Tuesday 1 December 2009 - Legislative Council - Government Businesses Scrutiny Committee A - Hydro Tasmania

LEGISLATIVE COUNCIL

GOVERNMENT BUSINESSES SCRUTINY COMMITTEE A

Tuesday 1 December 2009

MEMBERS

Ms Forrest
Mr Hall (Chair)
Mr Harriss
Mr Wilkinson

IN ATTENDANCE

Hon. David Llewellyn, Minister for Energy and Resources

Ministerial Office

Mr Nick Wright, Adviser

Hydro Tasmania

Dr David Crean, Chair
Mr Vince Hawksworth, Chief Executive Officer
Mr Lance Balcombe, General Manager, Strategy and Finance
Mr David Jeffrey, Manager, Government Relations

The committee resumed at 1.02 p.m.

CHAIR (Mr Hall) - Good afternoon. We have until 3 p.m. with a two-hour session with Hydro. David, would you like to make one of those succinct presentations that you have been doing? You did quite well this morning, I thought.

Mr LLEWELLYN - This is, I hope, fairly succinct as well but an important opening statement on this occasion. So thank you, Mr Chairman. I want to firstly congratulate the team of Hydro Tasmania for the dramatic turnaround in the Hydro's financial performance. The net profit of $291 million after fair value adjustments, an operational profit of $38 million, return on the

storages to almost 47 per cent of full energy and the management of Hydro Tasmania's debt position to finish the year at $904 million, which is some $55 million better than budget, I think are all hard evidence that the Hydro has turned the corner.

The strength of these results vindicates the Government's broader energy policies and our staunch defence of Hydro Tasmania from the baseless political and media attacks to which it has been subjected in recent years. A decade ago Tasmania had an isolated energy system, almost totally reliant on rainfall into our Hydro system. The risk of electricity shortages due to drought damaged confidence in the State's economy. There were no wind farms in Tasmania. There was a new national grid and electricity market on the mainland but Tasmania was not part of it.

This Government facilitated the construction of a gas pipeline under Bass Strait and the rollout of a backbone transmission and distribution grid in a short time. The thermal power station built as an emergency supply at Bell Bay was converted to run on natural gas instead of oil, and the savings in fuel costs at Bell Bay since then have covered the public contribution to the new gas network many times over. Woolnorth was constructed and later extended when first built, and then extended to Studland Bay. This was Australia's largest wind farm and it is now consistently amongst the best performing wind farms in the world. Basslink, the world's longest sub-sea high voltage direct current cable, was constructed to connect the Tasmanian and mainland electricity grids. Through the recent years of record drought, Basslink and gas generation were able to underpin Tasmania's electricity supplies without resort to power rationing.

Today I would like to make a few brief announcements about the future. This Government is proud of its energy strategy and reaffirms its commitment to the progressive introduction of competition in the generation and retail segments of the Tasmanian energy market. To that end, Cabinet recently decided to extend retail competition to a further 2 600 business customers from 1 January 2011 and will continue to provide robust consumer protection to these newly contestable customers. At this stage, the Government will not proceed to full retail contestability for domestic customers but will continually review the costs and benefits of doing so.

We will continue to ensure that residential customers are protected by robust, independent price regulation, and in line with yesterday's announcement on water and sewerage the Labor Government will permanently index concessions to future price rises so that low-income Tasmanians are insulated from any rises into the future. We intend to maintain the momentum on energy reform. In mid-2008, the Government commissioned an expert study into the relative roles of the three owned energy companies to look at what, if anything, the Government could do to improve its overall added value, and what, if anything, could be done to improve the efficiency and effectiveness of energy markets in Tasmania for the benefit of both customers and the public.

This strategic look ahead is supported by input from our three boards and management of Hydro Tasmania, Transend Networks and Aurora Energy. The Government expects to consider the findings of that review in early 2010. Our energy vision for Tasmania sees very large generation capacity for wind and geothermal sources, together with biomass, potentially generating thousands more megawatts into the Tasmanian and national grids. For the potential of thousands more megawatts of renewable energy the possibility that a second electricity link to the mainland may eventually be needed, and in the national interest is squarely on the medium-term agenda. Tasmania can contribute in a real way to reducing Australia's dependence on fossil fuels and, at the same time, earn money for our economy.

The Government has also decided that it will legislate to require Aurora to provide a feed-in tariff to customers to install smaller, renewable energy systems at their home or their business. Finally, the Government will provide $350 000 and work in partnership with the councils on King and Flinders islands to help residents on the islands increase their energy efficiency and reduce their overall energy costs by making sure that these residents are able to make the most of Australian Government programs, such as the Energy Efficient Homes Package, the Green Loans and Green Start facilitating the uptake of solar hot water and ceiling insulation through collective purchasing and installation arrangements, providing direct assistance for measures that help island residents reduce their electricity bills, and finally mandating a feed-in tariff on the islands that recognises the benefits of reducing the costs of generation from diesel fuel.

Mr Chairman, those are my opening comments and a little bit of policy enunciation and announcement in the energy sector. We have a number of media releases and we also have a background paper that is quite an extensive document. I would like to hand over now to the Chairman of Hydro Tasmania who will make some comments, too.

Dr CREAN - It is good to be here once again, particularly with my former colleagues in the Legislative Council. This year has been a better rainfall year for Hydro Tasmania, and I will come to that in a moment. I think it is opportune to look at where Hydro Tasmania is strategically. In doing that, I will give you a thumbnail sketch of where the organisation was at disaggregation in 1998 and the main factors that have influenced our strategic evolution to the point we are at today. If you recall, in 1998 disaggregation, Hydro Tasmania was a monopoly generator in the Tasmanian market. It was not very commercial. It had very good engineering skills but structurally it was not designed to add value to the organisation or to add diversification. At that time each year's budget was on the basis of average inflows of some 10 000 gigawatt hours a year. There were a number of major influences over the last 11 years. First of all, we had National Competition Policy and State legislation on commercialisation; we had Basslink and the interconnection to the National Electricity Market; we had wind farm developments and the Bell Bay closure recently and the Tamar Valley Power Station competition in the Tasmanian market. All these events, and others, had a significant influence on where we are today but I think Basslink clearly more than anything has determined our strategic direction. As you know, Basslink enabled connection into the National Electricity Market so Hydro became a competitor in the market, competing with large generators such as AGL and Origin, who were not only generators and wholesalers of electricity but also retailers.

As the years went by, in order for us to remain competitive in the national market it was necessary for us to develop a retail capability, hence the purchase of Momentum Energy, which is a small retailer that supplies small, medium and large businesses within the national market. That purchase was secured, first 51 per cent and then the final 49 per cent just recently. That retail capability has offered us growth opportunity, increase in cash flow opportunity and an important hedge against fluctuations in the wholesale price within the national market. This retail is very important for us and we wish to pursue growth as Australia's largest renewable energy business.

Hydro today is a competitive generator in the National Electricity Market. Tasmania is still our main market and always will be, but we are now a wholesaler and retailer within the national market. We are a much more commercial organisation. We still have very good engineering skills but the structure of the business is there now to add value, diversity and growth. Our yearly budget is now based on a de-rated system - we had this discussion two years ago at the last Legislative Council GBE committee hearing when the system had been de-rated - and our average inflows have been de-rated to 8 700 gigawatt hours.

Our growth strategy is inextricably related to our financial strength and the need for the organisation to reach a BBB rating over the next decade. We are currently looking at the best ways to achieve growth and our financial strength with the BBB rating in the best and quickest way. As well as the retail growth that I have just talked about, our vehicle in Victoria to attain growth, we are also experiencing growth through our consulting division which now has offices in Hobart, Melbourne, Brisbane and New Delhi and they are consulting in renewable energy, in Hydro power generation, in dam design, in water catchment management and environmental management providing services to mainland States and to Asian countries, assisting those jurisdictions in developing renewable energy and meeting the significant demands of climate change.

[1.15 p.m.]

Our growth strategy also includes our business development section, which first developed Roaring 40s which is now a joint venture between China Light and Power and Hydro Tasmania where we pursued growth in China and India. We have recently sold that and refocused on Australia. Business Development is also developing growth opportunities through its remote area power supply with pilot programs on the Bass Strait islands and we have just received a significant grant of some $15 million from the Federal Government to pursue renewable energy solutions on King Island, substituting for greenhouse diesel production.

As always, rainfall is our revenue. As I said we have de-rated the system to an average of 8 700 gigawatt hours. Our forward projections in the corporate plan are based on a budget of 8 700 gigawatt hours and if we achieve that we can achieve the twin objectives of financial improvement with BBB rating and the growth opportunities that I have talked about. Below average will make it harder, above average easier of course.

Last year, 2008-09, we had an improved rainfall situation but still less than the average; it was 8 400 gigawatt hours or thereabouts but we still were able to have a turnaround of some $100 million in profitability. Of course this year is shaping up as a better year with larger and healthier storages as we move into the summer months.

