within the NEM. The advice from the NCC Secretariat was:

First, the Secretariat does not consider that a subsidiary company with transmission as one subsidiary and distribution/retail as the other subsidiary satisfies Tasmania's COAG commitments to electricity reform;

Second, the Secretariat does not consider that a subsidiary company with generation as one subsidiary and distribution/retail as the other subsidiary satisfies Tasmania's COAG commitments to electricity reform; and

Third, a decision by the Tasmanian Government to create an integrated generation/distribution/retail entity or an integrated transmission, distribution and retail entity is contrary to the recommendations of the clause 4 review which recommended separating distribution and retail.

⁴⁶ NCP Progress Report – April 1995-31 July 1997, page 36-37.

On the basis of that advice the Committee concluded that separate transmission and distribution/retail entities was necessary. However, the concerns expressed earlier on the potential for the distribution/retail entity to thwart competition remain a risk in this structure.

The structure of businesses either in the NEM or potentially entering are private companies in Victoria and State Owned Enterprises in NSW, SA and Queensland with potential that some of these will be privatised at some point.

Finding 15

The Committee concluded that operators in the NEM are structured as both GBE and privately owned company models. The use of either separate company or separate GBE models for Tasmania is a matter of choice.

5.4.3 Timing Issues

The Committee had cause to examine the need to disaggregate the HEC at this time, given that the connection to the NEM would not occur until Basslink was installed by around 2001-2002.

The timing of change to meet the requirements of the NEM is within the choice of the State as stated by the NCC. The connection is likely to take at least four years; thus the need to disaggregate now is not a major pressure.

The major issue is ensuring that the new corporate entities have sufficient time to establish their business operations, systems and organisation structures to meet the pressures of competition. The timeframe for change in other States shows that disaggregation preceded the development of a competitive market although the timeframe varies among States.

Victoria and NSW have developed internal competitive markets for generation over periods of one to two years. Contestability limits for customers have been phased in over a period of three or four years. Queensland has an internal electricity market in development and will have an operational link by around 2001 thus allowing a development phase of around 3 years. South Australia has an operational interconnection to Victoria and is developing a link to NSW.

NSW and Victoria commenced NEM1 (involving trading across the two states) in May 1997, having previously established internal wholesale markets.

Finding 16

Evidence indicated that a reasonable lead-time is necessary to allow entities to prepare for competition in the NEM. It is suggested that around two years prior to connection would be an appropriate period.

5.5 The Need for Certainty on the Part of Basslink Investors

5.5.1 *The Need to Disaggregate*

The development of Basslink is proposed to take place on the basis of a private developer investing in and operating the link. The viability and appropriateness of the proposed Basslink development, including the extent of private and public sector investment, is to be fully explored in subsequent reports.

In its submission, the Government put forward a number of arguments on the matter of disaggregation providing certainty for Basslink investors.⁴⁷ The Government sees that disaggregation by mid 1998 would reduce the risk and therefore increase the certainty for potential investors.

In evidence Mr Challen expanded on the issues underpinning the needs of Basslink investors noting that investors need to be in a position to be able to negotiate separately with the generation and retail entities in Tasmania and very likely in Victoria to provide the contractual underpinning for the project.⁴⁸

The Committee was not in a position to speak with investors to validate these assertions but will be doing so when taking further evidence.

Finding 17

The Committee acknowledged the Government's view that investors working on a major investment require certainty on the system in which they would have to work. Failure to disaggregate may be seen by an investor as an obstacle to committing funds.

5.5.2 *The Appropriate Corporate Structure*

The Committee has considered three structural options for the separate business units, separate companies, separate GBEs or subsidiaries of the HEC.

In his evidence Mr Challen observed that

It [the choice between subsidiary companies or separate stand-alone companies] is a matter of degree. I accept that. It might well be the case that Basslink proceeds with a subsidiary structure. I think it is a reasonable objective to provide a Basslink developer with the tidiest view of the Tasmanian electricity supply industry that you can.

... What I think a developer does is he looks at the collection of arrangements in which he is going to have to make his investment.

⁴⁷ Department of Treasury and Finance, Tasmania, *Structural Separation of the Hydro-Electric Corporation*, February 1998, p.13

⁴⁸ Mr D Challen, 12 February 1998, p.9

... Some of the potential developers will look at it and will say, 'There's this list of pluses and there's this list of minuses', and maybe the subsidiary structure might be some way down the ranking of the list of minuses. Whether it is a deal breaker on its own at the end of the day I would not be prepared to say, but probably not.⁴⁹

The option of GBEs was not explored in depth at the time of the above comments from Mr Challen. However, the Committee was not persuaded that there were substantial differences between the options in relation to this objective of Government in undertaking disaggregation.

Finding 18

The Committee concluded in providing certainty for potential Basslink investors that:

- there is a choice of three options for disaggregation - subsidiaries, separate GBEs and separate companies; and
- provided a choice between one of these is made and there is a commitment to comply with COAG agreements, then there is no compelling argument in favour of one option over another.

5.5.3 Timing Issues

The Basslink project team has been established. Given the lead-time for development, there needs to be early decision making if it relates to improving the project's feasibility.

The Government submission stated that the cost of delaying the structural separation of the HEC would be the deferral of private sector interest in the construction and operation of Basslink.

Finding 19

The Committee considers that the early action to disaggregate would be important to facilitate genuine expressions of interest in the development of the Basslink project.

⁴⁹ Mr D Challen, 13 March 1998, p.26, parentheses added.

5.6 Sale/Lease of the Transmission and Retail/Distribution Businesses

5.6.1 The Need to Disaggregate

The Government has indicated its intention to withdraw equity from the HEC through the sale or lease of its transmission and retail/distribution assets

It is evident that in all other jurisdictions engaged in selling electricity assets or developing options for sale, that disaggregation to form the units for subsequent sale is an essential step.

The Salomon Bain report commented at Section 8.5 that “Investor perceptions that the businesses are separated and operating at arms length will be important to ensure that proceeds of the equity withdrawal are maximised.”⁵⁰

In the recommendations on action the Salomon Bain report stated that:

Consideration of the competitive and regulatory frameworks which are likely to be in place suggest that the HEC should be separated into a single combined distribution and retail company (DisCo), a single transmission company (TransCo) and a residual business containing generation and other assets.

Combining the distribution and retail businesses to create a single DisCo is recommended. Recent privatisations of combined distribution and retail companies have attracted significant investor interest. A single DisCo will still be relatively small on a global scale.

Investors will look for DisCo and TransCo to be separated and operating in an arms’ length manner from the other businesses for a period of time prior to equity withdrawal in order to minimise the separation risk. Provided this is achieved, an investor is likely to be indifferent as to the ownership structure prior to the equity withdrawal.

