

UNCORRECTED PROOF ISSUE

Thursday 3 December 2015 - Legislative Council - Government Businesses Scrutiny Committee A - Hydro Tasmania

LEGISLATIVE COUNCIL

GOVERNMENT BUSINESSES SCRUTINY COMMITTEE A

Thursday 3 December 2015

MEMBERS

Mr Armstrong
Mr Farrell
Ms Forrest (Chair)
Mr Gaffney
Mrs Hiscutt (Deputy Chair)
Mr Mulder

IN ATTENDANCE

Hon. Matthew Groom MP, Minister for Energy

Ministerial Office

Mr Michael Connarty, Senior Adviser

Hydro Tasmania

Mr Grant Every-Burns, Chairman

Mr Stephen Davy, Chief Executive Officer

Mr Miles Smith, Chief Financial Officer

Ms Rachel Steven, Government Relations Manager

The committee met at 8 a.m.

CHAIR - Welcome, minister. Thank you for getting here early for an early start. We appreciate that.

Mr GROOM - I thank you and the committee for facilitating that. It is appreciated.

CHAIR - We are happy for you to give some overarching comments about Hydro's performance and any other comments you would like to make.

Mr GROOM - Hydro Tasmania is a very important business to the state. It has an important role to play in delivering secure energy to the state, and also facilitating the delivery of energy in an efficient manner. In turn, that is important for households and businesses in Tasmania. In addition, it plays an important role in attracting and retaining business in Tasmania. It is a significant manager of natural resources and a significant employer. The business is celebrating 100 years. It has been around for a long time because it is good at what it does. It has a lot of experience in managing its assets effectively, delivering high-quality services, and delivering broader benefit to the people of Tasmania.

It has been difficult over the last 12 months. There have been some difficult circumstances in the market. Notwithstanding that, the financial performance of the company has been solid, delivering a before fair value profit of \$62.3 million, which is above forecast. This was as a consequence of a very focused effort by the business. The business has been determined to do all it can to encourage a strong customer focus, but also an efficient business structure, and one which is cost efficient. Hydro has undertaken a lot of work through the year in reducing its costs. As an example - it was a discussion at the previous hearing we had - international travel costs were down 37 per cent on the previous year. That is a reflection of the heavy focus.

Momentum Energy continues to play an important role for the business. Momentum had another solid year, reporting a before tax profit of \$37 million. That is a credit to all involved in that business. It operates in a very competitive market, and we understand that, but it can play an important role in providing access for Hydro to that market more broadly.

Entura has secured some important business opportunities as a consequence of its joint effort with Hydro China. We recognise there has been a lot of talk about the future of Entura. From the Government's perspective, I reiterate that we are encouraging Hydro to explore opportunities for growth for that business. In that context, we have agreed for Hydro to engage in joint venture discussions with Hydro China and Power China. It is with a view to finding a path for growth that is genuinely sustainable. It is continuing to undertake a significant asset management program. We recognise part of its function is to ensure it is investing in its asset base and ensuring it is in a position for many decades to come to continue to provide the services Tasmanians have come to expect. There has been good progress in relation to those efforts.

The current year is a very difficult year for Hydro Tasmania. We all recognise that. It is a consequence of the dry conditions we have had over the winter. We had some dry conditions at the back end of last calendar year, as well. There have been challenges for the business. There is no doubt that will have a significant impact from a financial perspective, but it is important to recognise Hydro Tasmania is in the business of managing these issues. It has done so for 100 years. It has made it clear it will be vigilant and prudent through this period. I have every confidence in the ability of the management of Hydro Tasmania to manage the way through this.

It is a very steady hand. Tasmanians can have confidence the management of Hydro Tasmania will steer the business through this period. What has been recognised where we have seen conditions such as this in the past, there has been - not infrequently - a fairly speedy recovery from that circumstance. That is important to acknowledge. We might hear from Hydro later on, but we need to not jump to conclusions as to what to expect in the coming months from a hydrological risk perspective. There are broader climatic patterns the experts believe are contributing to the recent dry patch. Some of those patterns are coming to end. There are forecasts which would suggest there may be a return to more normal patterns. It is a very dangerous business. It is difficult to forecast rain. While there may be some in our community who would have an expectation that because we have had a period of dry conditions, it is reasonable to anticipate that will continue for a period, yet the most recent forecasts suggest it might be returning to more normal conditions. What is critical is recognising Hydro Tasmania is prudent and vigilant and has a lot of experience in managing these types of issues.

