



2009

Legislative Council

Government Businesses Scrutiny Committee 'A' 2009

Report with Minutes of Proceedings

Members of the Committee:

**Hon Ruth Forrest MLC
Hon Greg Hall MLC (Chair)
Hon Paul Harriss MLC
Hon Terry Martin MLC
Hon Jim Wilkinson MLC**

Introduction

What are Government Businesses?

Government Businesses comprise Government Business Enterprises (GBEs) and State-owned Companies SOC.

- GBEs are established under an Act of Parliament and operate within the framework of that Act and the overarching framework of the *Government Business Enterprises Act 1995*.
- SOC are established under an Act of Parliament and are incorporated under the *Corporations Act 2001* (Cth).

Both GBEs and SOC have special requirements beyond those of their competitors in the private sector and operate within a different framework. For example, in the private sector, the shareholders appoint a board of directors responsible for governance issues and return on capital. Publically listed companies face the discipline and regulatory requirements of the stock market and financial markets.

In the case of GBEs and SOC, the shareholders are Ministers of the Crown. The Ministers appoint the board and have a role in determining the strategic objectives of the business. They do not face the same discipline and regulatory requirements of the stock market and financial markets.

Why do we need to have scrutiny of Government Businesses?

The requirements for Government Business Enterprises to provide accurate, timely and market sensitive information to the ultimate owners of the business (the taxpayers of Tasmania) fall well short of the standards applicable to publicly listed companies, many of whom compete directly with these Government Businesses.

Australian Corporations Law requires an entity to notify a market operator if it has information that is not generally available and is information that a reasonable person would expect, if it were generally available, to have a material impact on the price or value of the securities of the entity¹.

The Australian Securities Exchange, the organisation responsible for jointly supervising Australia's listed corporate entities, also operates a continuous disclosure regime, requiring companies to provide immediate notification when a range of events occurs, including a change in the entity's financial forecast or expectation².

GBEs and SOC are not publically listed companies and as such are not subject to a duty of continuous disclosure. The public and their elected representatives in Parliament, who are not members of the Government, are often unaware of material changes in performance until the release of the entity's annual report. This can be tabled in Parliament up to 16 months after the start of the reporting period.

In the absence of a requirement to disclose material changes in performance throughout the reporting period, the Parliament has agreed to put in place a scrutiny regime which enables elected representatives as Members of Government Business Scrutiny Committees to ask questions and require answers by Ministers, Chairmen of the Board, CEOs and other

¹ Australian Institute of Company Directors, continuous disclosure requirements.

² ASX Listing Rules, Chapter 3.

managers of Government Businesses so as to ensure Government Businesses and their shareholders (Ministers) remain accountable to the Parliament.

The Role of the Legislative Council

The Legislative Council is one of the Houses of the Parliament of Tasmania. It is unique in Australia in that the majority of its fifteen Members are independent and not members of a political party. Unlike the House of Assembly where the Government maintain a majority of members and through party discipline controls the outcome of any vote in that chamber, the Government must obtain the support of at least some of the independent members of the Legislative Council to pass any of its measures.

One of the Legislative Council's roles as part of the legislature is to scrutinise the activities of Government and bring it to account for its actions. This is part of the Legislative Council's role as a House of Review. This review role consists of not only scrutinising and where necessary amending legislation but also reviewing all aspects of Government activity. This activity includes the operation of business for which the Government is a shareholder for and on behalf of the people of Tasmania. In many cases these Government businesses are supported by taxpayer funds.

Tension between Government Ownership and Commercial Practice.

In most cases Government businesses are required to operate on commercial principles in a competitive environment. This can lead to tension between, on one hand, the requirement for openness and transparency when these businesses are required by a Committee to answer questions or produce documents and, on the other hand, the need to maintain the confidentiality of certain commercially sensitive information the publication of which may result in a loss of a competitive advantage.

Committees of the Parliament have extensive powers to order the production of documents or the answering of questions by witnesses. A claim that a question cannot be answered or document provided because to do so would reveal commercially confidential material is not a valid reason to refuse to provide answers or documentation to a committee.

The limits on the Council's inquiry powers are largely self imposed. Self imposed restraints include the provision in Standing Orders of the Legislative Council that, at the request of only one Member of the committee, require evidence of a commercially sensitive or confidential nature to be taken in camera and not published unless a resolution to that effect is passed by the Council.³ This standing order balances the competing interests discussed above.

Treasury Guidelines for Government Businesses

In October 2008 the Department of Treasury and Finance issued guidelines for Government Businesses. These guidelines consisted of:

- Governance Framework Guide
- Corporate Governance Principles;
- Guidelines for Assessing Board Performance;
- Board Appointments;
- Appointing the CEO as a Member of the Board;
- Director Induction, Education and Training;

The guidelines augment the existing governance framework provided by, relevant Government Business statutes, Treasurer's Instructions and, in the case of SOCs, their company constitution.

³ SO 232.



4602/03

SELECT COMMITTEE ON GOVERNMENT BUSINESS SCRUTINY 'A'

**MINUTES of Meeting held on Tuesday, 1 December 2009 at 8.50 am in Committee
Room 2
Parliament House, Hobart**

Present: Mr *Hall* (Chair); Ms *Forrest*, Mr *Harris*; Mr *Wilkinson*.

In attendance: Mr Nigel Pratt, Deputy Clerk (Secretary).

1. Apologies

Mr *Martin* (granted leave of absence).

2. Confirmation of Minutes of Meeting held on 30 November 2009

Deferred until next meeting.

3. Business Arising from Minutes

Deferred until next meeting.

4. Correspondence

Nil.

5. Publication of Transcripts

Resolved; That in accordance with Sessional Order 3 (SO 200), the transcripts of today's proceedings will be published when available. (Mr *Hall*)

6. Government Business Scrutiny Hearing

Hansard recorded the proceedings.

Witnesses took their place at 9:00am.

FORESTRY TASMANIA

The following witnesses appeared before the Committee:

Hon David Llewellyn MP, Minister for Energy and Resources;
Ms Karen Vadasz, Adviser, Office of the Minister;
Mr Adrian Kloeden, Chairman, Forestry Tasmania;
Mr Robert Gordon, Managing Director, Forestry Tasmania;
Mr John Mazengarb, Chief Financial and Commercial Officer and Secretary to the Board, Forestry Tasmania; and
Dr Hans Drielsma, Executive General Manager, Forestry Tasmania.

Witnesses examined.

The Committee notes the following evidence in relation to Forestry Tasmania (FT):

Overall Performance

- The trading year saw a strong performance in the first half contrasting with a rapid decline in demand in the second half of 2008-09. Sales were down 25 percent in the second half of the financial year.⁴
- The global financial crisis has impacted on demand for wood products in FT's largest market, Japan, and reduced demand has continued into 2009-10. This has had an adverse impact on FT, its contractors, and the entire forest industry.⁵
- The high Australian dollar is having a considerable impact on FT's competitiveness in international markets.⁶
- Anti-forestry campaigns have had some impact in FT's key Japanese market.⁷

Profit and Cashflow

- FT recorded a \$9.3 million operating profit, which was slightly up on 2007-08 profit of \$8.5 million but there was a softening of demand, particularly in the last half of 2008-09.⁸
- The majority of the 2008-09 profit was derived from the first six months of 2008-09 with a sharp decline in the second half of the year.⁹
- FT's capacity to generate cash from operating activities declined over the four year period, with this source of funds decreasing from \$10.597m in 2005-06 to \$3.315m in 2008-09.¹⁰

⁴ Transcript, Kloeden, p.17.