While the TransCo and DisCo businesses should be prepared for equity withdrawal on a stand-alone basis, a single investor should not necessarily be prevented from buying both businesses if the combined offer is more attractive than offers for the businesses separately.

Creation of TransCo and DisCo from the HEC will maximise the value of the equity withdrawal from the retailing and network assets and meet the requirements of competition and regulation. Further separation of system control and generation will also be required to enable operation of a competitive market.”⁵¹

The Salomon Bain report identified that “... as a minimum it is advisable to have completed a half year end reporting period under the new arrangements prior to buyer due diligence”.⁵²

⁵⁰ Salomon Bain, *Hydro Electric Corporation - Restructuring for Growth*, 2 February 1998, p.96

⁵¹ Salomon Bain, *Hydro Electric Corporation - Restructuring for Growth*, 2 February 1998, p.98

⁵² Salomon Bain, *Hydro Electric Corporation - Restructuring for Growth*, 2 February 1998, p.136

In evidence from Victoria, complete separation of each business is an essential step leading up to privatisation and is a requirement under NCC and COAG agreements.

5.6.2 *The Appropriate Corporate Structure*

Salomon Bain argued that:

To ensure the proceeds from equity withdrawal are maximised, investors must perceive that the businesses are separated from HEC, and operating at arms length from Generation and each other. In acquiring the transmission and distribution/retail businesses, potential investors are likely to require:

- Certainty in relation to the assets, liabilities and staffing arrangements of the business they are acquiring;
- Clarity in the business and technical relationship between those businesses that are being acquired and the remaining parts of the HEC (Generation and Systems);
- A smooth transition from public to private ownership to reduce transaction costs;
- A business 'track record', stand-alone support services and systems which minimise separation risk; and
- Independent management teams pursuing stand-alone business strategies⁵³

As noted above, Salomon Bain concluded that the creation of separate Transmission and Distribution/Retail companies, TransCo and DisCo respectively, would maximise the value of the equity withdrawal from the retailing and network assets and meet the requirements of competition and regulation.⁵⁴

Finding 20

The Committee found that the disaggregation of electricity assets to form separate businesses was an essential prerequisite to sale.

5.6.3 *Timing Issues*

The Committee recognised that the timetable set for potential sale or lease of the HEC assets requires a lead-time to prepare the businesses for sale.

Finding 21

The Committee found that the Government's current timetable would require prompt action on disaggregation given the plan to introduce legislation to progress the sale or lease later in 1998.

⁵³ Salomon Bain, *Hydro Electric Corporation - Restructuring for Growth*, 2 February 1998, p.15

⁵⁴ Salomon Bain, *Hydro Electric Corporation - Restructuring for Growth*, 2 February 1998, p.98

5.7 Summary Comparison

REASON	THE NEED TO DISAGGREGATE	APPROPRIATE CORPORATE STRUCTURE			TIMING ISSUES
		Subsidiaries	Separate GBEs	Separate Companies	
Obligations of NCP and COAG agreements	Disaggregation required because of commitments given to NCC. At a minimum Transmission must be separated from Generation and Distribution/Retail.	Not tested in absence of entry to NEM Unlikely to meet full compliance test by NCC	Fully consistent	Fully consistent	State matter. No obligations to NCC in respect of timing.
Development of competition in the ESI	Disaggregation desirable as a step towards the development of competition in the Tasmanian ESI.	Satisfactory interim phase but concerns over conflict of interest and anti-competitive behaviour	Consistent, however, may be easier to deliver competitive neutrality under standard legal company structure as opposed to GBEs	Fully consistent (based on NCC and IC assessments of SA)	Early disaggregation is likely to stimulate the development of competition
Business imperatives for the HEC	Disaggregation is a means to achieve increased efficiency. The competitive pressures of the NEM require the HEC to adopt a new business focus to succeed.	The HEC initially preferred the subsidiary option and had no firm view as to when it would ultimately move to separate companies.	Would allow for full benefits of disaggregation	Now HEC preferred option due to time delays since its initial proposal. Government preferred option	Early implementation will enhance the business evolution of the HEC Government wishes to see new structures established ASAP HEC committed to disaggregation by 1 July 1998
Proposed entry of Tasmania to the NEM via Basslink	Disaggregation is required. At a minimum the transmission business must be separated from generation and distribution/retail.	Subsidiary company for transmission not acceptable to NCC. Acceptability of Distribution/Retail and Generation as subsidiary companies untested.	Fully consistent	Fully consistent	Lead time required to allow entities to prepare for competition No immediate pressure given four year time frame around Basslink

REASON	THE NEED TO DISAGGREGATE	APPROPRIATE CORPORATE STRUCTURE			TIMING ISSUES
		Subsidiaries	Separate GBEs	Separate Companies	
Certainty on the part of Basslink investors	Disaggregation is desirable as a signal of change and to improve investor confidence in commitment to project.	Satisfactory alternative	Acceptable	Acceptable	Early decision-making may improve certainty of investment
Sale/Lease of the transmission and retail/distribution businesses	Disaggregation is essential.	Not preferred for sale as the model increases the separation risk	Increased separation risk because entities not operating in the way in which they will be. Likely to be less acceptable than separate companies because of market perception of unconventional structure	Maximises value in equity withdrawal Likely to be preferred by potential investors	Government timetable to achieve sale/lease requires prompt decision to disaggregate and form separate companies

5.8 The Costs and Benefits of Disaggregation and Impact on the Consolidated Fund

5.8.1 *The Costs and Benefits of Disaggregation*

Evidence from the HEC indicated that disaggregation to form two separate companies will involve additional costs. The Committee was presented with evidence by the HEC on the estimated cost of disaggregation. Whilst the costs were not identified in detail, the order of magnitude was as follows:

- Additional annual costs for duplication of current common services and Board for the Distribution/Retail company would be \$2.5 million.
- Additional annual costs to operate the Transmission company would be \$0.4 million.

The Committee was not in a position to test these numbers in any way. The Government produced further evidence in the form of an appraisal of the HEC's cost estimates by an accounting firm⁵⁵. This advice supported the estimates of cost, but did not give further detail.

The only comparison is to look at current costs of corporate overheads for the HEC as a whole. At present, the total cost for corporate services is \$20.4 million. These are currently allocated to the retail, distribution and transmission businesses as follows:

- Retail \$4.516 m
- Distribution \$4.912m
- Transmission \$1.647m.

In total these three account for 54% of total corporate overhead. In this context, the additional costs do not appear inconsistent. However, the suggested additional costs have not been defined with great precision which leaves the conclusion that there would be scope for these to be lower, or some risk of the cost being greater. The quantum of cost would ultimately rest on the management of the process and constraints placed on the new structures.