So, Mr Chairman, that is my brief overview. There are a lot of issues in that. We are anticipating a lot of questions so we will open it up for questions.

CHAIR - Thank you very much, Dr Crean. As we did with FT, we might focus on the financial aspects and I have a couple I will start off with before going down the table.

As far as dividends go, there have been no dividends paid for the past two years, yet if we go back to 2005-06 there was something like $40 million and in 2006-07, $21 million. In your annual report it talks about returning to paying a dividend in 2009-10 of about $3 million, which is still quite a bit less than what has been historically paid. The question is: do you expect to exceed that target if everything goes right and also why is it still low compared to historical levels?

Mr LLEWELLYN - I think the Chairman outlined the reason for that in his introduction in that we have been travelling through some very difficult times from a hydrology point of view. The finances of Hydro are very much dependent upon water intake. We have had protracted period of drought and that has shown up in the returns from a government dividend point of view

over the last few years. This year we are hoping that we will have a better outcome and I will ask the Chairman to make some comments about it.

Dr CREAN - As you would be aware, and I understand this applies to all government businesses and State-owned companies, the dividend policy is based on 50 per cent of net profit. From the beginning there was a difficulty created in this with the new accounting standards where profit was not only based on your cash outcome but also on other issues such as changes in fair value of the assets which is not a cash issue and there was quite significant volatility in the profit levels when you take into account the non-cash items. If it was based on that profitability you would have ridiculously high cash payments that could not be sustained. So we worked on the basis that, in terms of profitability, it would only be the cash items that were considered. Having said that, in relation to Hydro Tasmania because of our severe rainfall conditions, or lack of them over the previous three years, it was agreed with Treasury that our dividends would be paid on the cash basis of the profit, but only if we received above 8 200 gigawatt-hours of inflows and only if the storage levels were above 30 per cent. If the inflows were below 8 200 gigawatt-hours and the storage levels below 30 per cent, we would not pay any dividend and we have agreed that the proportion of profit, provided that criterion was met, in 2009-10 would be 20 per cent; in 2010-11, 30 per cent; in 2011-12, 40 per cent and in 2012-13, 50 per cent onwards.

Mr WILKINSON - In relation to your inflows and gigawatt-hours, there has been a lot of rain in July, August, September, October, November -

Mr LLEWELLYN - Not in October-November.

Dr CREAN - Not October-November, it has turned over.

Mr WILKINSON - Where are we now with inflows per gigawatt-hour this financial year?

Dr CREAN - We are above budget and tracking around 9 500 gigawatt-hours for the financial year. But we had very strong inflows in June, July, August and September but in October-November it turned off like a tap and we only got half inflows in October.

Mr WILKINSON - Yes, but the washer broke last weekend, didn't it?

Dr CREAN - Yes, there was some rain on the weekend but still, we hardly had any in November, so we will still be below the average for November. With the change in the pattern of rainfall it is very difficult to predict what situation you are going to be in but we have based our de-rated system on recent statistics and we believe that around 8 700 is the average that we could expect.

Mr WILKINSON - And we are tracking so far at 9 500?

Dr CREAN - About 9 500 for the financial year. But at the moment, for the calendar year we are in a similar situation. In order to get that 9 500 or above the average for the financial year, we need to have average rainfall for the remaining months.

Mr WILKINSON - One of the arguments has been that because there has not been as much snow, a couple of the catchment areas have not been as prolific as would otherwise be expected. Is that the case?

Dr CREAN - Snow is an issue in some areas but the main position is the actual rainfall. That is still the most significant. But certainly the snow in certain catchment areas is important in terms of flow through to the rivers and continuing flow into the system.

CHAIR - Just getting back, David, to that question I asked about 2009-10 and if things go well, you may be able to pay a dividend of more than $3 million?

Dr CREAN - It is based on a percentage of our net cash.

CHAIR - You mentioned those percentages.

Dr CREAN - I think that we need to look at, certainly in the future years, the total returns to government which is a combination of the guarantee fee, the rates equivalent, taxation and dividend. You add all those up and provided that we have this average rainfall over the course of our forward budgets, then we can expect the total returns to government to equate to around $70 million per annum by 2013-14 or thereabouts.

You have to look at the total returns and dividend is only one aspect of that.

CHAIR - The net debt situation fluctuates a bit; if you go back to 2007, $1.1 billion, then down to $872 million in 2008, then back up again to $904 million. What are the main factors in that increase in debt and what is the target for net debt in the coming year?

Dr CREAN - Basically, our net debt position fluctuates according to our cash flow, what is termed the net operating cash - the cash that is left after all expenses including taxation and financial expenses but not including capital expenditure and dividend. So the net operating cash is that cash that is available and, as you can see through the report, our net operating cash dropped last year to around $25 million and, out of that, we had to pay capital expenditure and other things - we did not have a dividend - so that is financed through increasing the debt level. Equally, if we have a better cash position, which we did this year, then the call on the debt is not only there but you actually have extra cash to reduce debt. So that is why you get the fluctuation in net debt. It is a reflection of your cash position and what your expenditures are in relation to cash.

The net debt is around $850 million today and we expect it to creep up to probably $885 million at the end of this financial year. So we are reasonably happy with that debt position.

CHAIR - You are comfortable with that debt-equity ratio in that respect?

Dr CREAN - Yes, our gearing - the debt-to-debt plus equity - is in a much stronger position than when we talked two years ago when we had the discussion about our ratios and so on and the need for the equity injection. Of course, we gratefully received the $220 million in equity but we argued very strongly that Hydro Tasmania should not have had that debt in the first place, at this aggregation, for a different reason, it was -

CHAIR - Was it $220 million or was it $50 million and $220 million?

Dr CREAN - The $50 million was the first instalment, which was basically to fund Roaring 40s' growth and then the $220 million was the equity to the balance sheet.

Mr WILKINSON - What is the debt-to-equity ratio now?

Dr CREAN - The debt-to-equity ratio now is around 40 to 45 per cent.

Mr BALCOMBE - We mentioned the leverage ratio, which is effectively the debt plus total equity, and that is around 38 per cent.

Mr WILKINSON - A couple of years ago it was -

Mr BALCOMBE - It was closer to 45 to 50 per cent - in that range.

Dr CREAN - I think it got up even above 50.

Mr WILKINSON - Did it?

Dr CREAN - Yes, because the equity was low.

Mr WILKINSON - How does that compare with your competitors?

Mr BALCOMBE - It is higher.

Mr WILKINSON - It is still higher at 38 per cent?

Mr BALCOMBE - Yes.

Mr WILKINSON - Where is the figure of your competitors approximately?

Mr BALCOMBE - Around 30 per cent.

CHAIR - Are you chasing any additional equity injections or do you think that you have done well out of the $50 million and the $220 million?

Dr CREAN - We are always grateful.

Laughter.

Mr WILKINSON - Especially considering getting it down to 30 per cent, which you have spoken about.

Dr CREAN - Notwithstanding what I said before that we shouldn't have had the debt but anyway -

Mr LLEWELLYN - Just be careful because Transend is sitting in the audience there.

Laughter.

Dr CREAN - All I can say is, I am not making any comment about equity other than that we are required to undertake a capital review regularly and there is another capital review under the requirements occurring at the moment. But that is just a capital review about where we sit and what our ratios and so on are.

CHAIR - So if there were some additional opportunities which presented themselves, who knows, you may request another injection from somewhere, hypothetically?

[1.30 p.m.]

Dr CREAN - I do not think 'request' is the issue. We have the capital reviews. It is done by Ernst & Young, a professional organisation. They make recommendations and then it is up to the Government of the day to act on any of those recommendations. We do not make requests.

Mr LLEWELLYN - You can recall, at the time of the equity injection and prior to that, there were some financial analyses of the situation and as a result of that report there were some obligations that Hydro were to undertake further reviews at particular times and that is what Dr Crean is talking about at the moment.

CHAIR - Ernst & Young, as I believe, were doing a follow-up review.

Dr CREAN - Yes.

CHAIR - Has that been completed?

Mr BALCOMBE - No, it is on foot at the moment and they will report to Treasury.

CHAIR - Okay. Will that be publicly released when it is done?

Mr BALCOMBE - We would have to defer to the Treasurer on that.

Mr LLEWELLYN - These matters are commercially sensitive and I would have to take some advice about them.

Mr WILKINSON - In relation to the debt-to-equity ratio, 56.5 per cent in 2008-09, that is certainly down a long way; in 2005-06, 117.3 per cent; in 2006-07, 124.4 per cent; down to 69 per cent last year and down again to 56.5 per cent. When you were talking about the 30 per cent, were you talking about 30 per cent debt to equity?

Mr BALCOMBE - It is debt over debt plus equity.

Dr CREAN - It is called a gearing ratio.

Mr WILKINSON - All right. So the gearing ratio of your competitors is the 30 per cent and yours is 38 per cent?