I commend the business for working effectively with the Tasmanian Government in implementing the State Energy Strategy, in particular, the work it has been doing exploring the potential for increased generating capacity of 10 per cent and understanding the preconditions to the second interconnector in Tasmania. I continue to believe this is an important area of work for the business and for the state. We need to recognise the energy sector has had some significant adjustments over the last five years. It is reasonable to expect the energy sector will have further adjustments in the future. That may present opportunities for Tasmania. It is important we do that work, so we are best placed to take advantage of any opportunities that may emerge.

I thank all the staff of Hydro Tasmania, Entura and Momentum Energy. It is an important business for the state. They do a great job. They have dealt with some difficult circumstances. I have no doubt they will effectively manage the circumstances we are currently dealing with.

CHAIR - Thank you. A couple of overarching issues. I am sure we will drill into all those points you have raised. They are all particularly relevant at the moment.

In terms of enhancing public reporting and accountability, your financials were signed off on 13 August. Why has it taken two-and-a-half months for us to get this?

Mr GROOM - I have no doubt the company seeks to do that in as timely a manner as possible.

CHAIR - Public listed companies do not take this long.

Mr GROOM - I have no doubt it is sought to be done in as timely a manner as possible. I have no doubt Hydro Tasmania has a strong commitment to ensuring it is in a position to keep the Tasmanian public informed about important matters. I take your point in terms of a different time frame to public listed companies, but I am quite sure it is genuine and good faith intent.

CHAIR - It is not just Hydro. They all will be asked. You will be asked again. Do not worry.

Mr EVERY-BURNS - We generally pride ourselves on signing the accounts as early as we can, but it is within the statutory period.

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CHAIR - It is. The statutory period provides for when you do it, when you table the annual report. The Auditor-General ticked on 13 August. The end of October is when we actually see them.

Mr GROOM - I take your point. The point I make is I have no doubt the company seeks to do this in as timely a manner as it can, and operates in good faith in accordance with the requirements. I cannot comment on the comparison with public listed companies.

CHAIR - On that same issue of reporting and the capacity for the Parliament, particularly, to adequately scrutinise, I am sure you have read the Energy Expert Panel's report.

Mr GROOM - It is a lengthy read, but yes.

CHAIR - Yes, it is. I want to take you to a couple of points in it. Under the heading of 'Enhancing Public Accountability' in volume 1, it talks about the ultimate owners of the energy business:

It is important for the Tasmanian community as well as shareholders can have access to regular information as to how well the business are achieving their stated objectives.

It goes on to say:

Public accountability of the state-owned energy business is largely focused on end-of-year performance.

Which is what we are looking at now.

The existing public reporting regime for the state-owned energy business attracted extensive comment from members of Parliament to the Energy Panel. A number of them expressed the view that the current level of information available to the Parliament, in particular, is insufficient for it to perform its accountability and oversight function on behalf of Tasmania. The Panel considers that there is merit from a public transparency perspective in improving the timeliness and currency of key state-owned energy business performance information provided to the Tasmanian Parliament.

It goes on to say:

Specifically, this should include a statement of corporate intent, a half-yearly report and an annual report.

Clearly we have the annual report, but no half-yearly report. They do make the point:

This kind of reporting regime is unlikely to result in any significant additional compliance burden of the state-owned energy businesses.

Is there any plan to go down this path?

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Mr GROOM - It is slightly out of my domain. It might be something that could be explored. I understand your point; from my perspective it is an open policy question as to whether there should be something further. It is a broader policy issue, not a Hydro issue specifically. From our perspective it is important the public is kept informed. There is balance in these things; notwithstanding the comments made they can be intensive processes in collating these things.

CHAIR - It is done anyway, minister.

Mr GROOM - Yes, and publicly presenting it involves an effort. I am not suggesting, nor am I suggesting the expert panel was suggesting it, but it is important we recognise slight differences with the public-listed environment, where you trade in shares in the company on a constant basis. It is different. I am not saying there should not be good information provided to the Parliament and to the people of Tasmania, but it is a slightly different context. These are reasonable policy questions.