Two cost comparisons arose in the debate on the *Electricity Companies Bill 1997* and subsequent discussions:

- the figures presented by ETSA in SA when the Industry Commission was exploring disaggregation; and
- figures presented by Reeves/Breslin in looking at the structure of retail/distribution.

⁵⁵ Letter from Ernst and Young to Department of Treasury and Finance, 11 March 1998.

Given their prominence in earlier debate some comment on each is considered useful to enable an assessment of the validity of these in any comparison with the current propositions.

In looking at ETSA, the structure of which has been described earlier, ETSA suggested that costs of disaggregation would be not less than \$18 million annually. These comprised:

- Establishment of "principal additional administrative functions" \$8.1m
- Loss of value added commercial activities in gas trading \$6.7m
- Increase in the overall cost of debt \$3.2m

These claims were not examined in detail as some had no relevance, but it is noted that the IC had doubts as to their validity. In addition, from evidence presented, only the first of these categories of cost would be faced in Tasmania.

In the case of the Reeves/Breslin assessment, the quoted costs from disaggregation of around \$3 million annually related to the splitting of retail from distribution and arose principally from the necessary duplication of customer billing systems and separate administration to handle 240,000 customers. In addition, the costs would only arise if Tasmania joined the NEM.

Finding 22

The Committee found that:

- The potential costs of the Government's preferred disaggregation model is likely to be around \$2.9 million annually. This cost arises from the need to separate and duplicate functions that are currently combined in the existing HEC structure including corporate overheads and Board costs.
- If the Reeves/Breslin model to separate the distribution and retail businesses were adopted there would be an additional \$3 million annual cost to disaggregation.

In cost terms, the HEC has suggested that efficiency savings realised will generate savings to offset the additional costs. A brief review by accountants Ernst and Young produced a suggested figure for savings in the order of \$2.7 million. However, this evidence was not backed by detailed cost estimates.⁵⁶

Significant weight was given to the benefits of business focus and efficiency in evidence presented in Victoria which would suggest that there may be substantial advantage in disaggregation. However, it must be recognised that some of the gain in Victoria has been through employment reduction and a change in risk management systems which involves a reduction in capital expenditure. The HEC is currently achieving a 4% annual reduction in operating costs, but also stated that, within its existing structure, the scope to maintain this in the longer term was questionable.

⁵⁶ Letter from Ernst and Young to Department of Treasury and Finance, 11 March 1998.

Evidence from Mr Alex Walker, Chief Executive Officer of Integral Energy (a state-owned distribution/retail GBE in NSW) identified reductions in labour costs as a source of considerable efficiencies but also noted the greater importance of capital efficiency in the case of Integral Energy:

But the other side that has improved - and in our case more dramatically - is capital efficiency. When we entered the current network regulated pricing arrangement in 1996 our previous year's capital expenditure on our network business was about \$130 million per annum. We contracted with the Regulator to reduce that to about \$90 million per annum. We have currently reduced it to \$50 million per annum, and we believe a viable level of investment is somewhere between \$40 million and \$50 million long-term, with a few bumps in it. That is a more dramatic level in those recent years. That is a more dramatic improvement than the operating cost side of things.⁵⁷

Evidence from many senior executives emphasised that in improved business focus, the process of restructuring, the capacity to identify and dispose of surplus assets and other scope to identify efficiencies, there is potential to remove any need for additional costs from disaggregation.

In further evidence to the Committee Mr Challen discussed the potential benefits from disaggregation in creating productive tensions between the entities and greater questioning of the costs and values of services in areas such as information technology.

The evidence presented also identified that by disaggregating and separating the natural monopoly parts of the business from the contestable parts, there would be closer scrutiny of costs in those monopoly areas subject to price regulation.

Comment from witnesses in NSW and Victoria (including Professor Hilmer and Dr Vertigan), raised doubt as to whether, with good management, there should be any extra net cost resulting from disaggregation after taking account of potential savings.

Finding 23

Disaggregation provides for potential efficiency gains and improved business focus leading to cost reductions and new business opportunities that may offset the additional costs.

⁵⁷ Mr A Walker, Sydney 19 March 1998.

5.8.3 *The Impacts of Disaggregation on the Consolidated Fund*

The only impact from disaggregation would be any reduction in dividends available to Consolidated Fund in the short term. This requires assessment of the costs and benefits above. On the evidence provided the net cost of disaggregation is in the range of zero to \$3 million dependent on the capacity of the new companies to generate new revenues, limit cost growth from the formation of new companies and to achieve cost reductions.

The extent to which the net costs would impact on the Consolidated Fund would also depend on the dividend policy applied.

In the longer term, if disaggregation did not occur, there is a risk to NCP tranche payments which in future years represent major revenues to the Consolidated Fund. Failure to achieve reform may prejudice the payments.

Disaggregation as the first step in sale/lease and positions the State for far greater impacts but no conclusions can be drawn at this point. This can only be addressed in subsequent reports.

Finding 24

The Committee concluded that disaggregation is unlikely to have a significant effect on the Consolidated Fund.

5.1 5.9 The Impact of Disaggregation on Contractual Obligations

HECEC Australia Pty Ltd, a private engineering company, presented a submission to the Committee and also gave evidence. In essence the concerns of HECEC on the issue of disaggregation relates to the impact of the creation of two new companies on the General Service Agreement (GSA) currently in place between the HEC and HECEC. This agreement gives exclusive rights to HECEC in access to HEC staff for consulting work nationally and internationally. As such the GSA is a major asset of HECEC for which a significant capital investment was made and change will threaten the value of the asset.

HECEC has had extensive discussions with the Minister for Energy on the nature of the threats to HECEC. Potential protections were subsequently covered in the Parliamentary debate on the *Electricity Companies Bill 1997*.

The Committee also received a submission and evidence from an engineering consulting firm that raised issues on the implications of the GSA for other engineering firms being able to access HEC skills for consulting work.

The management of contracts is a widespread issue for disaggregation. Similar concerns on transfer of contract rights arose in evidence from major industrial (MI) customers. Mr D Harrison, of Comalco Ltd., stated in evidence that:

...it is obviously crucial that in plotting a way forward through such changes, undertakings are developed to ensure that the substance and intent of all those contractual arrangements are preserved with the new operators. This is very important obviously for not only Comalco but for many others in the State.⁵⁸

The Major Employers Group, stated in its submission that members had agreed on a policy position that industry would require assurances that, if the HEC is either wholly or partially sold, industry would require assurances that the new owners would honour long-term contracts.⁵⁹

The Committee is not in a position to recommend action beyond commitments already made. However, as competition principles and policies are pursued, if there are any on-going anti-competitive practices these must be made transparent and be demonstrated to be in the public interest.