Dr CREAN - Yes, and I think were above 50 per cent on that a couple of years ago because I remember we had the discussion at the last hearing about it.

Mr WILKINSON - I was forgetting what that discussion was about, but there was half an hour taken up about asking a question and I think Mr Jeffrey was involved.

Dr CREAN - It was about the financial strength of the organisation and the balance sheet.

Mr WILKINSON - Yes, thanks, I just wanted to confirm that.

CHAIR - Are there any more questions on financial aspects?

Mr WILKINSON - In relation to underlying profit: obviously, it would be expected now to be increased in the forthcoming financial year because of the rain that we have had; the storage is up to around 47 per cent, I believe. What type of storage are you looking at in relation to feeling comfortable with? Because, of course, when Basslink came in the spin behind Basslink was: what we are about to do is export and make a profit. As a result of the low rains, of course, we have imported and had to pay for that.

Mr LLEWELLYN - The advice that I have received from Hydro consistently, since becoming minister, is that the preferable range is above 30 per cent. So, in other words, we would prefer for the water not to fall below 30 per cent in all storages.

Dr CREAN - That is what we aim for, to keep it above 30 per cent. Of course, we could not do that in the previous three years because of the significant rainfall issues. But it is a balance between prudent water management and being a commercial business and we really, as the minister said, we really want to keep it above the 30 per cent by end of June in the financial year. How effective you are in attaining revenue and cash flow from trading across the link depends not only on your capacity to do it - that is, your storage levels - but also on prices in the market, particularly the spot market, but contract prices as well in a particular year. But, as you are aware, there are two things about Basslink: one was that it was a tool to preserve storages and keep the lights on in Tasmania in times of poor rainfall, which has been more than adequately demonstrated over the last couple of years. The other benefit, of course, the other way it was intended to work, which we hope will be exposed over the coming years, is that with adequate rainfall and storages at good levels to export at high prices, particularly in the summer months, and import back to maintain the storages at lower prices. That is the model basically and we are hoping that we will be able to achieve more of that in this financial year and coming financial years, but it does depend on the rainfall.

Mr WILKINSON - And you would be in a better position now, I would imagine, than you have ever been since Basslink has been working as far as rainfall and storages are concerned?

Dr CREAN - Yes, coming up to the summer months. At the moment the spot prices in the average wholesale price in the national market are very low.

Mr WILKINSON - What is the reason for that?

Dr CREAN - There are a number of reasons. Vince might want to comment on that.

Mr HAWKSWORTH - Due to the global financial crisis and the consequences of that there has been some fall in demand over the period and that has turned up in the national market as more supply on the supply side, so effectively the electricity spot price is ending up being a meeting of supply and demand. The second area that we can observe is where forward prices 18 months ago have built in some certainty around a carbon pollution reduction scheme being in place by this year or next year. There has certainly been some softening of prices created by the uncertainty of that legislation passing. I think that is evidenced also by the brown coal generators in the Latrobe Valley reducing their contract position. They have been less willing to contract. I think that, given the circumstances of where they are today, as of today it is anybody's guess as to what is going to occur in the next few months. I think that will mean increasing volatility because

without certainty those businesses are not contracting. Again, it gives strong rationale for our position to manage our contract carefully and also our retail business in Victoria gives us some insulation from this volatility in wholesale prices.

Ms FORREST - Why do you suggest there is going to be increased volatility when it seems that with the uncertainty people are not wanting to get involved too much at this stage?

Mr HAWKSWORTH - The volatility is, I think, more likely to occur in the stock market because, given the uncertainty about forward contract prices - is there a carbon component or not? - what we are seeing is that the coal-fired generators are less willing to enter into contracts.

Ms FORREST - They are going to put a buffer on, are they?

Mr HAWKSWORTH - No, they will not write contracts in Victoria, which means they have to get their revenues through the spot market, which means there will be the issues of volatility depending on what volumes they need to get away and what revenues. When people are more highly contracted there is less volatility.

Dr CREAN - It is supply and demand.

Mr WILKINSON - In summary, as a result of the GFC, what we are looking at is that there is not the demand that was there previously and even though we have the supply, we do not have the demand to meet that and therefore the prices are low.

Mr HAWKSWORTH - That has tended to dampen prices. Those two issues operating together dampened prices in the short term.

Mr LLEWELLYN - There is also a climatic aspect to it, too. I think in the south-eastern part of Australia at the moment, where our immediate markets are, temperatures have not been quite what they were expected to be, although in South Australia it has been pretty hot, so there is a bit of transferring of energy there. I think when summer hits there will be higher demands and therefore, the prices will rise accordingly.

Ms FORREST - So your capacity there to be more profitable should be increased, if you can export at that time?

Mr HAWKSWORTH - Yes. If the hot weather in summer leads to high prices, our ability to respond to those is better with higher storages where we are more able to use water with less concern about the storage imposition. As the chairman said, we operate the storages on a basis of not being below 30 per cent at the end of June each year and that is the position that we want to be at the low point.

Ms FORREST - Currently they at?

Mr HAWKSWORTH - Currently they are at about 44 per cent but of course we are in a period where, as was said, October we got about 50 per cent of expected inflows so we had a good July/August and into September. October was about 50 per cent of what we expected and even with last weekend's rain that really hit Gordon, November is tracking to be about 25 per cent of expected inflows. Obviously December, January and February we expect to be low inflow months anyway but we will be monitoring that very closely because while on the one hand it will

be good to take opportunity for high prices in the first quarter if they eventuate, equally we do not want to be driving through that 30 per cent line by June.

Ms FORREST - But you have a 14 per cent buffer there already.

Mr HAWKSWORTH - Fourteen per cent can disappear pretty quickly if it does not rain.

Ms FORREST - It did take a number of years, I understand, and admittedly through drought, but to drop -

Dr CREAN - In December 2006 it was some 47 per cent and -

Ms FORREST - It was that recent, was it?

Dr CREAN - Yes, it dropped very quickly. They were particularly bad years, though, admittedly. There is not only volatility in the price but a huge volatility in the rainfall patterns and we are still working our way through all that. We hope that 8 700 is the minimum average or the average but we can only wait and see.

Mr LLEWELLYN - Obviously there are other issues that are there in the marketplace now, particularly since September this year, that were not there before and that is the fact that the Tamar Valley Power Station under Aurora is able to generate a fairly large amount of electricity, which again is absorbed into the market. It competes directly with Hydro Tasmania but it also mitigates the need to import because you do have that base power station now operating and that will act in favour of trying to mitigate the hydrology issue in the long term.

Ms FORREST - How much did we export and how much did we import last financial year?

Dr CREAN - Last year we had a net import of some 2 600 gigawatt hours and very little export. The little that we did export was at high prices. We had to import - and this is in the financial year and the rainfall really just came at the end of that so we were still importing very heavily - and the average import price was of the order of $30 to $36, which is higher than you want. We exported 81 gigawatt hours at an average price of $352 a megawatt hour and we imported 2 705 at an average price of $36.60, so that is a high import price. Normally, under the model when you have enough rainfall and you export, you want to be exporting at those prices more and you want to be importing less but at prices in the $20s and not the $30s.

Ms FORREST - That was nearly 200 gigawatt hours more than the previous year.

Dr CREAN - Yes.

CHAIR - Just following on from that, David, what level of water storage would you need to be able to export at full capacity through Basslink? Is there a figure that you have there somewhere in the mind?

Dr CREAN - No, there is no figure because it depends on a number of variables. It depends on the price in the national market. We do not want to export now -

CHAIR - No, because as you said, the price is low.

Dr CREAN - because the price is so low so it has to be a high price and then you have to try to retrieve as much of that as possible through imports so that your levels do not fluctuate but at a low price so you have to use that balance. If you are not importing what you export then you are running down the storage levels. The biggest market is Tasmania so you are constantly generating and exporting as well.

[1.45 p.m.]

CHAIR - Yes, then there are a couple of dimensions like the Tamar Valley Power Station and wind farms. I suppose that they come into the equation as well.

Dr CREAN - A significant thing from our point of view with Tamar Valley Power Station is that we are no longer responsible for security of supply. We were before because we were the only generator but that is shared now within the market because there is more than one generator. That put constraints on us as a commercial organisation so it is important that that aspect has been lifted.

Mr LLEWELLYN - I think that if you are talking about this in general, looking at the umbrella view of the issue, the change that has now happened over the last 12 months with the mix of energy and the second provider coming into the market has made it much easier from the Hydro's point of view to meet its obligations, certainly with regard to storages. I think that we can rest fairly easy about the issue of security of supply. Even with Basslink going down for a period now, we would not be in the situation that we would have otherwise been in because we have a capacity of something like 400 megawatts of alternative-sourced energy if you add the combined-cycle generator and the standby equipment that can be connected into the system.