CHAIR - The Auditor-General has made a similar comment. There is no policy position at this stage being looked at? This has been out for a while now.

Mr GROOM - It is not something that quite sits in my spot, but I am happy to take it on notice. We do not have a specific policy position on it at the moment.

CHAIR - I want to go to the Auditor-General's report on page 47 where he identifies some of the key issues and key risks for Hydro. He talks about the steps. He said, 'Clear from our analysis was that steps were taken by Hydro to reduce costs, but not all costs have moved directly in line with movements in revenue, and declines in costs were lower than decreases in revenue'. When you made your opening comments, minister, you talked about cutting costs in international travel, and that is good but it is a bigger problem than that.

Mr GROOM - That was just an example. That type of example can be reflective of the mindset of the corporation. It was cited as an example. There have many initiatives. They had a specific program to identify 100 ideas with a benefit of more than \$20 000 each over the course of corporate plan period. That was reflective of a broader effort by the corporation. Hydro would fully acknowledge this as an ongoing need. I do not think there is any suggestion that the job is done in terms of prudent cost management.

CHAIR - The next point from the Auditor-General was that, inconsistent with each of the three immediately preceding financial years, cash generated from operations was insufficient to fund capital expenditure. We saw the debt transfer and we have seen money come in, but we are still not generating enough cash flow to fund the capital expenditure. How are we going to manage this into the future? As you said, you are in the business of looking after your assets and maintaining them?

Mr GROOM - That requires prudent management of the business. There is no doubt the nature of this business is that revenue can fluctuate. Part of a requirement of the company is to take account of that and make sure it is in a position to deliver all the services it is required to deliver while, at the same time, ensuring it can deliver appropriate returns to the people of Tasmania. That requires prudent cost management, debt management and forward planning.

[8.15 a.m.]

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Mr EVERY-BURNS - Cost focus is very important to us. Your question went to cost focus and the issue of capital relief or debt relief. We are working very closely with Government in that area. You made the comment that \$205 million was given or paid away; there is a relief program at \$325 million.

CHAIR - Over the next two years.

Mr EVERY-BURNS - Yes, agreed with the Government. You have to be realistic in terms of asking can a company expect to get all that at once when the Government has constraints just like we have constraints. We understand that. It has been an agreement where we will work and do our part as much as we can, and the Government is starting to do its bit - the \$205 million was part of that. There is currently another debt relief tranche in sight, as discussed. That was contingent on Hydro being involved in cost-cutting exercises and many other things that we undertook. As far as I am concerned that is on track.

The Auditor-General makes a comment about various aspects. We take that on board. As far as I am concerned the Hydro is doing its bit.

CHAIR - The Auditor-General made the comment that the 2015 dividends could only have been funded through borrowings. The capital expenditure, which averaged \$133.468 million per annum over the past four years, will have to be funded from the current portfolio of borrowings so we are still not really getting ahead at this stage.

Mr EVERY-BURNS - The capex program is not running at an average of \$130 million anymore. The program this year is about \$110 million. My view of the ongoing program is about \$100 million-ish, so we are mindful of that. But as the minister has reflected, it is unreal and worrying if people suggest you do not continue to spend what I think is a correct amount of money on 100-year assets. You must do it.

CHAIR - That is my point.

Mr EVERY-BURNS - We have looked at it very carefully. It came from a spend that was a little bit higher than it is right now. We are putting a lot of effort into consideration of it; that is one aspect of it. The dividend and the capital injection are two completely separate things. It is easy to look at them as one animal; they are not. The payment of dividend is related to the very good fortunes to the company in a previous year.

CHAIR - I understand that.

Mr EVERY-BURNS - You raise working capital to pay those dividends. Separate to that is an issue of debt relief. The \$205 million is paid as debt relief, as agreed, relating to an earlier transaction, and that will continue.

From the board's point of view, we want the company to be on the most stable footing we can in terms of debt, revenue and costs, but it is in the interests of the company that it is done in a properly stable manner. I would like to have more money upfront, but that is not real. I would love to have much less cost immediately, but it is not real. I would love to have a lot more revenue, but it is not real. It has to be very steadily managed. The course you see at the moment is cooperative and steady.