⁵ *Ibid*, p.3.

⁶ Transcript, Llewellyn, p. 27.

⁷ Transcript, Kloeden, p.28.

⁸ Transcript, Llewellyn, p.2.

⁹ Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.9.

¹⁰ *Ibid*, p.10.

- Cash and cash equivalents at the end of the 2008-09 financial year amounted to just over \$37 million. Cash inflows included over \$42 million from the Tasmanian Community Forest Agreement.¹¹ TCFA funding represented FT's entire cash balance at year end.¹²
- FT has two components to its strategy to improve cash flows. Firstly, it is looking to sell assets that are performing at less than its expectations of a rate of return. Secondly it is making an assessment of assets that are not core business and looking to sell these. Other strategies include improving its asset management such as its motor vehicle fleet and diversification into other areas such as in its consulting business.¹³

Debt

- FT has approximately \$70 million of available borrowing capacity. It does not intend to resort to further borrowings.¹⁴

Dividend to Government

- FT paid no dividend to Government in 2008-09. This followed no dividend paid for 2007-08.
- The expectations in 2009-10 are less than the previous financial year given that the last reporting period's result consisted of one half year of quite strong demand and then a severe decline in the second half. The decline is continuing into the 2009-10 financial year so the result is likely to be less than the 2008-09 profit result.¹⁵
- FT is in negotiation with Treasury about a future formula for dividend payments but no agreement has been reached.¹⁶

Pulp Mill Wood Supply Agreement

- The Minister debunked suggestions that the wood to be supplied to Gunns under the Pulp Mill Wood Supply Agreement would be solely plantation based and confirmed that it would include pulp sourced from non-old-grown native forests.¹⁷
- FT explained that its contract with Gunns for the supply of wood pulp to the proposed pulp mill excludes the old-growth coupes and that the agreement is structured in a way that permits FT to supply both plantation and non-old-growth coupes to that mill. In FT's view this was the most environmentally responsible means of supply as it lowers the overall transport costs and the impact on the environment.¹⁸
- It would not be possible at today's level of plantation wood supply to be able to operate the proposed pulp mill under the current wood supply agreement solely on plantation timber unless a portion of this timber was imported.¹⁹
- FT made it clear that its intention in growing plantation timber was for high end sawlog product and not for pulpwood to supply the proposed pulp mill. Its plantation strategy is not planned around meeting the requirements of the proposed pulp mill but

¹¹ FT Annual Report (Financial Statements), p.4.

¹² Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.19.

¹³ Transcript, Gordon, p.34.

¹⁴ *Ibid*, p.22.

¹⁵ Transcript, Kloeden, p.17.

¹⁶ Transcript, Gordon, p.17.

¹⁷ Transcript, Llewellyn, p.31.

¹⁸ Transcript, Gordon, p.31.

¹⁹ Transcript, Llewellyn, p.32.

meeting the requirements of making available 300 000 cubic metres of high-quality wood.²⁰

Hardwood Pulp Price

- FT refuted claims that it sells timber to its four main customers; Gunns Limited; Artec, Ta Ann and Norske Skog at concessional rates. The Managing Director told the Committee that the prices obtained by FT for its hardwood pulpwood on stump are considerably higher than most other places in Australia.²¹
- FT did acknowledge that as a result of the need to restructure in the sawlog industry arising from smaller logs there was “probably an argument that we may be able to get more for some of our large high quality sawlogs.”²²
- On the export side, FT is more confident into the medium term. It believes that it is highly likely that the demand for hardwood woodchips will outstrip the supply because most of Indonesia and Malaysia has been over-cut.²³

Community Service Activities

- FT expends considerable resources providing community service activities, many of which have an adverse impact on its profitability.
- Community Service Activities mandated by legislation include:
 - Recreation and tourism use of the forest;
 - Forest research and conservation activities (native forest); and
 - Management of forest land not used for wood production.²⁴
- FT also undertake fire management with approximately 300 trained staff together with fire fighting appliances provided for this purpose which otherwise would have to be met from general State revenues. These activities are subject to an interagency agreement.
- The above community service activities accounted for over \$5 million in 2008-09, compared with \$5.876 in 2007-08.²⁵ The Chairman was of the view that the actual cost of community service obligations in addition to the reported figures is above \$20 million.²⁶
- The Auditor General has recommended to the Board of FT that it should give consideration to restructuring its income statement to separately highlight community service obligation costs.²⁷ The Managing Director told the Committee that there were difficulties in reflecting these costs in the statutory accounts because it does not really fit the accounting standard framework but that FT is looking at providing the information in a fuller and different way.²⁸ The Managing Director acknowledged the importance of being transparent in regards to the costs of delivering non-commercial services.²⁹

²⁰ Transcript, Gordon, p.33.

²¹ *Ibid*, p.25.

²² *Ibid*, p.26.

²³ *Ibid*, p.30.

²⁴ FT Annual Report, p22.

²⁵ *Ibid*.

²⁶ Transcript, Kloeden, p.8.

²⁷ Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.9.

²⁸ Transcript, Gordon, p.6.

²⁹ *Ibid*, p.9.

- The Chairman contended that one of the reasons FT enjoys broad support in the community is that in addition to its commercial activities FT also provides a range of community services. Collectively the value of these non-commercial activities equals or exceeds the entire profit of the corporation.³⁰

Disaggregation

- FT was of the view that disaggregation of its commercial activities from its other activities was neither desirable nor efficient.
- The Managing Director, while acknowledging the tension between managing commercially and its community service activities, pointed to problems with that apparent diversity of responsibility and authority in Victoria as a reason for maintaining the status quo.³¹
- FT's fire fighting and the management of non-timber production forests were provided as examples of increased efficiencies (and lower costs to taxpayers). FT contended that these services are interspersed with the forests they are managing for wood production and so its costs are considerably less than if the services were separated and responsibility provided to a separate entity.³²

Tourism Activities

- FT's tourism portfolio has been restructured under the Adventure Forests brand. Site management of each of FT's tourism activities has been divested to site managers who are now completely responsible for day-to-day operations.³³
- In early November 2009 as part of its strategy of divesting itself of non-profitable tourism business, FT chose a preferred partner to operate the Tarkine Forest Adventures, formerly known as Dismal Swamp. Negotiations over terms of the arrangement have broken down and FT is returning to other potential operators for further negotiations.³⁴
- Overall tourism operations remain profitable for FT. However, Tarkine Forest Adventures continued to operate at a loss of around \$200,000 per annum.³⁵

Contractor Numbers

- FT indicated that its contractor workforce was working at approximately 75 percent of quota.³⁶
- The Chairman told the Committee that FT employs contractors both for the employment benefits for the individual contractor but also for the ongoing economic performance of Tasmania.³⁷
- Although contractors were presently working at a reduced quota when the market recovers FT will need all the contractors who are on its books. It was not considering easing any contractors out of the industry. FT believed it had about the right number of contractors for normal operations but acknowledged that the contractors were going through a period of abnormal conditions.³⁸

³⁰ Transcript, Kloeden, p.4.

³¹ Transcript, Gordon, p.10.

³² *Ibid*, p.14.

³³ Transcript, Kloeden, p.3.

³⁴ *Ibid*, pp.3-4

³⁵ Transcript, Gordon, p.35.

³⁶ Transcript, Kloeden, p.3.

³⁷ *Ibid*, p.7.

³⁸ *Ibid*, p.3.