I think that we have a much more secure arrangement than we had. It was very difficult working through 2008 and into 2009 because we were keeping our eye very closely on the level of water inflows into the system, getting weekly reports on those issues and it was perilous at one stage when the storages got down to 17 per cent, or 16.8 or something.

CHAIR - In regard to the proposed Musselroe development, anecdotally I have heard that maybe that is a bit financially tenuous as an operation. Have you any comment on that?

Mr LLEWELLYN - The policy there and the attitude towards Musselroe is that we have begun the installation of that project and that will be followed through to completion. There are issues that centre on the RET process, renewable energy certificates and so on, that we are working through, and availability of finance. Because it is being conducted by Roaring 40s, the joint venture partner, we have to bring China Light and Power along as well as the Hydro on the project.

Dr CREAN - That is right. Certainly we are committed to Musselroe. There are two issues at the moment, as the minister has alluded to the Renewable Energy Target Scheme. There is a design fault within that scheme which has resulted in a flood of renewable energy certificates from solar hot water and photovoltaic solar which has reduced significantly the price of renewable energy certificates in the market to between $25 to $35 a megawatt hour.

To build a wind farm for a commercial return you need a renewable energy certificate of around $50 a megawatt hour because it is the addition of the renewable energy certificate plus the price of energy that determines a commercial return. At the moment because of this anomaly in the system, the renewable energy certificate price is too low and the Federal Government need to

address this relatively quickly because it will be difficult to get any wind farm up in Australia until that price goes up.

The second thing, and it is related to this to a large degree, is that in order to get wind farms to financial close, that is to get the bank support for the debt component of it, you need a power purchase agreement and you will not get a power purchase agreement where the renewable energy certificate price is so low. They are the two issues.

We have already spent something like $32 million or $33 million on Musselroe and we are progressing that site. We are confident that we are going to get to a point next year where we can really go full bore on this, but it does depend on addressing those issues. We know the Federal Government will address the renewable energy target issue because if they do not they will not reach their 2020 target. They are not getting any new renewable energy electricity being produced at the moment, and that is the only thing that will enable them to get to their 2020 target.

Ms FORREST - Does that only relate to wind? Are you talking about that issue?

Dr CREAN - Yes. Wind is the closest to commercial. For wind, you need about $50 for a renewable energy certificate. For geothermal, for example, you need more, and for a few others you need more, so wind is the closest renewable electricity generation structure to commerciality. Most of it will be taken up by wind, but geothermal is predicted to come on in about four or five years.

Ms FORREST - You are saying the Federal Government will address this, so if it is that patently obvious -

Mr LLEWELLYN - They have been a bit otherwise diverted with the Carbon Pollution Reduction Scheme.

Dr CREAN - They have been preoccupied, but it has only just come to the fore in the last two to three months. We did warn them about this when we were talking about the Renewable Energy Target Scheme about -

Ms FORREST - Some time ago, if I remember correctly.

Dr CREAN - When it was being developed others also warned them but they did not think it would have the impact. It has certainly come to the fore in the last three or four months, and I believe they will correct it because they have to, otherwise there will just be this bank-up of investment ready to go.

Ms FORREST - Yes. You say you are having to move on Musselroe next year. I know things are pretty volatile in places other than the spot market at the moment, and we could have a double dissolution, an election and a whole lot of turmoil around that, so again time goes on. It is imperative, as I hear you say, that it has to be sorted out before you can progress that, so that is the reality of it.

Dr CREAN - Yes.

Ms FORREST - You will not be going any further with the -

Dr CREAN - No. We believe it will be sorted out and there are things to do on site. There are lots of things to do, which we have been doing. As I said, we have spent $32-odd million and are continuing to spend money on the site to have it ready to go, but you cannot get anything up unless you have the backing of the banks. The banks will not back a development if there is no power purchase agreement that gives a commercial return.

If the Federal Government did nothing, we believe that the system would correct itself, but it would take several years. That is the belief at the moment because there is a limit to how quickly solar hot water can grow. It is being driven by renewable energy certificates, but also the rebates provided by the Federal Government, plus in New South Wales they have just introduced a feed-in tariff which will increase the growth again. So all these issues are feeding rapid growth in solar hot water in particular, and they are just flooding the market with renewable energy certificates. It is a supply and demand situation; the price drops.

Mr LLEWELLYN - I think the important thing to know from the Government's perspective is that the Government is committed to build Musselroe and we will build it one way or another, but there are some hiccups along the way with regard to financing even though there has been a fair expenditure on it at the moment.

Mr WILKINSON - We touched on Basslink a short a time ago, and page 125 of your report just says, 'The corporation currently has a disagreement with the owner of Basslink, City Spring Pty Ltd, relating to charges associated with the Basslink service agreement'. How is that going? Is it sorted out now? What are we looking at there?

Dr CREAN - That is in relation to the $7 million.

Mr HAWKSWORTH - There were two basic issues that occurred around Basslink. The committee might remember that there were some unplanned outages that were rather difficult times for us.

Ms FORREST - Adelaide was not happy.

Mr HAWKSWORTH - and there were numerous issues. As a result of those issues we went into a process with CitySpring, the now owners of Basslink, to identify engineering solutions to the majority of those issues. Earlier this year, about the end of September we had an outage, we took Basslink out for a four-day period, and they addressed some of those technical issues and reinstated it. In fact, in the year to date Basslink's availability - the amount of time it is available to us - is now above the contracted level. So those issues have been largely addressed and that included them getting certain stayers and other equipment as well as adjusting some of the software that controlled the way that the link worked. From that perspective we are very satisfied that CitySpring have come to the party and done the right thing under a little bit of pressure from us.

The second issue was the dispute over the way the commercial risk-sharing works. There is a base fee that CitySpring get and then there is a fee based on the highest and lowest prices that occur in Victoria as we trade over the link. We have a difference of opinion on how that operates and that largely relates to the first quarter of the calendar year. It was under review in the financial year and as such we have not resolved that dispute yet. We have taken significant legal advice including senior counsel advice and we are about to go back to CitySpring with a position, which in our view still supports our contention that they owe us $7 million. Clearly, it is a very

complex contractual arrangement and, as with all those things, we would rather solve that commercially than through a dispute process, which can result in your spending as much money as you end up gaining. We are still optimistic that we will reach a commercial solution with CitySpring over the coming months, but we are not keen to rush that because we want to get very sound and solid advice. So that is what that refers to.

Mr HARRISS - I want to try to understand the contribution to the business of subsidiaries, if I could call them that, like Momentum and the ongoing cash issues for the business which the Auditor-General has identified in his annual report, his annual assessment of Hydro. He cites specifically things such as funding of the corporation's capital refurbishment program. Dr Crean did touch on that earlier and the impact on your net debt and your borrowings and the like. It also talks about the continued investment funding of Roaring 40s and the funding of the acquisition costs and the capital of Momentum going forward. So I want to try to understand the impacts of those in particular on the overall businesses of Hydro. I have read what you have in your report about Momentum in particular and the diversification that provides for you but in the report year the loss was about $13 million. About $12 million of that was as a result of adjustments against Hydro's hedging arrangements with Momentum and so on. I want to try to understand more about that and what benefits in particular Momentum could be to the business going forward and what challenges the continuing funding of Roaring 40s might provide. I think I did a quick tally at some stage and Roaring 40s over the last four years had $13 million accumulated losses or aggregated losses.

Mr LLEWELLYN - You have to factor into that the acquisition sales that now have occurred with the China assets in Roaring 40s, which was a positive aspect. The other thing that maybe Vince might comment on is our consulting arm, which is engaged in a fair bit of external work by the department and the potential is enormous.

[2.00 p.m.]

Dr CREAN - We will start off with Momentum and it follows on from what I said in my opening remarks that, really, it was very important for us to achieve a retail presence in the national market. If we didn't, being a relatively small wholesaler and exposed to the market including the big generators who were both vertically integrated - wholesale and retail - there was a possibility that, at times, a wholesale margin could be squeezed which would affect us if we were just a wholesaler in the contract market.

So the purchase or the requirement to attain a retail presence was a strategic one, primarily for that reason. We went through a detailed process about setting up a greenfield site or purchasing an existing retailer. After the analysis it came down obviously that it was better for a number of reasons to purchase an existing retailer. Momentum was ideal for us because it retailed in green energy. We had an arrangement where we purchased the first 51 per cent for $17 million and then a process that would value the business for the remaining 49 per cent, depending on what was called the gross margins achieved by the business - the revenue minus expenses - and the growth in that determined what we would purchase the remaining 49 per cent. We intended to purchase it next year but we believed it was better for us for a number of reasons to make an offer recently, which we did, and we were able to purchase the remaining 49 per cent for $34.5 million, which is about $10 million less than we would have purchased it for 12 months later.

Having 100 per cent ownership of a retail business enabled us to provide a significant hedge against fluctuations in the wholesale price, which occurs because of the operation of the large wholesalers, retailers such as AGL and Origin.