Finding 25

The Committee considers that the Government must ensure that contracts to supply electricity and other services which have anti-competitive components must be transparent and demonstrably in the public interest.

The Committee concluded that, in disaggregation, changes to contractual arrangements will need to be managed to minimise financial risk.

⁵⁸ Mr D Harrison, 12 February 1998, p.4.

⁵⁹ Submission from The Major Employers Group, Tasmania, policy statement.

5.2 5.10 The Impacts of Disaggregation on Employment

In evidence to the Committee the HEC identified that analysis of its strengths showed that the HEC staff represented a major asset to both the HEC and the state. Therefore, in any disaggregation, the HEC wished to preserve this value as a basis for future growth in employment. However, the HEC recognised the need for new skills in the organisation to manage new dimensions of the business. The HEC wished to see restructuring occur in such a manner as to present an opportunity to grow employment in the State.

The HEC in its submission and evidence relating to the models for disaggregation placed considerable emphasis on the need for effective management of the change process and demonstrated a commitment to processes which maximised staff commitment and support and minimised skill loss. This in part underpinned the initial proposals to use subsidiary structures for the disaggregation process.

The theme of ensuring that the human capital and skills contained in the HEC through a period of disaggregation and change was reinforced in evidence from Sinclair Knight Merz. This reflected a view that engineering skills were at risk of being lost in Australia and that it was essential to ensure strategies are adopted to retain these skills in the new organisations.

In both NSW and Victoria, the evidence indicated that the process of formation of new companies to undertake differing roles did result in employment reductions. In some cases there was an overall reduction in numbers, in other cases there was an initial decline as skills not required were reduced followed by an increase in numbers due to recruitment of new skills.

A witness from the Latrobe Valley provided evidence on the negative impacts of disaggregation as a part of the subsequent process of privatisation and major employment reduction in the Victorian ESI. Significant social impacts have arisen from the reductions in employment in the generation industry in the Latrobe Valley.

Ms Munroe, Executive Director of the Energy Projects Division of the Victorian Treasury provided employment statistics for changes in the electricity industry in Australia.⁶⁰ These showed that in the period from June 1988 to June 1996 employment in the ESI declined by 63.6% in Victoria and 58.3% in Tasmania. These occurred against an Australian average of 47.6%. In using statistics on employment in the ESI, the results can be very misleading as there is no recognition of employment changes due to the contracting out of work, and over the same period there has been a huge reduction in construction activities and consequent workforce reductions.

It can be concluded from these employment changes that the major reductions in Victoria through the reform process are not significantly different to those that have occurred in Tasmania over the same period during HEC restructuring.

⁶⁰ Ms C Munroe, Melbourne 23 February 1998

The Committee also received a submission from the Australian Services Union expressing concern on the proposals to disaggregate. The submission argued for specific industrial arrangements to protect workers in the transition process, particularly relating to management of any subsequent sale of the businesses.

Finding 26

The Committee concluded that the management of the disaggregation process must take significant account of human resource management to minimise skill loss.

The Committee concluded that, following the disaggregation process, efficiency improvement is likely to result in reductions in employment levels. However, it was recognised that the subsequent proposals for sale or lease could have more significant employment impacts.

5.3 5.11 Consumer Impacts from Disaggregation

Issues relating to consumer impacts appeared to relate more to experience in a post privatisation environment than the process of disaggregation. However, experience in Victoria did highlight some points of relevance.

Evidence presented in Victoria by Denis Nelthorpe for the Consumer Law Centre suggested that in the period between corporatisation and privatisation of the distribution companies there was a rise in disconnections as the companies were prepared for sale. However, data presented for the period since privatisation showed a decline in disconnection.

Whilst this cannot be directly attributed to disaggregation, if this is a phase in improving the business prior to sale, it was suggested that there be full monitoring of the business behaviour. In Victoria, the absence of effective statistics on business performance prior to disaggregation did not allow effective comparisons to be drawn.

Other industry witnesses emphasised that, particularly since privatisation, public and media interest in electricity business performance has risen steeply. Under public ownership there was no particular focus on system outages or other problems. The media now follows such occurrences closely giving rise to public perception that system performance has declined. Statistics presented by witnesses countered this view.

Similarly, a common public perception was that power prices had risen in Victoria, yet evidence provided supported a view that contestable prices are declining at this time. Maximum prices in the domestic sector are set by legislation to the year 2000. However, the complexity and legitimacy of comparing energy prices across states with differing tariff structures militates against ready comparison.

Finding 27

The process of disaggregation is not likely to create particular consumer impacts. However, in any intermediate phase between disaggregation and sale/lease where a business is being prepared for sale/lease whilst in public ownership, its performance in relation to consumer issues such as disconnections should be monitored to ensure no significant negative impacts occur.

5.4 5.12 Conclusions and Recommendations

It must be noted that this is an interim report about disaggregation and the Committee has not yet completed its deliberations about the sale/lease of the transmission and distribution/retail businesses and the proposed development of Basslink. As such, the findings, conclusions and recommendations presented must not be considered to pre-empt those that may be made in subsequent reports.

The Committee recommends that the HEC be disaggregated into three separate businesses:

- **generation;**
- **transmission; and**
- **distribution/retail.**

The Committee concluded that disaggregation is unlikely to have a significant effect on the Consolidated Fund.

The Committee concluded that a number of factors indicate that there are significant impediments to the development of competition in both the generation and retail sectors of the Tasmanian electricity supply industry. These include:

- the lack of any significant competition in generation;
- the size and nature of the Tasmanian market;
- the integrated nature of the hydro system;
- the unique nature of the Tasmanian network monopoly;
- the absence of planned separation between distribution and retail as noted by the NCC; and
- the time-lapse before the planned entry of Tasmania to the NEM.

The Committee concluded that these factors would prevail regardless of whether the businesses are operated in public or private ownership.

The Committee concluded, however, that disaggregation is the first step to the introduction of contestability and subsequent competition in the generation and retail sectors.

The Committee, in recommending disaggregation as a first step to the introduction of competition, recommends that significant effort be applied in preparing further strategies to enable the development of competition in the generation and retail sectors of the Tasmanian electricity supply industry.

The Committee concluded that the preferred corporate structure for each business is dependent on the outcome/s sought through disaggregation. The options are summarised in the following table.