Staffing

- FT employ over 474 Full Time Equivalent (FTE) staff. Since June 2009, FT has reduced its FTEs by 8.4. Staff numbers will be reduced mainly through natural attrition and transition to retirement. These measures will ensure that the corporate knowledge is maintained across the business. The reduction in staffing numbers is due to a change in skills requirement within the business and the operating environment in the industry.³⁹

Cost Efficiencies

- FT has introduced cost saving measures including installing Voice Over Internet Protocol (VOIP) to replace its telephones for internal communications and replacing its customised FT vehicle licence plates which are more costly than regular plates.⁴⁰

Tasmanian Communities Forest Agreement Fund

- The TCFA, negotiated under the Regional Forest Agreement, is a significant source of revenue for FT. Under the TCFA the Commonwealth agreed to contribute \$131.2 million of funding for specific activities including the establishment of new hardwood plantations and research and development activities. The State agreed to contribute \$90 million under the agreement.⁴¹
- The TCFA is the most recent of a series of government compensation plans that have been put in place and the general thrust of those has been to provide FT with money to establish plantations to replace the volume of timber that would have been produced from the productive areas of State forest that are now in reserves.⁴²
- The policy to end conversion of native forest to plantation has placed further pressure on FT and limited some of the activities for which the TCFA funding was intended.
- FT is pursuing more intensive pruning and thinning regimes in its plantations, so as to replace its traditional native sawlog resource but these new silviculture regimes have taken some time to perfect.⁴³
- FT has approximately \$15-20 million of State based funding of the TCFA to draw down which is in addition to approximately \$37 million of Federal funding.⁴⁴
- The Minister told the committee that a review of the Regional Forest Agreement under which the TCFA was negotiated has been underway for some time and that the Tasmanian Government has been waiting for a response from the Federal Government.⁴⁵ The Minister also told the Committee that in 2017 there will be a review of the resource security.⁴⁶

³⁹ Transcript, Llewellyn, p.16.

⁴⁰ Transcript, Gordon, p.22.

⁴¹ Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.18.

⁴² Transcript, Gordon, p.21.

⁴³ *Ibid*, p.24.

⁴⁴ Transcript, Drielsma, p.25.

⁴⁵ Transcript, Llewellyn, p.2

⁴⁶ *Ibid*, p.2.

New Markets

- FT's priority is to seek out and secure new markets for its wood products.⁴⁷ New markets in China, Taiwan, South Korea and Indonesia have been identified as potential buyers of hardwood chips.⁴⁸
- There is potential for lower-grade kiln logs to be used for export. These logs are not of sufficient quality for the Ta Ann rotary veneer mills at Huon and Southwood but they are better-quality pulp logs. If FT is successful, it will mean the resumption of whole-log exports providing more work for contractors.⁴⁹

Diversification

- FT is developing alternative revenue streams due to a softening of its traditional markets.

Forest Technical Services

- FT has established a consulting arm called Forest Technical Services which has won contracts in South America, China and within Australia using the expertise it has developed in forest management over the last 90 years.⁵⁰
- FT has tendered for business in an African country to use its new Lidar technology, which provides topographic and tree inventory data.⁵¹

Trees on Farms

- FT has established the trees on farms project where, together with Tasmanian farmers, woodlots are being planted on gorse-affected lands and to provide environmental plantings.⁵²
- The Managing Director explained that the project was a result of the policy to cease the conversion of native forest to plantation. FT has turned to private land based plantation either for environmental remediation, or to provide new silviculture opportunities for wide space plantations to grow sawlogs much quicker.⁵³

Newood Pty Ltd

- FT holds a 100% interest in Newood Holdings Pty Ltd (Newood).⁵⁴
- The Managing Director explained that one of the impediments for Newood was the legislative support for renewable energy targets and renewable energy certificates required to drive investment in the renewable energy sector. Now that a clear target has been set of 20 percent of electricity generation by renewables by 2020, investment funds will be available. The prospect of a wood fired power station at the site is based on the waste resource as well as bringing in what would have otherwise been lost in regeneration burns⁵⁵

⁴⁷ Transcript, Kloeden, p.3.

⁴⁸ Transcript, Gordon, p.30.

⁴⁹ Transcript, Kloeden, p.3.

⁵⁰ *Ibid*, p.3

⁵¹ Transcript, Gordon, pp.22-23.

⁵² Transcript, Kloeden, p.3.

⁵³ Transcript, Gordon, p.24

⁵⁴ Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.9.

⁵⁵ Transcript, Gordon, p.36

Biomass Electricity Generation

- FT is confident that a biomass electricity plant will be built in Tasmania. Mr Gordon advised that wood waste was used to fuel many power generators around the world, including in Europe.⁵⁶
- Initial generation capacity is expected to be between 10 and 15 megawatts. Mr Gordon explained that Australia has a huge potential for biomass renewable energy and nearly all of it will replace fossil fuels.⁵⁷
- FT had “floated the option” that one of the potential uses of some of the McCain ex-infrastructure in the soon to be closed Smithton plant would be for a small biomass power station.⁵⁸
- The Minister was of the view that a wood-fired biomass power station will create another couple of hundred thousand tonnes of activity for people throughout the State. Wood that is currently being left on the ground and burnt in regeneration burns can be picked up and transported to the biomass station which will create work for harvesters and contractors and the transport contractors.⁵⁹

Leatherwood Resource and Beekeepers

- Beekeepers and FT have agreed to a special management zone in a location known as ‘The Wedge’ to retain Leatherwood trees for honey production.
- The protocol involves variable retention harvesting rather than clear felling, leaving stands of Leatherwood and not burning after harvesting. Forestry again pointed out the community service aspect of this practice and the unaccounted cost to it. It was suggested that the practice costs FT \$5 per tonne harvested from that management zone.⁶⁰

No Sale of Forestry Tasmania

- In answer to a question as to whether there was any potential for any consideration of the sale of FT, the Minister answered “No”.

10.30 am, Hearing suspended.

10.44 am, Hearing resumed.

Mr Gordon tabled a FT publication ‘Trees on Farms with Forestry Tasmania’.

12.04 pm, Witnesses withdrew.

12.04 pm, Hearing suspended.

Tabled Documents:

FT publication ‘Trees on Farms with Forestry Tasmania’.

Additional Information Requested:

1. The cost to Forestry Tasmania in the 2008-09 financial year of providing its community service activities including but not limited to fire fighting, reserves management, roads maintenance, research and tourism. Please list the cost of

⁵⁶ *Ibid*, p.37

⁵⁷ *Ibid*, p.38.

⁵⁸ *Ibid*, p.37.

⁵⁹ Transcript, Llewellyn, p.39.

⁶⁰ Transcript, Drielsma, p.42.

- each individual community service activity as subtotals together with the total cost of all community service activities.
2. The documents and any other information provided by Forestry Tasmania to the Auditor-General in relation to the examination by the Auditor-General of Forestry Tasmania's community service activities.
 3. A numeric breakdown of the total Full Time Equivalent Forestry Tasmania employees by sectors of the Forestry Tasmania business, including the number of Forestry Tasmania employees who work in public relations, Government relations and corporate relations.
 4. How much funding remains in the Tasmania Community Forests Agreement fund and when this funding is expected to be fully expended?