In addition, we believe that we could create significant synergies between Hydro Tasmania and the retailer whereby costs within the organisation of Momentum could be reduced. We are undertaking that process now which will result in significant cost reductions. In addition, it is a relatively small retailer. It has a retail base of about 900 gigawatt hours per annum, so that is small. Because of its small size, economies of scale and so on and in the growth phase, you are always behind in terms of getting new customers and acquiring the cash. So as the business grows, there will be a crossover where the cash will outrun the costs of that growth but we are anticipating that we would like to grow to something like 5 000 gigawatt hours by 2014. So it is a significant growth step and we expect, by 2014, that the net operating cash will be around $33 million per annum, which is a significant amount, bearing in mind that Hydro's total operating cash over the last couple of years has been $25 million to $43 million.

That is where we are in terms of Momentum. In terms of Roaring 40s, the strategy for Roaring 40s is different now than it was when we commenced. When we commenced with Roaring 40s and we acquired the 50 per cent partner in China Light and Power, it was a pure growth strategy - build, build, build - you build enough, the cash flow eventually becomes positive again in this growth phase determining the cash flow loss or the cash flow positive.

When we sold out of Asia - and we were in Asia because we couldn't do anything in Australia - when the focus was back on Australia because of the Renewable Energy Target Scheme, we had that fund within Roaring 40s of some $163 million to pursue wind farm growth. The two wind farms that we have our sights on are Waterloo in South Australia and Musselroe. Beyond that, from our point of view the issue is not about a sausage factory where you keep producing wind farms for growth's sake, it is about producing wind farms for strategic reasons. Our strategic reasons for wind farms, going forward, will be renewable megawatt hours to back our retail growth. You do not need new construction to do that necessarily. You can achieve that by contracting in the market and to equate to that growth in retail - that is, the 5 000 gigawatt hours by 2014.

We are currently looking at the best mix - and I alluded to this in my opening remarks - between achieving that growth with capital expenditure and contracting to match the growth in concert with achieving our BBB rating on the financial strength. So, as I said at the start, they are inextricably related and that is one of the important assessments we are going through at the moment to get that combination right because we are, in a sense, cash constrained. We have many opportunities with limited resources. Having said that, we have had poor cash flow over the last couple of years because of the rainfall. If we get the 8 700 gigawatt hours on average from now on, over the next five years we are expecting our net operating cash, which has been down to $25 million and is $43 million this year, to rise to $110 million on average each year. That gives us greater scope to fund our capital investment program and run down debt or pay other growth opportunities, much more scope than we have had over the last three years.

Mr HARRISS - The other part of my question related to your capital refurbishment program.

Dr CREAN - The capital refurbishment program, on average, is between $60 million and $70 million and that comes out of our net operating cash and, as I say, with, on average, $110 million a year, it is more than covered by that. The difficulty we have had over the last couple of years is that our net operating cash has been low and we have had to fund some of it out of debt. But provided we get the rainfall, on average, then that will be covered within our net operating cash.

Mr HARRISS - Finally, on that mix of the business, the sale to China Light and Power, the international component of the business, I suppose, will the sale proceeds of that be sufficient to fund Roaring 40s' further investments in that renewable energy?

Dr CREAN - No, it will do one wind farm and then we have to source the funds for Musselroe from both China Light and Power and ourselves.

Mr HARRISS - So when you say it would fund a wind farm, what sort of generating capacity would the proceeds of that fund?

Dr CREAN - Waterloo is about 110 megawatts.

Mr BALCOMBE - It has been used to fund the equity component in the wind farm, so we do not have to make any more equity contributions to that wind farm. So we did the financial close on that wind farm in July.

Mr WILKINSON - Can you supply an update on the wind farm at Waterloo? We have had a bit of chat already in relation to Roaring 40s, but what about Waterloo?

Dr CREAN - Waterloo is smaller, 110, as compared to 168 at Musselroe. Both Waterloo and Musselroe were to be done together. We did Waterloo first because we could get the finance for it because it was a smaller wind farm and we were able to get the banks together. Our partner was also keen to do Waterloo first and then we were to move on to Musselroe. Since financial close on Waterloo we have had all these things happen, particularly the renewable energy target situation. As I mentioned before, an issue that we have to overcome for Musselroe is the liquidity issue. We have to get banks to support the debt component and fundamental to that is the power purchase agreement that I talked about, and fundamental to that is correcting the anomaly of the Renewable Energy Target Scheme. We are committed to that and what I said about Musselroe is that we are becoming increasingly confident that next year those changes will occur and the liquidity issue, which is a hangover effect from the global financial crisis, will improve even further.

Ms FORREST - It may be difficult to answer this at the moment and I appreciate that if it is the case, but with Momentum, for example, what sort of return are you expecting on your investment there? Is the CPRS likely to impact on that and how?

Mr HAWKSWORTH - As the Chairman said, in 2014-15 we expect it to be producing $33 million of positive cash contribution. Inevitably, as we build up the customer numbers, we have some working capital needs and those needs over the first couple of years mean that we will probably turn positive in that contribution not in this financial year but the financial year afterwards and that is what we would have expected in terms of the business case we put together to do it.

In terms of the CPRS, one of the benefits of having a retail business that is accessing small, medium and larger businesses is that we will always access the retail margin, the difference between the wholesale and retail price, and that margin will be there irrespective of the CPRS. It is just that when CPRS goes through that will move wholesale prices and they will also flow through to retail prices and we will be able to take the wholesale and retail margin at that time but in the time between now and then we will still be accessing the wholesale and retail -

Ms FORREST - The end user will pay the price, there will not be any detriment to Momentum Energy then?

Mr HAWKSWORTH - No. Momentum Energy does not see any detriment due to that. From a strategic perspective, we would hope that Momentum Energy would succeed more with a price on carbon and greater renewable energy signals. Backed by Australia's largest renewable energy business, we have a very good brand story to tell to those consumers who are interested in their carbon footprint. We have already seen some customers who are attracted to Momentum now because it is linked to a renewable energy generator.

Ms FORREST - They are mainland customers obviously?

Mr HAWKSWORTH - Yes. We see that as a way of retaining those customers and having lower churn than the churn that occurs in the market because we can continue to offer that product and service that a segment of the business market is seeking. From that point of view, clear signals on carbon price are useful because that reinforces that story.

Mr LLEWELLYN - Just coming out of your last comments, I am sure people realise that although Hydro has become a gen-tailer in a sense by having Momentum, it is only able to retail electricity on the mainland of Australia.

Ms FORREST - That was my next question, Minister.

Mr LLEWELLYN - Was it? Well, I pre-empted it.

Ms FORREST - You did, and you can answer it for me. Is there any plan to expand Momentum Energy into Tasmania, and compete with Aurora?

[2.15 p.m.]

Mr LLEWELLYN - Obviously by having Momentum as a retail arm, Hydro would be in a better position to translate that into Tasmania. But it is an issue that has been subject to the review that I announced a little earlier on that has been undertaken by Pricewaterhouse Coopers now for over 12 months and we will have an outcome from that in a little while. There have been some remarkable changes in the energy business over the last few years. We are now seeing gen-tailers and people who are integrated again and it is like Hydro were years ago, frankly, on the mainland. So, the best way that we can position ourselves internally here in Tasmania is being assessed at the moment and we will have some knowledge about that in the future. It would be premature to make any comment about that.

Ms FORREST - I will ask again in a few months' time. I was going to head down a slightly different path.

CHAIR - I will go down another little path and then we will go back to you, or we might be on the same path.

Mr HARRISS - I will stay on the same path of financial and business opportunities for Hydro. David, you said earlier that the door is always open for further equity injections. It raises the question as to, first of all, where the company is at with its borrowings and how much more the company could feasibly borrow to progress further capital development and what sort of

constraints the company might be operating under in the absence of further equity injections and trading that off against further borrowings.

Dr CREAN - As we established before in answer to a question from the Chairman, the debt goes up and down according to your net operating cash. As you can see from what we have said, that net operating cash for Hydro - provided that we get the average inflows - will be significantly higher at $110 million. In addition, by 2015 there will be the additional cash flow of $33 million from Momentum Energy. So, you have a position of what your cash flow is and what your demands are on that cash flow as well. In addition, if you finance growth on balance sheet, then it is the cash that is left over plus any debt that you want to take on.

Having said that and if you equate it with what we said before, currently we are a BB-rated organisation and we want to get to BBB. Getting to BBB basically depends on your debt level, interest payments and free cash flow. They are the two basic determinants of the ratios that are used by credit rating agencies to determine your rating.

You can see all those things are considered together as we move on strategically to improve our financial position, but also to achieve the sort of growth path that we are talking about. If we have average inflows it is a lot easier, if we don't then it is not so easy. The big call on any funds in terms of growth is capital expenditure - not for base assets, this is new assets. That is why I mentioned before the option of gigawatt hours to support your retail growth on the mainland can be through building your own capacity, that is wind farms, or contracting the capacity in the national market which does not require capital expenditure.