OUTCOME SOUGHT: FUTURE DEVELOPMENT OF ELECTRICITY SUPPLY INDUSTRY IN TASMANIA
 (in isolation from NEM interconnection and equity withdrawal)

1998

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	5.5 BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
FUTURE DEVELOPMENT OF ELECTRICITY SUPPLY INDUSTRY IN TASMANIA (in isolation from NEM interconnection and equity withdrawal)	Wholly Government owned private companies established under the <i>Electricity Companies Act 1997</i> .	Yes	<ul style="list-style-type: none"> • Consistent with model proposed by Government. • Can be rapidly implemented given legislation already in place. • Provides complete separation of business elements. • Clear capacity to meet NCP obligations. • Accountable to Parliament through the Memorandum and Articles of Association of the companies. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Disaggregation can continue consistent with HEC's current timeframe of 1 July 1998 for start of new businesses.
	Separate GBEs	Yes	<ul style="list-style-type: none"> • Consistent with existing GBE structures. • Provides complete separation of business elements. • Able to comply with all NCP requirements. • Currently accountable to Parliament. 	<ul style="list-style-type: none"> • New legislation required.
	Subsidiaries of existing HEC	Yes	<ul style="list-style-type: none"> • Enables smooth transition to disaggregated structure for HEC. • Does not provide for complete separation of business elements - remaining connection between businesses through HEC Board. • Potentially fulfils COAG/NCP obligations in isolation from NEM but not fully tested. • Simplifies accounting transition for HEC. • Allows maximum flexibility to Government to vary structure in the future. • Originally HEC preferred position but later changed. 	<ul style="list-style-type: none"> • No new legislation required. • Can be implemented for 1 July 1998 start based on previous HEC view

OUTCOME SOUGHT: DEVELOPMENT OF BASSLINK AND NEM INTERCONNECTION

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	5.6 BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
DEVELOPMENT OF BASSLINK AND NEM INTERCONNECTION	Wholly Government owned private companies established under the <i>Electricity Companies Act 1997</i> .	Yes	<ul style="list-style-type: none"> • Fully complies with COAG/NCP obligations. • Well recognised corporate structure. • Consistent with models in other States involved in NEM. • Distribution/Retail structure not fully resolved with NCC. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Entry currently proposed for 2001-2002 with lead-time for investor commitment and development. • Disaggregation timing is not critical but consistent with HEC's current timeframe of 1 July 1998.
	Separate GBEs	Yes	<ul style="list-style-type: none"> • Potentially complies with COAG/NCP obligations but not fully tested. • Well established model in Tasmania. • Comparable to models in other states involved in NEM. • Distribution/Retail structure not fully resolved with NCC. 	<ul style="list-style-type: none"> • New legislation required. • Entry currently proposed for 2001-2002 with lead-time for investor commitment and development. • Disaggregation timing is not critical but consistent with HEC's current timeframe of 1 July 1998.
	Subsidiaries of existing HEC	Yes	<ul style="list-style-type: none"> • Does not comply with COAG and NCP obligations for NEM. • Could be considered for interim step. Cannot be recommended in longer term. 	<ul style="list-style-type: none"> • No new legislation required. • Acceptable prior to entry to the NEM.

OUTCOME SOUGHT: EQUITY WITHDRAWAL VIA LEASE OR SALE

OUTCOME SOUGHT	CORPORATE STRUCTURE OPTIONS FOR TRANSMISSION AND DISTRIBUTION/RETAIL BUSINESSES	IS DISAGGREGATION RECOMMENDED?	5.7 BENEFITS/CONSIDERATIONS	TIME CONSIDERATIONS
<p>EQUITY WITHDRAWAL VIA LEASE OR SALE</p>	<p>Wholly Government owned private companies established under the <i>Electricity Companies Act 1997</i>.</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Maximises value for sale. • Preferred structure in consultant's work. • Model is well understood in marketplace. • Ensures separation risk is minimised. • Not tested for lease. 	<ul style="list-style-type: none"> • Legislation for disaggregation in place through <i>Electricity Companies Act 1997</i>. • Requires a minimum six months' trading results for "due diligence" processes. • Disaggregation can occur consistent with Government's timeframe to achieve new structures from 1 July 1998. • Consistent with the HEC timetable for change.
	<p>Separate GBEs</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Unlikely to affect sale price. • Potentially less acceptable than private company due to more limited familiarity in marketplace. • Not tested for lease. 	<ul style="list-style-type: none"> • New legislation required. • Requires minimum six months' trading results for "due diligence" processes.
	<p>Subsidiaries of existing HEC</p>	<p>Yes</p>	<ul style="list-style-type: none"> • Not preferred for sale as the model increases the separation risk. • Could only be considered as interim position to simplify initial separation. • Not tested for lease. 	<ul style="list-style-type: none"> • No new legislation required. • Would require additional time to move to full separation and have minimum of six months' trading results.

Glossary

ACCC	Australian Competition and Consumer Commission
COAG	Council of Australian Governments
ESI	Electricity Supply Industry
ETSA	Electricity Trust of South Australia
GBE	Government Business Enterprise
GBF	Gordon-Below-Franklin
GPOC	Government Prices Oversight Commission
GSA	General Services Agreement
HEC	Hydro-Electric Corporation
MI	Major Industrial
NCC	National Competition Council
NCP	National Competition Policy
NEC	National Electricity Code of Conduct
NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NGMC	National Grid Management Council
OEPC	Office of Energy Planning and Conservation
PAC	Public Accounts Committee
SECV	State Electricity Commission of Victoria
SPC	Special Premiers' Conference

**PUBLIC ACCOUNTS COMMITTEE INQUIRY INTO
DISAGGREGATION OF THE HYDRO-ELECTRIC CORPORATION**

APPENDIX 1 - DOCUMENTS RECEIVED AND TAKEN INTO EVIDENCE

No.	Description	Date Tabled
1.	Bain International and Salomon Brothers. Hydro-Electric Corporation 'Restructuring for Growth': Executive Overview.	22/12/97
2.	New South Wales. Committee of Inquiry into the Sale of the NSW Electricity Assets. Report.	22/12/97
3.	Smith, Stewart. Electricity and Privatisation New South Wales Parliamentary Library Research Service.	22/12/97
4.	Letter from Dr. Norton to Mr. Challen. 'HEC Financial Projections', dated 28 July 1997. (Copy).	2/2/98
5.	Reeves, Andrew, Commissioner, H.E.C. National Competition Policy. Review of the Structure of the Hydro-Electric Corporation's Distribution and Retail Businesses - Issues and Options October, 1997.	2/2/98
6.	'Memorandum Of Understanding' in relation to the provision of financial assistance to Tasmania in respect of the cessation of work on the Gordon River Power Development (stage 11).	2/2/98
7.	Tasmania. Government. Premier. Media Release dated 6 February, 1998 - "Appointment of Financial Adviser for Restructuring and Partial Sale of Hydro-Electric Corporation".	11/2/98
8.	Electricity Week's Energy Risk - November 7, 1997, Vol.2, No. 9.	11/2/98
9.	Hydro Electric Corporation - Annual Report, 1997.	11/2/98