OBSERVATIONS/CONCLUSIONS

1. FT's performance and profitability and competitiveness in international markets has been negatively impacted by the global financial crisis, the high Australian dollar and the lack of demand and oversupply of pulpwood in the global market, particularly Japan, one of Forestry Tasmania's major customers.
2. FT recorded a \$9.3 million operating profit, slightly higher than the 2007-08 profit of \$8.5 million, the majority of which was derived during the first six months of 2008-09 with a sharp decline in the second half of the year.
3. FT has not paid a dividend to Government since 2006-07 and is not expected to pay a dividend in 2009-10 as the severe decline in demand in the second half of 2008-09 is expected to continue into the 2009-10 financial year. A future formula for dividend payments is under negotiation with Treasury.
4. FT's capacity to generate cash from operating activities has declined over the four year period and relies heavily on funding from the Tasmanian Community Forest Agreement with the current funding of \$42 million, representing the entire cash balance at year end. A reliance on this funding to finance operational costs could result in financial pressures to meet expenditure requirements under the TCFA
5. FT needs to improve cash flows by either selling poorly performing assets and focusing on its core business such as improving its asset management and diversification.
6. FT's profitability is adversely impacted through the considerable expenditure associated with providing community service activities, some of which are mandated by legislation.
7. FT also undertakes fire management, subject to an interagency agreement and provide services which otherwise would have to be met from general State funds.
8. Forestry Tasmania should consider restructuring of its income statement or another reporting framework, to separately highlight community service activity costs.
9. The Pulp Mill Wood Supply Agreement with Gunns is structured to permit Forestry to supply both plantation and non-old-growth coupes to a future pulp mill. It would not be possible at today's level of plantation wood supply to be able to operate the proposed pulp mill under the current agreement solely with plantation timber unless a portion of this timber was imported.

10. FT is confident that biomass electricity generation will occur in Tasmania, with a further possibility of using some of the McCain ex-infrastructure in the soon to be closed Smithton plant for a small biomass power station.
11. FT and the Beekeepers Association have agreed to a special management zone in an area known as 'The Wedge'. This involves variable retention harvesting rather than clear felling, leaving stands of Leatherwood and not burning after harvesting.
12. FT was of the view that disaggregation of its commercial activities from its other activities was neither desirable nor efficient.
13. The contractor workforce is currently higher in number than required, due to reduced demand, and have been working approximately 75 percent of quota. FT's view is that all contractors will be fully employed when the market recovers. Consequently, consideration of supporting any contractors out of the industry is not being considered
14. Anti-forestry campaigns continue to have had some adverse impact in Forestry's key Japanese market.
15. FT is not for sale.

1.00 pm, Hearing resumed.

HYDRO TASMANIA

The following witnesses appeared before the Committee:

Hon David Llewellyn MP, Minister for Energy and Resources;
Mr Nick Wright, Senior Adviser, Office of the Minister;
Dr David Crean, Chairman, Hydro Tasmania;
Mr Vince Hawkesworth, Chief Executive Officer, Hydro Tasmania;
Mr Lance Balcombe, General Manager, Strategy and Finance, Hydro Tasmania; and
Mr David Jeffrey, Manager Government Relations, Hydro Tasmania.

Witnesses examined.

The Committee notes the following evidence in relation to Hydro Tasmania (Hydro):

Overall Performance

- Hydro's financial performance has improved from a net operating loss of \$58 million in 2007-08 to a net profit of \$38 million. These figures exclude changes in profit and loss caused by movements in fair value of assets and financial instrument being brought to account. Dam storage levels have significantly improved providing a base for stronger financial performance.
- The Minister advised the Committee that the Government would be considering a review of the three energy businesses, Hydro, Transend and Aurora Energy Pty Ltd in early 2010. The purpose of the review is to determine what Government could do to improve the efficiency and effectiveness of energy markets in Tasmania for the benefit of both customers and the public.⁶¹

Profit and Cashflow

- An after-tax profit of \$291 million was recorded for 2008-09. Cash flow from operations was \$43.8 million, an improvement from \$25 million in 2007-08 but still well down from \$140 million in 2005-06.
- Accounting standards which record increases in fair value of assets and financial instruments are included in the net profit result. The net profit result before these gains was \$38 million. Hydro views this as a better reflection of its trading result.⁶² This net profit result represents an improvement of almost \$100 million from last years operating loss of \$58 million.
- Asset sales of \$163 million, a capital injection of \$220 million by Government and higher rainfalls were significant factors in improving Hydro's balance sheet.

Debt

- Net debt has increased from \$872 million in 2007-08 to \$904.4 million in 2008-09.⁶³
- Hydro benefitted from an injection of capital of \$220 million.⁶⁴ This was the significant factor in reducing Hydro's debt servicing levels by \$9 million.⁶⁵

⁶¹ Transcript, Llewellyn, p.2.

⁶² Hydro Annual Report 2008-09, p.6.

⁶³ *Ibid*, p.22.

- The transfer of capital from Transend to Hydro was explained by the Chairman, Dr Crean as more properly balancing the debt levels of the three Government energy businesses than was the case at disaggregation in 1998.⁶⁶ The Committee notes that at the time of disaggregation Dr Crean was the Treasurer in the then Jim Bacon lead ALP Government and the Minister responsible for the *Government Business Enterprise Act 1995*.
- In the past, Hydro has indicated that the desirable debt-to-equity position is a ratio of 40:60.⁶⁷ In 2007 the ratio was 45:55. The Tascorp gearing ratio in 2008-09 was 41 percent.⁶⁸
- Currently Hydro is a BB-rated organisation. The Chairman expressed a desire to improve the credit rating to BBB. Obtaining a BBB rating is dependent upon debt level, interest payments and free cash flow.⁶⁹

Dividend to Government

- Hydro did not pay a dividend to Government in 2008-09. Dividend payments for the last five financial years have been as follows:
 - 2008-09 Nil
 - 2007-08 Nil
 - 2006-07 \$21.2 million⁷⁰
 - 2005-06 \$40 million⁷¹
 - 2004-05 \$40 million⁷²
- The usual arrangement for the payment of dividends to Government is 50 percent of net profit. This would ordinarily have resulted in the payment of a dividend to Government of approximately \$19 million based on net operating result. This did not occur due to a change in policy for the payment of dividend from Hydro.
- The Chairman explained that due to the absence of rainfall and inflows over the previous three years, it was agreed with Treasury that Hydro's dividends would be paid on the cash basis of the profit, but only if two conditions precedent were met:
 - That Hydro received above 8 200 gigawatt-hours of inflows; and
 - Storage levels were above 30 per cent.
- Hydro has agreed with Treasury that the proportion of profit to be paid as dividend to Government, providing 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.⁷³

⁶⁴ A capital injection of \$50 million was paid to Hydro from Transend Networks Pty Ltd in 2007-08 to assist with its Roaring 40's venture with China Light and Power. Total transfer of capital from Transend to Hydro in the previous two financial years totalled \$270 million.

⁶⁵ Hydro Annual Report 2008-09, p.21.

⁶⁶ In 1998, immediately prior to disaggregation, the debt of the Hydro-Electric Corporation was \$1.362 billion. Of that total Hydro's initial allocation was \$1.013 billion; Aurora was allocated debt of \$349 million; and Transend was allocated zero debt. This allocation reflected a balance between the expected capital requirements of the businesses and the sale process proposed by the then Liberal Government. See *Hansard*, 27 May 2008, Ministerial Statement to the House of Assembly by Hon David Llewellyn MP, Minister for Energy and Resources.

⁶⁷ Government Business Scrutiny Committee A Report 2007.

⁶⁸ Hydro Annual Report 2008-09, p.13. Crean, p.7.

⁶⁹ Transcript, Crean, p.19.

⁷⁰ Ordinary dividend.

⁷¹ \$30m ordinary dividend and \$8m special dividend.

⁷² \$22.6m ordinary dividend and 17.4m special dividend.

⁷³ Transcript, Crean, p.5.