Mr LLEWELLYN - I will add one thing which we have not touched on. The Hydro do have a strategy for another 1 000 gigawatt hour capacity out of renewable energy by improving and trying to augment the Hydro system with smaller generators, mini-hydros and so on. They are progressing on that but that is contingent on capital investment. It will ultimately replace some of that climatic change that we have seen - if it comes to fruition - by adding another 1 000 gigawatt hours into the system.

Ms FORREST - That is upgrades, not new systems?

Mr LLEWELLYN - Both.

Dr CREAN - Mini-hydros.

Ms FORREST - Where are we talking about then and which ones in particular?

Mr LLEWELLYN - Lake Margaret is one.

Ms FORREST - My favourite.

Mr LLEWELLYN - Yes, the Hydro did a very good job on the Lake Margaret Power Station.

Ms FORREST - They have indeed, Minister.

Mr LLEWELLYN - Also on the lower station, which I am waiting with expectation to have you along at the opening of.

Ms FORREST - I hope you will give me a ring to consult my diary before you make the date.

Laughter.

Dr CREAN - None of us has control over that. We did mention your apology.

Ms FORREST - Yes, I know. I am interested in the others that you are talking about, the upgrades to bring the extra capacity.

Mr LLEWELLYN - Vince might like to mention a few things.

Mr HAWKSWORTH - We have talked about Lake Margaret and the lower station. We currently have a canal called the Red Hills Diversion, which is in the north-west which will be another few gigawatt hours, so all of those projects are going on. Another project that we have done in the last year was the Macquarie Settlement-Lake River pipeline. Whilst that at first blush says you are providing water, the way that we are then meeting that water obligation actually meant that we saved 10 gigawatt-hours that we would have used through Poatina. So we would have lost it because the water is coming out below Poatina now instead of above Poatina and we are getting that extra energy through Poatina itself.

Ms FORREST - So you are taking out below?

Mr HAWKSWORTH - Yes, so that pipeline will give us another 10 gigawatt hours.

Then you take the Poatina station upgrade itself, which is part of our core asset refurbishment program. Over the cycle of those refurbishments we should get an extra 10 gigawatt hours per machine refurbished because we are using more up-to-date runners that are more efficient and more effective and the control systems are being updated at the same time. Each time we do an upgrade we are now looking at those upgrades on a number of bases, primarily looking at extending the life of the plant to its full life, so from a 40-year time frame that they are being refurbished in for another 40 to 50 years and then, secondly, how much more energy we can get out of those refurbishments - so again, that adds in.

On top of that we have identified a series of mini-hydro opportunities around the State. Those mini-hydros which would be not dissimilar to what we are doing now at Lake Margaret are opportunities to put new plant in the system where we are already transferring water from one place to another. There is a whole range of those that are in very different circumstances; there are places such as the McPartlan Pass canal between Pedder and Gordon and that is at the larger end of the scale; at the other end of the scale there are things such as looking at a mini-hydro in the Cataract Gorge at the base of the Trevallyn Dam and potentially in the Duck Reach area where the old Duck Reach power station is. There are a lot of these projects. They rely on two things: obviously the renewable energy target for these mini-hydros is very, very important because they will attract renewable energy certificates so in that scheme all of the issues that we talked about around Musselroe apply to these projects as well. Obviously we need to be able to generate the cash to make the investments and some are easier than others. The upgrades are happening anyway and some have environmental and social and community expectation issues around them which will take some time to work through. I think if we learn anything from the process at Lake

Margaret and then the lower station, it is the more involved the community can become, the better solution we get.

Mr WILKINSON - In relation to your maintenance and capital expenditure, you have forecasted $74 million to $75 million for the next year; Lake Margaret obviously is part of that, and the mini power station you are talking about is not.

Mr HAWKSWORTH - No. These -

Mr WILKINSON - Over and above.

Mr HAWKSWORTH - Yes.

Mr WILKINSON - So what do you believe has to be done within that $74 million or $75 million?

Mr HAWKSWORTH - Our approach to the whole core asset maintenance process is: it starts from the position of safety of people first, safety of the plant second, and safety of production third. So when we are thinking about how we apply that money, that is the broad high-level thinking. Obviously the system has machines and plant that are of varying ages and most of the plant needs a major looking at and refurbishment around about its half-life. We are probably a little behind that, but having said that, we are catching up reasonably fast. Over the last three years we have done a lot of work at Trevallyn, Gordon and now Poatina. The next station will be Tungatinah and that is in the planning process because it takes a couple of years to get the orders in for equipment, so we would expect to start work in Tungatinah towards the end of next calendar year.

We also, because the starting point is safety of people, have a very extensive dam safety program, and a large lump of money has been going into the Catagunya refurbishment. That is a significant risk management and engineering exercise, in fact it is unique in the world to refurbish that type of dam, where we are putting new steel cable anchors into the ground and grouting those in to ensure that the dam meets the highest levels of safety expected around the world.

Mr WILKINSON - Are there any problems with that dam at the moment?

Mr HAWKSWORTH - No. The dam is fine, there are no issues, it is just that as technology moves forward and standards move, I suppose it is a bit like cars that never used to have airbags but have airbags now. The standard has moved for dams and Catagunya therefore came to the top of our risk register for dams. We have done a lot of work and we are spending considerable money; it will then move that dam to being a very low risk dam again, and that work will be finished in the middle of 2010 calendar year. The next dam we will look at which is in the program will be Rowallan, and there are some smaller bits of work.

We put a lot of time and effort into looking at all of our assets, and applying money on a risk base, as I described. We get the dam program reviewed externally by independent experts. Even though within our own business we have people who are world renowned in their field, we make sure we are not single-minded without taking other people. Ultimately, that is what that money goes to, but would we spend more if we had it? I think we always would, but could we spend that money and still run the business? It is all about timing and keeping assets available to earn money, but we have a very robust program.

Mr WILKINSON - So that encompasses the $74 million you envisage?

Mr HAWKSWORTH - Yes.

CHAIR - Thanks. I would like to turn to a slightly different subject, and I know that the minister or Dr Crean talked about and mentioned the prospect of a second Basslink cable. It might have been the minister, I think.

Mr LLEWELLYN - Yes.

CHAIR - Minister, if that occurred, what would be Hydro's involvement in that project, and have you had any discussions, albeit with the issues you have had, with CitySpring which was mentioned a while ago? May they be part of that development?

Mr LLEWELLYN - There were a lot of hypotheticals there, I think.

CHAIR - I know. I like to throw a few of those in.

Mr LLEWELLYN - I know, and it has been mentioned that Hydro have been actively discussing various issues with regard to the operation of Basslink and so on, and they will be ongoing. CitySpring obviously owns Basslink and, as the owner of Basslink, I am sure if they saw an opportunity for an additional cable because of the renewable capacity of Tasmania to deliver to the rest of the mainland, they would judge that on a commercial basis.

I know that Transend - and you will be investigating Transend a little later on today - have done some preliminary and been discussing -

[2.30 p.m.]

CHAIR - I might ask you the same question next time around.

Mr LLEWELLYN - Yes, discussing the issue of alternative and additional links to the mainland, as they are bound to do. They are a transmission authority and it is more in their bailiwick, I guess, to discuss those things.

But naturally, the arrangements with Basslink are integral to Hydro's operations and I think on that basis they have certainly been talking to CitySpring. The comments that I made are medium-term comments. We do have a remarkable capacity to generate renewable energy, I think, both from wind and ultimately from geothermal, if things work out that way. It could be many megawatts of energy and I think the Australian Government, certainly their desire to address the carbon pollution reduction issues, fossil fuel use and so on, there is an opportunity for Tasmanians to participate in that in a real way. But we do not have the industries in Tasmania to absorb the amount of energy that I am talking about, so we have to get that energy from Tasmania to mainland Australia in order to maximise the benefits from it.

Ms FORREST - It will attract more industries.

Mr LLEWELLYN - That is right.

CHAIR - In light of what you have just said, do you endorse the recommendations of the West report which basically, in one part, talked about the fact that some of our major players like the Rios and Nyrstars of this world, ought to pay full odds and therefore, if they in fact closed down then we would be able to make more money out of exporting renewable power to the mainland? That was the hypothesis that he put forward.

Mr LLEWELLYN - In the West report, Professor West certainly makes some very good points about some innovative and visionary things for Tasmania. But to the extent that he was talking about the energy market and particularly our major industrial customers, I do not agree with him.

CHAIR - You do not agree with him?

Mr LLEWELLYN - No.

CHAIR - I thought perhaps that might be the case, I just thought I would ask you.

Ms FORREST - Just along the path of industrial customers, I have been informed that the base contract price for 2010 in Tasmania will be $54 per megawatt-hour, then they have to add on transmission rent cost and other costs. In Victoria it is only $43 per megawatt-hour. So what is driving the price differential there? Obviously there is an element of water risk but the water risk is much less now than last year.