10. Tasmania. Department of Treasury and Finance. The impact on the Consolidated Fund of the Partial Sale of the HEC. February, 1998. 12/2/98
11. Tasmania. Department of Treasury and Finance. Tasmania's Debt Burden. February, 1998. 12/2/98
12. Tasmania. Department of Treasury and Finance. The Structural Separation of the Hydro-Electric Corporation. February, 1998. 12/2/98
13. Tasmania. Department of Treasury and Finance. The Tasmanian Budget: Competing Demands and Budgetary Constraints. February, 1998. 12/2/98
14. Tasmania. Department of Treasury and Finance. The Regulatory Framework for Tasmania's Electricity Supply Industry. February, 1998. 12/2/98
15. NEMMCO. Australia's National Electricity Market - An Introduction. 12/2/98
16. Tasmania. Terms of Reference: Financial Adviser on the Sale of Electricity Businesses. 12/2/98
17. Tasmania. Department of Treasury and Finance. The Structural Separation of the Hydro-Electric Corporation. National Competition Policy Implications, 1998. 12/2/98
18. Tasmania. National Competition Policy Progress Report, 1997. 12/2/98
19. Tasmania. Office of Energy Planning and Conservation. Electricity in Tasmania. A position paper on the current market situation and future prospects. April, 1997. 12/2/98
20. Moody's Investor. Regional and Local Government - Australian States Analysis, 1997 p. 128, pp 15 - 17. 12/2/98
21. 'Standard and Poors'. Tasmanian Government Reports, 1997 - pp 118-119; pp2-18. 12/2/98
22. *Confidential (Kept in Separate File)*
Bain International and Salomon Brothers. 'Hydro-Electric Corporation. Restructuring for Growth' October, 1997. 12/2/98

23. *Confidential (Kept in Separate File)*
Tasmania. Basslink Development Steering Committee.
Report December 1997. 12/2/98
24. *Confidential (Kept in Separate File)*
Tasmania. Department of Treasury and Finance.
Competition Project Team. *Electricity Competition
in Tasmania.* 12/2/98
25. *Confidential (Kept in Separate File)*
'Options for the Structural Separation of the HEC' Report:
August, 1997. 13/2/98
26. Victorian Treasury & Finance Department.
A folder entitled 'Information provided to the Public
Accounts Committee, Parliament of Tasmania, Inquiry into
Disaggregation of the Hydro-Electric Corporation and
Related matters' containing the following documents was
tabled by Dr Michael Vertigan, Secretary, Department
of Treasury and Finance, Victoria and Ms Chloe Munroe,
Executive Director, Energy Projects Division, Department
of Treasury and Finance, Victoria. 23/2/98
1. Economic and Social Relevance.
- (a) The Electricity Supply Industry in Victoria, A
Competitive Future - Electricity, Summary, October, 1993.
- b) Reforming Victoria's Electricity Industry Stage 2 - A
Competitive Future - Electricity, February, 1994.
- c) Victoria's Electricity Supply Industry - Towards 2000,
June, 1997.
- d) The Privatisation of the SECV, Your 20 Questions
Answered.
- (e) Reforming the Electricity Supply Industry - A brighter
Future for All Victorians pp 2-4.
2. Consumers Issues.
- (a) Victoria's Electricity Supply Industry - Towards 2000,
June, 1997.

(b) Community Service Obligations, Policy Statement and Background to Policy, August, 1994.

(c) Reforming the Electricity Supply Industry - A Brighter Future for All Victorians pp 12-17.

(d) Electricity Brochures.

- i) Competitive Structure and Customer Choice. Guaranteed.
- ii) Special Benefits for Concession Card Holders. Guaranteed.
- iii) Reduced Bills and Improved Services. Guaranteed.
- iv) Utility Reform The Benefits.

3. Measurement of Privatisation Vs Public Ownership.

(a) 1997-98 Budget Statement, Budget paper No. 2 p.131.

(b) Report of the Auditor-General on the Government's Annual Financial Statement 1997/98, p.42.
(Website - <http://home.vicnet.net.au/~vicaud1/aghome.htm>)

(c) Auditor-General's Office - Report on Ministerial Portfolios, May 1996, p.275.
(Website - <http://home.vicnet.net.au/~vicaud1/aghome.htm>)

4. Employment.

(a) ESAA Employment Data - Summary.

(b) The Privatisation of the SECV, Your 20 Questions Answered, Q.19.

5. Budgetary Considerations.

(a) 1997-98 Budget Statement, budget paper No. 2, pp 129-131.

(b) Report on Ministerial Portfolios, May 1996 p.275.
(Website - <http://home.vicnet.net.au/~vicaud1/aghome.htm>)

(c) Victoria - The Story So far - 4th Annual Report, pp.12-13.

6. Environmental Impacts.

(a) Victoria's Electricity Supply Industry - Towards 2000, June 1997, Chapter 10.

(b) Reforming the Electricity Supply Industry - A Brighter Future For All Victorians pp.18-22.

7. Disaggregation Issues.

(a) Special Report No. 38, Privatisation - An audit framework for the future, Victorian Auditor-General's Office, November 1995, pp.35-36.

(Website - <http://home.vicnet.net.au/~vicaud1/aghome.htm>)

(b) Victoria's Electricity Supply Industry - Towards 2000, June 1997, p.14.

27. Walker, Dieneke, Consumer Benchmarks for Energy and Water: A Consumer Perspective of Regulation and Service Delivery, Melbourne Consumer Law Centre Victoria Ltd.1996. 23/2/98
- 28.(a) Victorian Power Exchange Annual Report, 1997. 23/2/98
- (b) Victorian Power Exchange - Vicpool and the National Electricity Market, August, 1997. 23/2/98
- 29.(a) Electricity Industry Ombudsman (Victoria)Limited, Annual Report, 1996-97 and summary.
- (b) Electricity Industry Ombudsman Victoria Limited. Mission Statement and guiding principles.
- (c) Copies of Electricity Industry Ombudsman Newsletter - Resolution Nos 1-4. 24/2/98
30. Solaris Power - Appendix to presentation. Parliament of Tasmania. Standing Committee of Public Accounts. Inquiry into Disaggregation of the Hydro-Electric Corporation and Related matters. 24/2/98
31. Hydro-Electric Corporation. Report on Structural Separation - project and progress. (List attached to Correspondence from H.E.C., 6th March, 1998, (No. 1) 9/3/98