Hydro Generation Capacity Reduction

- Hydro has de-rated the system by 300 GWh per annum from 9,000 GWh to 8,700 GWh. This was due to a more conservative approach being taken to hydrological analysis and the resulting predictions in future rainfall and inflows.
- In the 2009-10 financial year improved rainfalls have Hydro over budget at approximately 9,500 GWh.

Basslink

- Locally generated supply could not meet demand and as a result Tasmania's electricity supply had to be supplemented by imported electricity via the Basslink cable. This has been the case since the cable began operating in April 2006. The following has been the net export over Basslink:
 - 2008-09 2600GWh⁷⁴
 - 2007-08 2300GWh⁷⁵
 - 2006-07 1400GWh⁷⁶
- In addition to the desire to guarantee electricity supplies to Tasmania, a significant argument to join the NEM was the economic benefits this would bring in enabling the exporting of power from Tasmania to mainland States connected to the NEM in times of high demand. This benefit has yet to materialize. However, improved rainfalls in 2008-09 may result in net export of power in 2009-10.

Grown Dependent Upon Rainfall

- The finances of Hydro are very much dependent upon water inflows which are directly related to rainfall.⁷⁷
- If Hydro maintains inflows sufficient to generate 8 700 gigawatt hours on average from now on, over the next five years Hydro will expect net operating cash to rise to \$110 million on average each year. This compares with a low of \$25 million and the 2008-09 figure of \$43 million. This will provide Hydro with greater scope to fund its capital investment program and reduce debt or provide liquidity for other growth opportunities.⁷⁸

Water Storage Levels

- Dam storage levels have improved to around 47 percent compared with a low during the peak of the drought of around 17 percent. Both the Minister and the Chairman indicated that Hydro had a preference to maintain storage levels at 30 percent.⁷⁹ Basslink could be used as a tool to import power when the prices were low whilst maintaining storage and generation capacity to export prices to the mainland during the summer when prices were high.⁸⁰

Capital Refurbishment Program

- Hydro's capital refurbishment program, on average, is between \$60 million and \$70 million and is funded from net operating cash. This is more than covered if Hydro returns to an average cash position of \$110 million a year. Hydro has encountered difficulties during low inflows where its net operating cash has been low

⁷⁴ Hydro Annual Report 2008-09, p.6.

⁷⁵ Hydro Annual Report 2007-08, p.3.

⁷⁶ Aurora Annual Report 2007-08, p.4.

⁷⁷ Transcript, Llewellyn, p.4.

⁷⁸ Transcript, Crean, p.16.

⁷⁹ Transcript, Llewellyn, p.9.

⁸⁰ Transcript, Crean, p.9.

and capital refurbishment has had to be funded or partially funded out of debt. Provided Hydro gets average inflows then its capital works program will be covered by its net operating cash.⁸¹

Price Spikes on NEM

- There were two instances in the reporting period of significant price spikes for Hydro generation and other related services.
- The Australian Energy Regulator reported that:
“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.”
- FCAS stands for ‘Frequency Control Ancillary Service’. FCAS are a range of services that typically generators provide to maintain the safe operation of the system by keeping the power system frequency within 50 Hz standard.⁸²
- The Australian Competition and Consumer Commission (ACCC) is investigating this matter.
- The Office of the Tasmanian Economic Regulator (OTTER) is currently investigating whether contingency frequency control services should be made a declared electrical service in Tasmania, essentially allowing OTTER to regulate the price of the service. OTTER is reviewing submissions to its Issues Paper and will make a decision soon.⁸³
- In relation to a spike in the spot price of electricity the AER reported that:
‘From 1 June to 19 June the spot price in Tasmania exceeded 5 000 megawatt hours on 13 occasions.’
- AER explained the origins of the price spike as follows:
“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.”
- Hydro explained that in June 2009 when there was high volatility in the spot price, the inflows of July and August had not occurred and it was working to manage its dam storage targets. This contrasted with the much lower prices in July and August when storages had built strongly as a result of inflows and it was exporting power via Basslink.⁸⁴
- Dr Crean was of the view that if retail businesses are buying and selling electricity in the spot market, then they must have strong risk management strategies in place, either by hedging or other processes that reduce exposure to price fluctuations.⁸⁵

Major Industrial Customers

- Major industries consume approximately 60 percent of the power generated by Hydro. These clients contract direct with Hydro for their power supply requirements.
- Hydro sees no conflicts arising from the fact that in the absence of these major industrials, power could be exported to the NEM at potentially higher prices than those achieved by long term supply contracts to major industrial users.

⁸¹ *Ibid*, p.16

⁸² E-mail AER to Committee dated 30 November 2009.

⁸³ *Ibid*.

⁸⁴ Transcript, Hawkesworth, p.26

⁸⁵ Transcript, Crean, p.25.

- The Minister specifically disagreed with the views of Professor Jonathan West in his recent report⁸⁶ in which it was contended that the electricity pricing to major industrials should be at market rates rather than current rates which in some cases were less than production costs.⁸⁷
- Factors other than pricing are at play, including the need to maintain local employment and investment.⁸⁸

Momentum Energy Pty Ltd

- On 31 August 2008 Hydro acquired a 51 percent stake in Momentum Energy Pty Ltd. Hydro has recently acquired the remainder of the company at a total cost of \$51.5 million.⁸⁹
- Momentum is an energy retailer based in Melbourne with retail licences in Victoria, South Australia, New South Wales and the ACT.
- The diversification into a retail capability has offered Hydro growth opportunity, increase in cash flow opportunity and an important hedge against fluctuations in the wholesale price within the national market.⁹⁰
- The purchase was a strategic one due to Hydro being a relatively small generator competing with other wholesale generators on the NEM who are vertically integrated with retail businesses.⁹¹
- Momentum made a loss of around \$13 million in 2008-09.
- The Chairman anticipated that Momentum would grow from 900 to around 5 000 gigawatt hours by 2014 and that at that time the net operating cash will be around \$33 million per annum. This is significant as Hydro's total operating cash over the last couple of years has been \$25 million to \$43 million.⁹²
- Momentum was likely to make a loss in the 2009-10 financial year as it builds a customer base and requires working capital. It was expected that Momentum would become cash positive in 2011-12.⁹³
- Momentum is currently only able to sell energy into the retail mainland market. This is because the Tasmanian retail market (residential and small business (≤ 0.15 GWh)) remains a monopoly with the sole retailer being Aurora Energy Pty Ltd. Aurora also benefits from being a generator by its ownership of the Tamar Valley gas fired power station through its wholly owned subsidiary Aurora Tamar Valley Power Pty Ltd (AETV). The non-contestability of the Tasmanian residential and small business retail market is being reviewed by Price Waterhouse and Cooper.⁹⁴
- The acquisition of Momentum to move into the retail sector is part of a shift in strategy by Hydro. The Chairman told the committee that capital expenditure for new assets places a large burden on cash within the business. An alternative to increasing

⁸⁶ *An Innovation Strategy for Tasmania – A New Vision for Economic Development – Conceptual Overview and Options Outline*, by Jonathan West, Australian Innovation Research Centre, University of Tasmania, October 2009, pp.56-57.

⁸⁷ Transcript, Llewellyn, p.23.

⁸⁸ *Ibid*, p.28

⁸⁹ Transcript, Crean, p.15.

⁹⁰ Transcript, Llewellyn, p.3.

⁹¹ Transcript, Crean, p.15.

⁹² *Ibid*, p.16.

⁹³ Transcript, Hawkesworth, p.17.