Mr LLEWELLYN - I think, by and large, what you will find is that the price of electricity in Tasmania - are you are talking about to a residential consumer or to a large user?

Ms FORREST - To a large user, the base contract cost.

Mr LLEWELLYN - Obviously, those contracts are commercial in confidence but I think at both levels you would find that the energy in Tasmania that is supplied to users, both large and small, is competitive with the rest of the mainland.

Ms FORREST - Regardless of that, though, we have been informed that there is a significant price differential between basically the same arrangement in Victoria and Tasmania. So Tasmanian users are paying a premium - whether you consider it a premium or not. They are paying considerably more than Victorian customers who use similar quantities. There is obviously some risk -

Mr LLEWELLYN - Where are you quoting that from?

Ms FORREST - That is information that I have been provided with.

Mr LLEWELLYN - I see. I can only respond in the way that I did and I am sure -

Mr HAWKSWORTH - All I can say is that I am not aware of any of those customers we have direct relationships with having that issue. We are not a retailer in Tasmania and the majority of people deal through a retailer and I have no idea where those numbers would come from.

Ms FORREST - If they are dealing with a Tasmanian retailer, Aurora, then obviously Aurora are one of your major customers so I could be asking on behalf of Aurora.

Mr HAWKSWORTH - You could be asking on behalf of Aurora but Aurora are now a gen-tailer. I have no idea how they run their business but one assumes that they make decisions based on their determination to run the Tamar Valley Power Station and any contracts they choose to buy from us. For those large industrials that we have more direct relationships with, I am not aware of that sort of pricing discussion.

Ms FORREST - Do you then factor in a percentage of water risk in your pricing arrangement when you are determining a contract price?

Mr HAWKSWORTH - When we look at all of those things our forward pricing rather depends on a number of factors. One is the term of the arrangement. Inevitably longer-term arrangements allow for smoothing of shorter-term volatility issues. Short-term arrangements need to reflect the current risk position and they also need to reflect what the current market prices are doing, of which one input is Victorian prices. Those issues all sit there when we look at pricing in the short term. In the longer term those things smooth out a bit more because in the long term any short-term water issues are, one would hope given that we budget on what we budget on, smoothed out over time.

Mr LLEWELLYN - In the contestable market which a lot of major customers are now and I announced today that we would add another 2 600 customers that have an aggregate use of more than 50 megawatt hours, that will include small businesses and so on into the competitive market. Those people may wish not to contract but to take their energy on the spot market. They have to then take the risk that the energy prices at times might be high and at other times low, so that is a competitive risk that they take.

Ms FORREST - Why then did the Australian Energy Regulator single out South Australia and Tasmania as areas of concern with regard to market power earlier in the year?

Mr LLEWELLYN - The Tasmanian system really is essentially a government monopoly but I do not think that indicates that people are getting unnecessary increases in their power or that businesses are taking an unnecessary profit out of the system. Since those statements in September we have become more competitive even though both of the businesses that are in competition with another are in government ownership. I do not know what promoted that comment.

Ms FORREST - Behaviour in the market in the first two weeks of June probably did, where a price cap had to be put on up to $10 000 a megawatt hour -

Mr LLEWELLYN - That is an issue that is being analysed by the Australian Competition and Consumer Commission -

Dr CREAN - No, it is not; it is nothing to do with it.

Ms FORREST - What is the ACCC looking at then?

Dr CREAN - As you know, the ACCC is looking at a series of events that occurred in early April -

Mr LLEWELLYN - I thought that was what the honourable member was referring to.

Dr CREAN - No, no you were talking about June.

Ms FORREST - Yes, the volatility in June.

Dr CREAN - There is no issue. It is in relation to the events in April and it is not to do with energy prices, it is to do with the frequency control ancillary service prices.

Ms FORREST - Is that all the ACCC is looking at? They are not looking at -

Dr CREAN - Yes.

Mr LLEWELLYN - Sorry, I misunderstood the dates. I thought you were referring to the ACCC's investigation into that other FCAS issue that emerged.

Dr CREAN - It is a complex market. Volatility in the national market is a common thing -

Ms FORREST - It has not been as volatile since though.

Dr CREAN - We explained why the prices were low at the moment but that could change quickly even notwithstanding the reasons we gave why the prices are low. You just have to look at the spot market over the last couple of years. It has been hugely volatile and the lesson is that if you are buying and selling in the spot market, you have to have some strong risk management about the pricing. You either hedge or you do other things. It is a risk management issue.

Ms FORREST - Which the big companies take very seriously.

Dr CREAN - All companies should that are buying in the spot market. It doesn't matter how big you are. In fact, the smaller companies should take even more note, I think, but that is my personal view. It is all about risk management and your risk appetite.

Mr WILKINSON - Can I read this comment out to you and please answer it as you think appropriate:

> '1 April to 19 April Hydro Tasmania offered sustained high prices in FCAS in Tasmania. As the only provider in Tasmania, they have market power. Other participants in Tasmania were adversely affected with some of the smaller participants being forced to pay more for FCAS than they earned in energy.'.

I understand that is what ACCC is having a look at, at the moment. Do you want to comment on that?

Dr CREAN - We cannot because it is under investigation. All we can say is that the ACCC are investigating for a possible breach of the Trade Practices Act. We maintain that we have acted with integrity and within the law at all times and we will strongly defend the position.

This process will take many, many months. We have supplied them with an enormous amount of information and it will run its course, but we will defend it vigorously.

Mr WILKINSON - Can I go to the second comment, and it says:

> 'From 1 June to 19 June the spot price in Tasmania exceeded 5 000 megawatt hours on 13 occasions.'

Dr CREAN - $5 000.

Mr WILKINSON - '$5 000', I beg your pardon.

> 'Hydro Tasmania made sudden and repeated cuts in the output of its non-scheduled mini-hydro generators, forcing the dispatch of higher-priced generation in its portfolio. The strategy led to administered pricing being applied for four days in June, the first time ever in Tasmania.'.

Ms FORREST - That is what I was talking about.

Mr WILKINSON - Yes, that is right.

Dr CREAN - The first thing is that that is not under investigation. The second thing is that you just have to look at the national market to see how many times you get this volatility within the national market. As I say, it is a complex market, we are operating in a competitive market. The way that consumers' businesses cope with the volatility in the market is to hedge and to hedge is very common in the national market. As I said before, it is a risk management issue.

Ms FORREST - But it is the first time that a cap has been placed. That was the significant point, I think.

Dr CREAN - The fact is that there is competition in the market. That changes volatility in a market.

Mr HAWKSWORTH - Obviously it is the first time, I do not think it is in dispute at all that that was the case. However, inside the last month we have seen $10 000 prices in South Australia followed by the administrative cap. We saw that again at the beginning of the year in South Australia and Victoria. We are seeing the same prices in New South Wales and Queensland in the last month and, as a retailer in many of those months through Momentum, we ensure that we have hedged so we are not exposed to that risk.

In the circumstances in June, we had not had the inflows that occurred in July and August and the comment was made, 'Well, we haven't seen these prices since'. In July, August and September we spilt an awful lot of GM, we were on export a lot of the time and prices were inevitably very low because there was a lot of water coming through.

In June it was significantly colder and the Hydro is trying to work to its storage targets to maintain that position.

Ms FORREST - There was some criticism - I do not know whether it came your way or not - that Hydro made lots of money at that time and Aurora lost lots or incurred huge expenses. So it is like one government business flogging another, almost.

Mr HAWKSWORTH - All I can say to that is - and I have seen the Aurora annual report - we are a retailer in other parts of the market and risk management is a key part of being a retailer. Yes, we are both government businesses but there is no doubt that the ACCC would have something to say if we were not competing with each other. We manage our position in a competitive environment, which is the wholesale market in Tasmania.

[2.45 p.m.]

Dr CREAN - Aurora has customers on the mainland so we must have a risk management strategy on the mainland as well.

Mr LLEWELLYN - The only thing that I would add is that the two companies do act quite independently and there is no thought of -

Ms FORREST - No collusion then.

Mr LLEWELLYN - Collusion or anything between companies. It is even taken to the extreme at times probably past where it ought to be but nevertheless that is the position that both companies take in competition with one another. I think that we have to do that because of the requirements under the Trade Practices Act.

Mr WILKINSON - Talking about customers, if I can talk about major industrial contracts, can you provide a brief overview on how many major industrial contracts there are and when each contract expires and when the next expire? If you can mention the companies fine, if you cannot I can probably understand that.

Mr LLEWELLYN - I think that we can do that with the major customers because I think there are now only one or two that we have not renewed contracts with.

Dr CREAN - There are only two that we have not - Temco and Rio.

Mr WILKINSON - Right, and the other major ones?