32. Hydro-Electric Corporation. Advice to Government on Debt Allocation to Separated Businesses. (No. 2) 9/3/98
33. Hydro-Electric Corporation. Detailed Analysis of Recurrent Costs of Disaggregation. (No. 3) 9/3/98
34. Hydro-Electric Corporation. Cost Implications of Separating Generation from Transmission. (No. 4) 9/3/98
35. Hydro-Electric Corporation. Cost Savings from Disaggregation, Efficiency Gains, etc. (No. 5) 9/3/98
36. Hydro-Electric Corporation. Benchmarking Against Other Utilities. (No. 6) 9/3/98
36. (b) Hydro Generation Benchmarking.
36. (c) Australian/New Zealand Transmission Authorities Comparisons - 1996/97.
36. (d) Electricity Supply Association of Australia Ltd. Electricity Australia 1997.
36. (e) Hydro-Electric Corporation. Comparative Interstate Electricity Pricing Study; Commercial and Light Industrial Customers, 1995.
36. (f) Coopers and Lybrand Consultants. Hydro-Electric Corporation 1994 - Comparative Assessment of Electricity Distributors in Australia.
36. (g) UMS Group Best Performer.
37. Hydro-Electric Corporation. Total Residual Hydro Potential (Regardless of Land Use). (No. 7) 9/3/98
38. Hydro-Electric Corporation. Advice to Government on Gas Potential. (No. 8) 9/3/98
39. Hydro-Electric Corporation. Load Factor for King Island Wind. (No. 9) 9/3/98
40. Hydro-Electric Corporation. Cloud seeding - *not yet available*
41. Hydro-Electric Corporation. Latest Solar Energy Developments. (No. 11) 9/3/98

42. The Electricity Supply Association of Australia. The 4th Renewable Energy Technologies and Remote Area Power Supplies Conference, 23-25 February, 1998, Hobart, Tasmania. (No. 12) 9/3/98
43. Hydro-Electric Corporation. Break up of Costs Between Generation, Transmission and Distribution and Allocation to Various Classes of Customer. (No. 13) 9/3/98
44. Hydro-Electric Corporation. Demand Forecasts. (No. 14) 9/3/98
45. Hydro-Electric Corporation. Onselling of Power - Restrictions on. (No. 15) 9/3/98
46. Hydro-Electric Corporation. Annexure accompanying letter dated 13 February, 1998 9/3/98
47. Tasmanian Chamber of Commerce and Industry. Electricity Prices. Interstate Comparisons. (Source ESAA 1998) 10/3/98
48. Government Prices Oversight Commission. Derivation of Regulated Charges for Use of the Transmission Network. 10/3/98
49. Hydro-Electric Corporation: Transmission Capital Expenditure. 12/3/98
50. Reeves, A. Government Prices Oversight Commission: Demonstration of Impact of new Capital Expenditure on Annual Charges for HEC transmission and Distribution. 13/3/98
51. Tasmania. Department of Treasury and Finance Commonwealth Tax Compensation and Privatisation. March, 1998. 13/3/98
52. Tasmania. Department of Treasury and Finance. Letter from Ernst and Young dated 11 March, 1998, Preliminary Assessment of HEC Disaggregation Recurrent Costs and Benefits. 13/3/98
53. Australian Services Union, MEU Branch. Submission to the Committee of Inquiry into Electricity Privatisation in New South Wales 1997. 18/3/98

54. Australian Labor Party Taskforce. Submission to the Committee of Inquiry into the Sale of Electricity Assets, 1997. 18/3/98
55. Labor Council of New South Wales. Submission to the Committee of Inquiry into Electricity Privatisation in New South Wales, 1997. 18/3/98
56. Sinclair Knight Merz Pty. Ltd. - Presentation to Tasmanian Parliament's Joint Standing Committee on Public Accounts (Note Page 7 tabled separately and *in confidence*.) 19/3/98
57. Letter HEC dated 11 March with Attachment:- List of Documents and Reports held by HEC considered Relevant to Public Accounts Committee Inquiry into HEC Disaggregation. 26/3/98
58. Letter dated 24 March with Attachment:- Notes for Standing Committee of Public Accounts - 'Impact of Disaggregation on Major Industrial Contracts'. 26/3/98
59. Letter CEPU dated 11 March re: HEC Disaggregation. 26/3/98
60. National Competition Council. Compendium of National Competition Policy Agreements. 26/3/98
61. Government Prices Oversight Commission. Hydro-Electric Commission Retail Prices Investigation. Final Report 1996. 26/3/98
62. Hilmer, Fred - Structural options for the Hydro - a competition policy perspective - Tasmania Paper from 2010 Forum: The Hydro - Who should own it? Forum IX Hobart 1996. 26/3/98
63. Tasmania. Department of Treasury and Finance. Regulation of transmission and Distribution Network Pricing. 26/3/98
64. National Competition Council. Assessment of progress: NCP and related reforms. First Tranche Assessments: Tasmania pp104-115. 26/3/98
65. Industry Commission. The Electricity Industry in South Australia, 1996. 26/3/98

66. Letter:- Department of Treasury and Finance Dated 26 March citing the report Corporatisation and Private Equity Options for the HEC by Cresap Langton. 30/3/98
67. National Competition Council: Press Release dated 20 March 1998 re: the Public Accounts Committee hearing in Sydney on the 19 March 1998. 30/3/98
68. Folder comprising transcripts of evidence taken in Melbourne on 23, 24 February, 1998; and in Sydney 18, 19 March, 1998. 6/4/98
69. HEC. Letter dated 10 October, 1997, to Minister for Energy 'Competition arrangements'. 6/4/98
70. HEC. Letter dated 10 October, 1997, to Minister for Energy 'Establishment of New Structural Arrangements for the Hydro-Electric Corporation'. 6/4/98
71. HEC. Letter dated 13 October, 1997, to Minister for Energy 'Proposed Legislation to Establish New Structural Arrangements for the Hydro-Electric Corporation'. 6/4/98
72. HEC. Letter dated 15 October, 1997, to Minister for Energy 'Proposed Legislation to Establish New Structural Arrangements for the Hydro-Electric Corporation'. 6/4/98
73. HEC. Letter dated 26 November, 1997, to Minister for Energy re 'Ministerial Statement Implementation of New Energy Directions' 19 November 1997. 6/4/98
74. Weston, Steve: Review of Energy Production Capability of the Hydro-Electric System. 6 November, 1995. 6/4/98
75. National Grid Management Council: 'Empowering the Market' 1994. 6/4/98
76. Bannister, Hugh: 'A review of recent Basslink Studies': A report prepared for the Office of Energy Planning and Conservation and the Hydro-Electric Corporation. 6 February, 1996. 6/4/98
77. Bannister, Hugh: 'Developing a Business Case for Basslink': A report prepared for the Office of Energy Planning and Conservation and the Hydro-Electric Corporation. 14 February, 1996. 6/4/98