⁹⁴ Transcript, Llewellyn, p.18. Contestability means the customer will be able to choose their electricity retailer. Before 2010 the State Government committed to undertake a public benefit test to decide whether competition should also encompass residential users of electricity.

gigawatt hours to generate cash from new capital assets such as wind farms is to purchase gigawatt hours from the existing generators to support retail growth on the mainland. The latter does not require capital expenditure.⁹⁵

Roaring 40s - Sale of International Business to China Light and Power

- Hydro sold its Chinese and Indian assets in Roaring 40s to its joint venture partner China Light and Power (CLP) during the reporting period.
- Proceeds from Roaring 40s' sale of its Chinese and Indian assets to CLP were approximately \$163 million. The proceeds have been committed to the joint venture's renewable energy projects in Australia with the wind farms at Waterloo in South Australia and Musselroe in Tasmania being the priority projects.⁹⁶
- The sale proceeds will not be sufficient to fund Hydro's entire component of Roaring 40s renewable energy projects in Australia. Dr Crean advised that the sale proceeds were sufficient to fund one wind farm and that Musselroe would have to be financed jointly by Hydro and its joint venture partner CLP.⁹⁷ The fully funded wind farm is at Waterloo in South Australia which has a generating capacity of approximately 110 MWh.⁹⁸

Wind Farm Development

- The Chairman suggested that development of wind farms was being hampered by the low price of renewable energy certificates. These needed to reach approximately \$50 per MWh to enable commercial wind farms to become economically viable and attract investment. Finance for wind farms requires a power purchase agreement and getting that agreement will not be possible where the renewable energy certificate price and the price per GWh for generation do not make the wind farm economically viable. The Chairman's view was that the Federal Government needed to address this issue quickly because it will be difficult to develop commercial wind farms in Australia until the price of renewable energy certificates go up.⁹⁹
- The Waterloo wind farm was completed first because the joint venture obtained finance for this project.¹⁰⁰ Since the financial close on Waterloo the renewable energy target situation has hampered investment and fundamental to that is correcting the anomaly of the Renewable Energy Target Scheme. Hydro is 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.¹⁰¹
- Hydro has spent approximately \$32 million on the Musselroe site to date.¹⁰²

Additional Generation

- Scheduled replacement of generating equipment as part of Hydro's asset refurbishment program at Trevallyn, Gordon and Poatina has resulted in more efficient energy generation from existing sources.¹⁰³

⁹⁵ Transcript, Crean, p.19.

⁹⁶ Hydro Annual Report 2008-09, pp.6-7.

⁹⁷ Transcript, Crean, p.17.

⁹⁸ Transcript, Crean & Balcombe, p.17.

⁹⁹ Transcript, Crean, pp 12-13.

¹⁰⁰ Musselroe is 168MWh compared with Waterloo at 110MWh.

¹⁰¹ Transcript, Crean, p.17.

¹⁰² *Ibid*, p.14.

¹⁰³ Transcript, Hawkesworth, p.21.

- Hydro has also identified a series of mini-hydro opportunities around the State similar to the Lake Margaret scheme. These take advantage of movement by Hydro of its water assets in places such as McPartlan Pass canal between Pedder and Gordon and on a smaller scale the Cataract Gorge at the base of the Trevallyn Dam and potentially in the Duck Reach area. Like wind farms these mini hydro projects rely on renewable energy certificates and the need to meet renewable energy targets.¹⁰⁴
- Hydro plan to add another 1000GWh of renewable power to the system through these mini hydro systems and improvements in efficiency of generation.¹⁰⁵

Geothermal Generation

- Hydro and its consulting arm are not directly involved in any geothermal research but maintain a watching brief. Hydro's focus is on renewable generation that is immediately capable of commercialisation.¹⁰⁶

Biomass Generation

- Hydro has had some preliminary discussions with Forestry Tasmania regarding the potential for biomass electricity generation.¹⁰⁷

No Sale of Hydro

- The Minister stated that the Government remain committed to public ownership of the hydro system and the transmission and distribution network.¹⁰⁸

3.00 pm, Witnesses withdrew.

Tabled Documents:

Nil.

Additional Information Requested:

Nil.

OBSERVATIONS/CONCLUSIONS

1. Hydro Tasmania's financial performance has improved from a net operating loss of \$58 million in 2007-08 to a net profit of \$38 million.
2. Asset sales of \$163 million from the sale of Hydro's Roaring 40s' Chinese and Indian assets to its joint venture partner China Light and Power, a capital injection of \$220 million from Transend and higher rainfalls with significantly improved dam storage levels, were significant factors in improving Hydro's balance sheet and stronger financial performance. The capital injection was explained by Dr Crean as more properly balancing the debt levels of the three Government energy businesses than was the case at disaggregation in 1998. The Committee notes that at the time of disaggregation Dr Crean was the Treasurer and Minister responsible for the *Government Business Enterprise Act 1995*.

¹⁰⁴ *Ibid*, p.20.

¹⁰⁵ Transcript, Llewellyn, p.19.

¹⁰⁶ Transcript, Crean, p.29.

¹⁰⁷ Transcript, Hawkesworth, p.30.

¹⁰⁸ Transcript, Llewellyn, p.31.

3. A review of the three energy businesses, Hydro, Transend, and Aurora Energy Pty Ltd will be undertaken in early 2010 to determine ways of improving the efficiency and effectiveness of energy markets in Tasmania.
4. Hydro's net debt has increased from \$872 million in 2007-08 to \$904.4 million in 2008-09.
5. Hydro did not pay a dividend to Government in 2008-09 or 2007-08, in spite of the net profit position as a result of a change in policy. A recent agreement with Treasury will result in increasing dividends being paid to Government in coming years.
6. The preferred dam storage levels are 30 percent and have recently improved to around 47 percent compared with a low during the peak of the drought of around 17 percent.
7. Hydro has de-rated the system from 9,000GWh to 8,700GWh, as a result of a more conservative approach being taken to hydrological analysis. Improved rainfalls have Hydro currently over budget for inflows at approximately 9,500GWh.
8. Hydro expect net operating cash to rise to \$110 million on average each year if inflows are sufficient to generate 8 700 GWh per annum, over the next five years.
9. The intended economic benefit to the State of joining the NEM through the export of power from Tasmania to mainland States over Basslink in times of high demand and at peak prices has not yet materialized. However, improved rainfalls in 2008-09 may result in net export of power in 2009-10 for the first time.
10. Hydro's capital refurbishment program averages between \$60 million and \$70 million and is funded from net operating cash with some difficulties during low inflows where net operating cash has been low and capital refurbishment has had to be funded or partially funded out of debt. With average or above average inflows, the capital works program can be covered through net operating cash.
11. Hydro is a monopoly provider in the supply of Frequency Control Ancillary Service (FACS). Prices charged by Hydro in April 2009 resulted in some of the smaller participants being forced to pay more for FCAS than they earned in energy. This matter is currently under investigation by the Australian Competition and Consumer Commission (ACCC).
12. The Office of the Tasmanian Economic Regulator (OTTER) is currently investigating whether contingency frequency control services in Tasmania should be made a declared electrical service in Tasmania, essentially allowing OTTER to regulate the price of the service.
13. The Australian Energy Regulator (AER) is currently investigating a period of extreme volatility in the spot market price of electricity in June 2009, which resulted in administered pricing being applied for four days; the first time this had ever occurred in Tasmania.
14. Major industries consume approximately 60 percent of the power generated by Hydro Tasmania, a situation that Hydro Tasmania does not consider a conflict and the Minister specifically disagreed with the views of Professor Jonathan West in his recent report in which it was contended that the electricity pricing to major industrials

should be at market rates rather than current rates which in some cases were less than production costs.