Mr HAWKSWORTH - Norske Skog, Nystar and Tas Australian Paper are the other ones we would have in that category. We have recontracted with all those over the last two to three years and at various times and they all have contracts that last out to different times into the future. It is really their commercial prerogative to indicate where they end in the future but we have recontracted with them. As the Chairman said, Temco and Rio Tinto are outstanding and we are currently in negotiations with both those businesses, one whose contract is likely to come to some conclusion sooner and the other one later because the existing contract lasts longer.

Mr WILKINSON - They are presently within the contract period and there is the option to renew and it is in that option period that you are looking at. Is that right?

Mr HAWKSWORTH - Their contracts have a drop dead date. These are significant contracts and they are not the sorts of negotiations that occur within a week or a month so, as the other parties, we are taking a very considered view, understanding each other's business drivers, understanding how we might come up with arrangements that can work for both parties over a number of months and even years.

Mr LLEWELLYN - I think that it is okay for me to say because I think it is on the public record, that the contract of the larger of the two, that is Rio Tinto, expires in 2014.

CHAIR - Twenty-five per cent of the power or thereabouts.

Mr LLEWELLYN - Yes.

Mr WILKINSON - And those major ones that you have spoken about encompass 60 per cent of the supply, is that right?

Mr LLEWELLYN - Yes.

Mr WILKINSON - Does Hydro believe that it has a conflict of interest in dealing with the major industrials in the sense that Hydro can get market prices for its power over Basslink and the employment provided by the major industrial is not really a direct concern of Hydro? That is, if a major industrial moves offshore because Hydro raises power prices by too much, what does this matter to Hydro if it can sell the power over Basslink et cetera. Do you believe that you have a conflict?

Dr CREAN - No. The fact is that we can only sell a limited amount of power over Basslink - it has a limit to what we can do. We are interested in all customers, particularly major industrials in Tasmania. But the environment for negotiating contracts has changed. The contracts were negotiated at a time when we were a monopoly generator in the Tasmanian market. We were not exposed to the national market or national competition but we are now, so that places a different dimension on things. The other thing that places a different dimension is the increasing inevitability of the price on carbon at some near point. That is something that comes into negotiations as well into the future and we are keen to maintain as many customers as possible.

Mr LLEWELLYN - From a government point of view, the electricity issue is not the only issue.

Mr WILKINSON - That was my next question to you, in relation to employment and what part government plays.

Mr LLEWELLYN - That is a very important aspect and, while we do not interfere with Hydro in its negotiations, I am sure they would consider that in the overall context of the situation. As the Chairman has said, the Carbon Pollution Reduction Scheme and the likely assistance to major industry that is energy consuming in large amounts will obviously be important in any negotiations into the future with regard to the renewal of contracts.

CHAIR - It is a bit of a balancing act, isn't it? Some of those industries came to Tasmania because of cheaper power back in those days and now it is a balancing act. If their infrastructure is starting to run down, for example, they are going to have to make a commercial decision as to what they do.

Mr LLEWELLYN - As I have said to a number of them, there is some value in the fact that they are consuming renewable energy to produce their products and the marketing is up to them with regard to that aspect of it.

Ms FORREST - But, Minister, those prices that are set in world markets being produced by renewable energy mean nothing. It might mean something to make them feel good but it does not make a difference to the price they can get for their product in the world market.

Mr LLEWELLYN - Unless you have a discerning market where you are selling it.

Ms FORREST - Which does not entirely seem to be the case with some of those end products.

Mr LLEWELLYN - No, that is right, they are involved in commodities.

CHAIR - I will turn to other avenues of generating power, and I think Dr Crean talked about geothermal and some possibilities there. I do not know how far that is down the track and he might expand on that a little bit as to what the potential is there with that. The other matter, Minister, and we talked about it with Forestry this morning, is biomass and the potential there. Is there any potential, say, for Hydro to work with Forestry to look at biomass generation?

Mr LLEWELLYN - It is up to Hydro to do that but they have a consulting capacity that rivals the best so I am sure that if people want to get involved in that they will. The Government is actively promoting alternative energy generation in Tasmania and that is not all generated by Hydro. I am talking about private generation of electricity as well and obviously that generation, if it occurs, will be competing against Hydro and Aurora.

CHAIR - I think Hydro has some expertise in generation so maybe they could work with Forestry - that was the point I was making.

Mr LLEWELLYN - I think biomass is an important thing to be looking at, certainly from a Forestry point of view. I am sure there has been some discussion with Hydro already on that. As to the geothermal aspect, currently a lot of assessment has been going on, a lot of holes have been drilled by KUTh Energy and there is also interest from other companies as well. I am not sure that Hydro has been directly involved in discussions there.

Dr CREAN - Hydro Tasmania, through business development, keeps a watching brief on all renewable energy development but we pursue things that are rarely close to commerciality and have some application for us. That is why we are in wind and doing the remote area power supply pilot on King and Flinders islands, which is about substituting greenhouse-producing diesel power with the combination of renewable energies including biodiesel, wind, solar, and a number of technologies: a resistor technology, which increases the penetration of wind; smart grids, which operate the whole system more efficiently, and storage mechanisms. Given that most renewable energy is variable you need some sort of storage, so we are looking at carbon block and the Vanadium Redox Battery. There is a number of technologies in there. We also have a watching brief and are having some interaction with a wave power company again, I think, on King Island. Although we are not getting directly involved at this stage, we think that offshore wind, tidal and wave, and the synergies that you get between wave, tidal and offshore wind, are the renewable energies of the future. When you look at the rest of the world, for example, renewable energy offshore wind is very big in Denmark and now Scotland.

CHAIR - So when you talk about close to commerciality, you know that the hot rocks or the geothermal option is still a little bit out there at this stage.

Dr CREAN - Yes. We are not directly involved in any geothermal, but we are aware, as a watching brief, of what is going on. Do you want to add anything?

Mr HAWKSWORTH - Just to the point that was made about Forestry and their interest in biomass. Bob Gordon and I have had a couple of chats and our consulting team and Bob's team are talking to each other about where we can provide expertise and to assist in their thinking about things like grid connection and how those plants might end up operating. We have also talked about how we might collaborate in other parts of Australia with both sets of expertise, bringing biomass on board.

I think in Tasmania itself, one of the good things that is occurring - and geothermal is an example of that - is having other interested parties making investigations as well. As the largest player, we are very conscious of the fact that we do not have to do everything, and it is important that other parties come in and develop other technologies, and geothermal is a good example. Hot rocks geothermal, though, is challenging, and one of the good things about Tasmania is that it hasn't got the distance-to-grid issues that it has in other parts of Australia. Obviously, though, as the minister said, at some point you have to be able to get all of these opportunities out of Tasmania, or have some other load to take them. In many ways, the document that we seem to have with our annual report was a bit like saying there are all these opportunities and this is our view of the world.

Mr WILKINSON - A good story to finish on, if we can. The report mentioned a number of projects for 2008-09, one that interested me was the potential benefits and impacts of plug-in vehicles for Hydro Tasmania.

Ms FORREST - How long is a cord?

Mr WILKINSON - What is it about? How close to reality is it?

Mr HAWKSWORTH - This falls right under the category that the Chairman mentioned about keeping an eye on what is developing. Globally there is a huge amount of interest in vehicles that plug in, and when they are stationary they discharge back into the grid to provide energy. So effectively you have all these vehicles that plug in, take electricity out, charge up, and at times when there are peak requirements where they are parked in the garage and they plug back in and the electricity goes back in.

Interestingly, I note there was a program on the ABC a couple of weeks ago which talked about China's largest car manufacturer which effectively decided they cannot compete in the internal combustion engine market because the Germans and the Americans are far too far ahead of that, so it has 8 000 engineers working six days a week on electric cars that can discharge back into the grid. Ultimately that may be another energy solution where renewable energy could be stored and then discharged later, so we are just interested to see how that develops.

[3.00 p.m.]

Mr LLEWELLYN - On an anecdotal note, I used to have a plug-in vehicle in Canada when I was over there but it was to actually keep the engine warm enough so that you could start it.

Laughter.

Mr WILKINSON - Is Hydro playing a major role at all in this, or just a watching brief?

Mr HAWKSWORTH - The capital requirements to become a major player in something like this are enormous but it is important that we understand how that technology might develop and how that interfaces with the renewable system which we operate and what opportunities it might provide in the future for customers that we have.

Ms FORREST - Has there been discussion, is there any plan, has any consideration been given to the selling of Hydro?

Mr LLEWELLYN - I made that statement certainly in the energy policy statement that I put out today that we remain committed to public ownership of the hydro system and the transmission and distribution network.

Ms FORREST - So the answer is no?

Mr LLEWELLYN - No.

CHAIR - Thank you very much, Minister. On behalf of the committee I would like to thank you and the team from Hydro for that session and I would like to invite you personally to come back at around 3 p.m. We will suspend the hearing so we can get up and have a stretch and go and have a cup of tea for five minutes.

The committee suspended at 3.01 p.m.