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Mr GROOM - This business is a complex business and there is no doubt it is dealing with some difficult circumstances right now. The key to that is a very close working relationship between the government and the business, and that is very much the case. As the chairman has indicated, there are further plans for additional debt relief, but at the same time we are working on meeting certain KPIs in terms of cost management and other outcomes, and that is appropriate.

Mr GAFFNEY - You just mentioned cost reduction targets. I am wondering how the ones targeted for 2016-17 compare with 2015-16 cost reductions, and what actions Hydro is going to take to further reduce their costs, both operating and capital, in 2015-16 and 2016-17 which will help this underlying -

Mr EVERY-BURNS - I have already referred to the capital. It will come down to a steady level circa \$100 million, and that is our current plan. That will vary depending on what happens but that is our current plan. That will vary depending on what happens but that is our current plan. That is addressed.

Mr GAFFNEY - When you say it is addressed, how is it addressed?

Mr EVERY-BURNS - The asset management plan is a 10-year plan. When you map this out, it is done on a risk management basis which is the standard used in the corporate world nowadays. We would look at the age of assets. We look at the criticality of the assets to revenue generation. We look at where they are placed in the hydrology of Tasmania. Then you look at the current operating conditions. You make a well-informed judgment about those capital programs and the requirements of the business, and then we use external experts to advise us and proof some of that work. Apart from the belief that management is able to do the work very competently, the board has a risk committee that examines those issues and we have an external review of that. That is in terms of capex.

With the operating expenditure, or the fortunes going ahead, there are two elements to it. One is revenue: what is our view of revenue going ahead? And the other is expenditure. In a world where prices do not seem to go down for anything, you have to be measured in what you expect but at the moment we expect management to continue to deliver flat or reducing operating costs overall. That is where we are. This year we have done it. There has been an 11 per cent reduction in non-customer facing costs; we watch and monitor, we discuss it regularly, it is reported on. There is no intention that the costs are going to run away. This is a tough world. They are going to be contained.

Mr GAFFNEY - My question is, and it might not be through you, how is it going to be managed? You say the board will look at this and experts will come in. I want to know how practical the process is and what strategies are in place to bring that down. It is not from a board's point of view; it is more from the management point of view of Hydro.

Mr GROOM - I alluded to one example, Mr Gaffney, without being specific - a program to identify ideas for cost reduction - 100 ideas delivering \$20 000 or more in cost reduction.

Mr DAVY - There are a number of mechanisms that we use to try to ensure the management of Hydro Tasmania is still on a course of business efficiency.

The first one is that we set a budget target across the corporation that contains costs as much as we can. Over the last few days the nominal cost targets have been set to decline and will

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continue to either hold or increase lower than CPI for future years. That is the way we will set our overall targets. Setting targets is one thing but you need to also give people the tools with which to reach those targets.

As the minister said, last year we ran a 100 ideas program to move the mind set to cost efficiency and cost control. We are repeating that program this year because of the dry conditions. The way we want to further embed cost efficiency and business improvement is by having corporate-wide business efficiency programs. We have a business improvement program underway at the moment. We are identifying key corporate-wide processes that we can map and improve the efficiency of. I believe that is going to deliver a lot of dividends in those processes alone but it is also embedding the practice of continuous improvement within the company.

We are also focusing at Momentum on reducing cost to serve, to make Momentum as competitive as they can be. While Momentum is growing, the total cost of Momentum will be higher but the cost per customer will be lower. We do that by process mapping and identifying how to do each process as efficiently as possible.

Mr GAFFNEY - You mentioned Momentum. I will come back to that.

Mr EVERY-BURNS - On the cost, Steve, you have underplayed the 100 ideas. You might say what you achieved.

Mr DAVY - We targeted 100 ideas to reduce costs by \$20 000 each. We received 300 submissions for cost-saving ideas. The total costs reduced in the 2014-15 year was \$8.5 million. The recurring cost savings was some \$6 million out of that program. Overall, we think we reduced costs in 2014-15 from the previous year by \$18 million.

Mr EVERY-BURNS - It was not insignificant. The reason I asked you to go back to that was that it is easy to say, 'What are your plans for the future? How are you going to do this? How do you know it is going to happen?' Management has to energise the minds of people. They have to be genuinely fostering and encouraging the results we want. That is an example I have not seen used all that often in industry. The result, where management thought 100 was a stretch, has produced results worth, in that case, probably millions of dollars more than expected.