15. On 31 August 2008 Hydro acquired a 51 percent stake in Momentum Energy Pty Ltd, an energy retailer based in Melbourne with retail licences in Victoria, South Australia, New South Wales and the ACT and recently acquired the remainder of the company at a total cost of \$51.5 million. This diversification into a retail capability has offered Hydro growth opportunity, increase in cash flow opportunity and an important hedge against fluctuations in the wholesale price within the national market.
16. Momentum made a loss of around \$13 million in 2008-09 and is likely to make a loss in the 2009-10 financial year as it builds a customer base and requires working capital. It was expected that Momentum would turn cash positive in 2011-12.
17. The development of wind farms including the Roaring 40's project at Musselroe is being hampered by the low price of renewable energy certificates.
18. An additional 1000GWh of renewable power generation is being progressed through the scheduled replacement of generating equipment as part of Hydro's asset refurbishment program at Trevallyn, Gordon and Poatina and a series of mini-hydro opportunities which rely on renewable energy certificates for their viability.
19. Hydro has had some preliminary discussions with Forestry Tasmania regarding the potential for biomass electricity generation.
20. Government remains committed to public ownership of the hydro system and the transmission and distribution network.

3.00 pm, Hearing Suspended.

3.13 pm, Hearing resumed.

TRANSEND NETWORKS PTY LTD

The following witnesses appeared before the Committee:

Hon David Llewellyn MP, Minister for Energy and Resources
Mr Nick Wright, Senior Adviser, Office of the Minister;
Mr Ray Brown, Chairman, Transend Networks Pty Ltd
Mr Mike Hunnibell, Acting Chief Executive Officer, Transend Networks Pty Ltd
Mr Paul Oxley, Company Secretary, Transend Networks Pty Ltd

*The Committee notes the following evidence in relation to Transend Networks Pty Ltd:
(Transend)*

Overall Performance

- Service performance was outstanding with Transend exceeding service benchmarks set by the regulator.
- Revenue increased by almost \$23 million¹⁰⁹ but the company's profits were hit by higher costs.

Financial Position

- Transend's debt /equity structure altered significantly in 2008-09.
- The transfer of \$220 million from Transend to Hydro (after an earlier transfer of \$50 million in 2007-08) in order to improve Hydro's balance sheet significantly increased Transend Network's debt to \$488 million.¹¹⁰
- The transfers were funded by borrowings which increased Transend's debt servicing costs by \$21.914 million.¹¹¹ This had a significant impact on Transend Network's profitability.
- Asset revaluations and significant capital expenditure program resulted in an increase in depreciation of 7.057 million.¹¹²
- The purchase from Hydro of its communications business resulted in Transend taking on the unfunded superannuation liability of 31 new employees who are members of the Retirement Benefits Fund defined benefits scheme.¹¹³ This resulted in an increase in unfunded superannuation liabilities.¹¹⁴
- Transend's Retirement Benefits Fund defined benefits scheme superannuation liability was affected by the drop in value and returns of equities caused by the Global

¹⁰⁹ Revenue was \$158.619 million in 2008-09 compared with \$136.674 million in 2007-08.

¹¹⁰ This equity injection was in two tranches; a \$50 million dollar injection (13 December 2007) effected by the passage of the *Consolidated Fund Appropriation (Supplementary Appropriation for 2007-2008) Act 2007* (Bill No.65, Act No.58 of 2007); and a later injection of \$220 million (10 June 2008), the transfer implemented by way of a Transfer Notice under section 10 of the *Electricity Companies Act 1997*.

¹¹¹ Transend's finance costs for 2007-08 were \$10.499 million compared with \$32.423 million in 2008-09.

¹¹² Transcript, Brown, p.3

¹¹³ Transcript, Oxley, p.12.

¹¹⁴ Unfunded superannuation liability rose from \$22.5 million in 2007-08 to \$35 million in 2008 - 09.

Economic Crisis. This required Transend to top up the scheme by \$7.481 million to account for these losses.¹¹⁵

- All of the above factors combined to reduce net profit to \$7.232 million. This compares with a net profit in 2007-08 of \$18.727 million, a drop of 61 percent.

Dividend to Government

- The dividend policy for payments to Government by Transend has not changed. A dividend is paid to Government based on a formula of retaining 50 percent of profit and paying out 50 percent. The Board recommended a dividend payment to Government of \$3.6 million in 2008-09. This compares with:
 - 2007-08 - \$9.36 million.
 - 2006-07 – \$15 million.
 - 2005-06 – \$18.774 million.
- The Minister acknowledged that the requirement for Transend to service debt had eroded the capacity to return a dividend to Government.¹¹⁶
- The Chairman, Mr Brown, indicated that the projection for 2009-10 is for a profit of \$17.9 million. This would result in a dividend payment to Government next year of approximately \$8.9 million.¹¹⁷

Borrowing Capacity

- Despite Transend Network's increased debt level, the Committee was advised that the Company still had a capacity to borrow an additional \$100 million based on borrowing limits set by TASCORP Pty Ltd.¹¹⁸
- The Chairman indicated that this capacity should be retained for unforeseen circumstances. This could be to fund an additional equity withdrawal required by Government or alternatively some other unforeseen eventuality, for example additional unplanned capital investment.¹¹⁹
- Due to Transend's payments to Hydro totalling \$270 million being funded by debt, its debt to equity ratio declined to 37:53.

Regulation

- Transend is a regulated monopoly. It has just commenced its present regulatory period (2009-2014). Transend is a participant in the National Energy Market (NEM) which encompasses the eastern seaboard mainland States and South Australia.

Australian Energy Regulator Revenue Determination

- The Australian Energy Regulator (AER) is the regulator. On 30 April 2009, the AER released its decision on Transend's revenue proposal for the period July 2009 to June 2014.
- Transend appealed this determination to the Australian Competition Tribunal (ACT).¹²⁰ The ACT determined on 12 November 2009 that the AER had made

¹¹⁵ Transcript, Oxley, p.11.

¹¹⁶ Transcript, Llewelyn, p.13.

¹¹⁷ Transcript, Brown, p.14.

¹¹⁸ *Ibid*, p.4.

¹¹⁹ *Ibid*, p.4.

¹²⁰ [2009] ACompT 8 (12 November 2009). Application Under Section 71b Of The National Electricity Law For A Review Of A Transmission Determination Made By The Australian Energy

certain errors in its original determination. This resulted in an increase to the revenues permitted to Transend during the five year regulatory period.