78. The Hydro Vision : Briefing material March, 1997. 6/4/98
79. Hydro-Electric Corporation Annual report 1997 and Promotional Material in folder for Public meeting 1997. 6/4/98
80. Hydro-Electric Corporation Press releases dated 10 April, 18 April, 20 April, 21 April, 1997. 6/4/98
81. Cresap Langton: Corporatisation and Private Equity Options Executive Summary. 9 August, 1993. 6/4/98
82. Cresap Langton: Corporatisation and Private Equity Options Report. Sections 11 to V11. 9 August, 1993. 6/4/98
83. Cresap Langton: Corporatisation and Private Equity Options Appendices to Report. 9 August, 1993. 6/4/98
84. Letter from Premier to National Competition Council dated 10 November, 1997, seeking responses to the Government's energy initiatives as detailed. 6/4/98
85. Letter from National Competition Council dated 9 December, 1997, replying to letter from Premier. 6/4/98
86. Evidence submitted to the Committee by Mr. Colvin Smith, 47 Valley Road, Devonport, dated 30 March, 1998 6/4/98
87. Letter from National Competition Council dated 9 April, 1998, to Secretary, Department of Treasury and Finance. 15/4/98

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APPENDIX 2 - SUBMISSIONS RECEIVED AND TAKEN INTO EVIDENCE

No.	Description	Date Received	Date Tabled
1.	Government Prices Oversight Commission GPO Box 770 HOBART 7001, Mr. Andrew Reeves, Commissioner.	29/1/98	2/2/98
2.	HECEC Aust. Pty.Ltd., GPO Box 1484R, HOBART 7001, Mr. Arthur Watts, Managing Director	2/2/98	9/3/98
3.	Tasmanian Independent Wholesalers, Locked Bag 4, LAUNCESTON 7250, Mr. Sam Richardson	2/2/98	9/3/98
4.	Hydro-Electric Corporation, GPO Box 355D, HOBART 7001, Dr. Daniel T. Norton, Chief Executive Officer	5/2/98	9/3/98
5.	Tasmanian Chamber of Commerce & Industry, 30 Burnett Street, North Hobart. 7000, Mr. Tim Abey, Secretary	9/2/98	11/2/98
6.	The Major Employers Group (Tas.), GPO Box 937, Hobart 7001 Mr. Terry Long, Convenor	9/2/98	11/2/98
7.	Department of Treasury and Finance, Franklin Square, Hobart 7000, Mr D. Challen, Secretary		12/2/98
8.	Australian Services Union, Tasmanian Branch, 265 Macquarie Street, Hobart 7000, Mr T.J. Cordwell, Branch Secretary	13/2/98	9/3/98
9.	Submission: Letter, anonymous Hydro-Electric Corporation employee. (Addressed to Dr. Crean)	2/2/98	2/2/98
10.	Mr. John Hale, "Culbone", The Lea, Kingston 7050		9/3/98

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APPENDIX 3 – LIST OF WITNESSES

Transcripts of all evidence provided by witnesses except, where it has been taken in camera, are available on the Internet at <http://www/parliament.tas.gov.au/pac.htm>. It should be noted that in quoting from transcript the report uses page references that may vary from those within the Internet version.

Date

23.1.98	Kerslake, Mark	Department of Treasury and Finance
	Rutherford, Bob Conservation	Office of Energy Planning and
	McShane, Nick	Department of Treasury and Finance
11.2.98	Rae, Hon. Peter	Hydro-Electric Corporation
	Norton, Dr. Daniel	Hydro-Electric Corporation
	Kelleher, Mark	Hydro-Electric Corporation
12.2.98	Challen, Donald	Department of Treasury and Finance
	Harrison, David	Comalco
	Watts, Arthur	HECEC
	Dreverman, David	HECEC
13.2.98	Challen, Donald	Department of Treasury and Finance (‘In Camera’)
	Sulikowski, Richard	Electricity Planning Unit (‘In Camera’)
23.2.98	Vertigan, Dr. Michael	Department of Treasury and Finance, Victoria
	Munroe, Ms Chloe Victoria	Department of Treasury and Finance,
	Tamblyn, John	Regulator-General, Victoria

	Nelthorpe, Dennis	Consumer Law Sector
	van der Mye, Dr. Stephen	NEMMCO
	Macaulay, Charlie	NEMMCO
	Gallagher, James	Victoria Power Exchange
24.2.98	Jenkins, Brendan Victoria	Deputy Mayor, Latrobe Council,
	Blanch, Stephen	Eastern Energy, Victoria
	Spaulding, Dan	Powercorp, Victoria
	McLeod, Ms Fiona	Electricity Ombudsman, Victoria
	Marshall, John	Solaris Power, Victoria
10.03.98	Abey, Tim	Tasmanian Chamber of Commerce and Industry
	Behrens, Nick	Tasmanian Chamber of Commerce and Industry
	Long, Terry	Major Employers Group
	Wilson, Andrew	Major Employers Group
	Reeves, Andrew	Government Prices Oversight Commission
11.03.98	Rutherford, Bob	Office of Energy, Planning and Conservation
12.03.98	Rae, Hon. Peter	Hydro-Electric Corporation
	Norton, Dr. Daniel	Hydro-Electric Corporation
	Kelleher, Mark	Hydro-Electric Corporation
	Warnock, Tony	Hydro-Electric Corporation
	Bevan, Richard	Hydro-Electric Corporation

13.03.98	Challen, Donald	Department of Treasury and Finance
	Richardson, Sam	Tasmanian Independent Wholesalers
	Court, Clive	Tasmanian Independent Wholesalers
18.03.98	Hilmer, Prof. F.	Pacific Power, New South Wales
	Richardson, Mark	Bain International (‘In Camera’)
	Croft, David	Transgrid, New South Wales
	Botsman, Dr. Peter	University of Western Sydney
	McLean, Greg	Australian Services Union
19.03.98	Knight, Jack	Sinclair Knight Merz (Part ‘In Camera’)
	Lawson, Bill	Sinclair Knight Merz (Part ‘In Camera’)
	Willett, Ed	National Competition Council
	Samuel, Graeme	National Competition Council
	Kelly, Stephen	NECA
	Walker, Alex	Integral Energy, New South Wales
06.04.98	Challen, Donald	Department of Treasury and Finance
	Sulikowski, Richard	Electricity Planning Unit
08.04.98	Norton, Dr. Daniel	Hydro-Electric Corporation
	Challen, Donald	Department of Treasury and Finance