- The view of Transend was that the increased allowances in the new determination were a recognition that the decision made in 2003 by the Australian Competition and Consumer Commission provided insufficient operating expenditure allowance for Transend to meet its obligations during the 2004-2009 period.¹²¹
- The AER has allowed \$606 million in capital expenditure and around \$254 million in operating expenditure over the five-year period. The Chairman's view was that this determination provides a platform for improved financial performance for Transend over the next five years.¹²²
- The AER has also allowed a \$400 million contingency amount that could be used by Transend to fund increased renewable energy connections.¹²³
- The ultimate outcome of the AER determination will be an increase in charges for transmission services. Transmission charges have increased 30 percent in the last year and are expected to rise again. Mr Brown indicated that transmission charges account for approximately 14 percent of a residential customers' electricity bill.¹²⁴

Expenditure on Capital Programs

- Past and future capital expenditure was outlined as follows:
 - 2012/13 \$98 million (projected);
 - 2011/12 \$93 million (projected);
 - 2010/11 \$157 million (projected);
 - 2009/10 \$143 million (projected);
 - 2008/09 \$130 million;
 - 2007/08 \$61 million; and
 - 2006-07 \$71 million.
- Three key areas drive Transend's capital program:
 1. augmentation to existing infrastructure, the most recent being the Waddamana-Lindisfarne transmission line which provides additional security point in the southern part of Tasmania so as to reduce reliance on generation from the Gordon Hydro scheme. Total spend for this project is expected to be \$220 million;
 2. planning with Aurora Energy Pty Ltd relating to constraints or bottle necks in load capacity or reliability issues in the existing transmission system. This spend is driven by the local regulator which is currently the Office of the Tasmanian Economic Regulator (OTTER) which sets the maximum prices Aurora can charge for distribution services. However this role will be transferred to the AER at the next determination; and
 3. Transend Network's renewables program.¹²⁵
- Replacement for end of service life and unreliable equipment are other areas that drive Transend's capital program. Capital spend in any one financial year for end of

Regulator In Relation To Transend Pursuant To Clause 6a.13.1 Of Chapter 6a Of The National Electricity Rules. See <http://www.austlii.edu.au/au/cases/cth/ACompT/2009/8.html>

¹²¹ Transend Networks Pty Ltd Annual Report 2008-09, p.16.

¹²² Transcript, Brown, p.3.

¹²³ *Ibid*, pp.3-4.

¹²⁴ *Ibid*, p.17.

¹²⁵ Transcript, Hunnibell, pp. 13-14.

service life equipment is determined by planned and costed replacement programs. Load demand is the primary driver for capital works.¹²⁶

‘Grid Vision’ and Basslink II

- Transend has an internal planning process called ‘Grid Vision’. This is a 30-year projection to consider future transmission system requirements. This involves strengthening parts of the system, properly maintaining parts of the system, also the interrelationship with Basslink. The prospect of a second Basslink cable is included in this planning process so that when a significant increase in generation occurs, for example through renewable energy, there is a capacity to transmit this into the NEM. The Chairman emphasised that Transend is not driving the Basslink II process but is planning for this contingency should it eventuate.¹²⁷
- Current planning is based on a 0.9 percent per annum increase in load over the next 20 – 25 years.¹²⁸ Potential challenges are the prospect of increased renewable energy coming on-line due to the renewable energy target (RET) of generating 20 percent by 2020. The Minister indicated that Transend’s low growth predictions could dramatically change as a result of what is happening right at the moment at a national level (RET + Carbon Pollution Reduction Scheme) or what is envisaged from the point of view of geothermal or wind generation in the State.¹²⁹
- Given the limitation on the existing capacity of Basslink to export power to the mainland, a significant increase in generation without a corresponding increase in demand from Tasmania would need additional transmission capacity across Bass Strait so as to take advantage of export to the NEM.¹³⁰

Indexed Concessions

- The Minister used the committee hearing to announce that residential customers would be protected from price increases in the electricity marked by having their concession permanently indexed “to insulate those Tasmanians already entitled to concessions on their electricity bill from future price pain.”¹³¹
- The Minister did not indicate the cost to the Tasmanian community of subsidising these users.

Tamar Valley Power Station Connection

- Transend worked closely with Aurora Energy Tamar Valley, the owner of the new gas-fired power station, to connect and commission the generating plant. ATV is Transend's newest transmission customer. The transmission side of the business now has 18 customers including Aurora Energy, Basslink, Hydro, Roaring 40s and a number of industrial customers.¹³²

Acquisition of Communication Business from Hydro

- In November 2009, Transend purchased Hydro’s communications network. This business was renamed Transend Communications Services.

¹²⁶ *Ibid*, p.7.

¹²⁷ Transcript, Brown, p.5.

¹²⁸ Transcript, Hunnibell, p.7.

¹²⁹ Transcript, Llewellyn, p.7.

¹³⁰ *Ibid*, p.8.

¹³¹ *Ibid*, p.16.

¹³² *Ibid*, p.2.

- The strategic purpose of the acquisition was to enable Transend to maintain security of telemetry systems and ensure reliability.¹³³ Transend no longer has to rely upon Hydro for these services and now contracts with Hydro to provide its communications services.¹³⁴
- The acquisition has been profitable.¹³⁵ It also gives Transend the opportunity to participate in the National Broadband Network.¹³⁶

New Business Inquiries

- The Minister mentioned the potential for new connections for the proposed silica plant and for additional power connection at Port Latta. The Norske Skog plant in the Derwent Valley also significantly increased its power requirements from 75 megawatts up to 110 megawatts.¹³⁷ The potential for wind farms at Lake Echo, and Smithton in addition to the planning already provided for Mussleroe.

No Sale of Transend

- The Minister stated in answer to a question as to whether there was any intention at this stage to sell Transend that the "Government remains committed to public ownership of the Hydro system and the transmission and distribution network."¹³⁸

3.38 pm, Hearing suspended.

3.46 pm, Mr *Wilkinson* withdrew.

3.56 pm, Mr *Wilkinson* resumed his seat.

4.12 pm, Mr *Hall* withdrew.

4.18, Mr *Hall* resumed his seat.

4.38 pm, Witnesses withdrew.

Tabled Documents:

Transend Networks Pty Ltd - 'Tasmania's Electricity Transmission System'.

Additional Information Requested:

Nil.

OBSERVATIONS/CONCLUSIONS

1. Transend's profits were affected by the \$220 million debt funded transfer of capital to Hydro. Increased debt funding costs was to some extent offset by increased revenue of almost \$23 million.

¹³³ *Ibid*, p.12.

¹³⁴ Transcript, Brown, p.13.

¹³⁵ Non-transmission fee income increased \$7.842 million primarily due to this business. See Tasmanian Audit Office, Report of the Auditor General No.2 of 2009, Volume 2, November 2009, p.103.

¹³⁶ Transcript, Brown, p.13.

¹³⁷ Transcript, Llewellyn, p.9.

¹³⁸ *Ibid*, p.18.

2. Transend's dividends to Government have declined over the last three financial years. The Minister acknowledged that the requirements for Transend to service an increased level of debt had eroded its capacity to return a dividend to Government.
3. Transend's debt to equity ratio declined due to the need to fund increased debt \$270 million arising from capital injections to Hydro of \$50 million in 2007-08 and \$220 million in 2008-09.
4. As a result of the AER price determination and increase in charges for transmission is expected which are in addition to the 30 percent rise experienced in 2008-09.
5. Transend's expenditure on capital programs is expected to peak at around \$157 million in 2010-11. A significant project is the Waddamana-Lindisfarne transmission line which will have a total capital outlay of approximately \$220 million.
6. A second Basslink cable is included in planning processes so that when a significant increase in generation capacity occurs there is a capacity to transmit this into the NEM.
7. Transend has made a strategic acquisition of Hydro's communications business. The new business has been profitable and provides Transend with an opportunity to participate in the National Broadband Network.
8. The Government remains committed to public ownership of the Hydro system and the transmission and distribution network.

RECOMMENDATION

The Committee recommends that all three energy businesses, Hydro, Transend, and Aurora Energy Pty Ltd be subject to scrutiny by the one House of Parliament each year.

7. General Business

Discussion ensued in relation to the format for the committee's report to the House.

Ordered; That the Secretary provide a draft report for consideration of the committee by Monday, 14 December 2009 (Mr Hall).

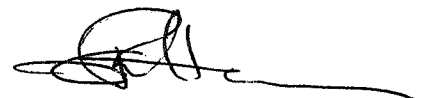
8. Adjournment

The Committee adjourned at 5.35 pm until a date and time to be fixed by the Chair.

DATE

21 Dec 09

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CHAIR

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