That is one of the things you have to do with management, with faith that this is what will happen. You begin to set the targets for cost reduction, cost driving efficiency. It is quite amazing what people will do. You do not always know what the drivers will be next year and the year after. I have confidence that the way we ask the place to be managed will deliver what we need.

Mr ARMSTRONG - Could you give us a couple of examples of what came out of that?

Mr DAVY - Mostly it is about doing things more efficiently, requiring fewer people to do the same process. For example, when your people are heading out to the remote sites, a number of the jobs that need to be done are done at the same time rather than when they are scheduled.

CHAIR - You need to talk to the NBN company.

Mr DAVY - We do that internally.

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CHAIR - They could do with some help.

Mr DAVY - We have a business that operates in many centres. We have vastly increased the use of video conferencing and telephone conferencing rather than having people flying around to attend meetings. That has been useful. We have rationalised quite a few of our sites in terms of rental, so we are reducing the amount of space we rent.

Mrs HISCUTT - It sounds like logical stuff.

Mr DAVY - You have to go looking for it before you find it.

Mr GROOM - It is important you have processes for identifying those things. Mindset, I think, is very important. I have noticed that shift in the business. Through the board and through senior management you can encourage a culture within the business that is looking for ways to do things more efficiently and find cost savings. That can be a very significant driver in achieving cost savings. That is why I cite that example of the international -

It might seem like an innocuous thing. We all recognise this is a business that needs to travel, so it is not to say that parts are being costed. That is a significant reduction, and is reflective of a shift in the mindset. That is an important point.

Mr FARRELL - Back on the debt and the capital works, how much more debt can Hydro carry on present projections? What impact will that have on your capital works program?

Mr GROOM - We are seeking to reduce it over time, Chair.

CHAIR - You have 200 undrawn at the moment, according to your financial -

Mr EVERY-BURNS - In regard to the borrowing authority, I do not think we need to go to the detail of that. There is sufficient headroom there, when I was asked the question about borrowing for dividends and things like that. That is not an issue for us. The issue for me is not about whether I am going to crash into borrowing limits. It is a matter of what myself and the board believe would put us on the most sustainable footing. In the years ahead a more sustainable footing is somewhat less debt than we currently have. The effect of that is to reduce the cost of borrowing to some extent, which is wonderful. We spend \$50 million a year on borrowing costs at the moment, so that would reduce. The other thing it does is take pressure off the company, government and state about the variability that goes on in business. You get natural hydrological variability that the minister is talking about. In the years that happens, if you are a bit thinly capitalised then you will end up hitting the profit line or with negative profits. Everyone goes, 'Oh gosh', but in fact it does not really reflect on the management of the corporation or on governments. It is simply a situation where, if your capitalisation is more stable, then you would simply have profits that were a little more predictable. That is what we strive for.

The general impression that Hydro ought to be giving is one that it is stable. It is in the interests of the state, the public and the business community to see it as stable. You can have a negative profit and still have a completely stable business, but you have to explain it. I feel more comfortable with companies that operate at the normal profit margin; it just gives confidence.

Mr FARRELL - Are there any costly capital works that are coming up, like replacement of dams or -

Mr EVERY-BURNS - No, none of it is cheap. On dams, there is some work that continues, but Rowallan Dam has just completed a reasonably major works program. It has been reported as one of the first in the world. That was in the order of a \$20 million capex over a period, but that is quite a lumpy one and is behind us at the moment. We have had a series of turbine replacements that are somewhat lumpy, but they are halfway through at the moment.

Looking ahead, we have some protection equipment, valves and alternators. The way we work those now is to try to do them in a program that is not a one-off. We find if you try to purchase particular pieces of equipment or particular jobs as a one-off then it is not as cost-effective for us or the state as doing it in a well-considered program that runs out. Sometimes we might be authorising expenditure of \$15 million or \$20 million on a particular type of works, but it will spread over half a dozen or a dozen power stations and it will run for a five-year program. You do it in that way as the most cost-effective way of doing it.

Those programs in the last few years have worked very well for us. Coming from the power sector, I am looking at what management is doing and I am very thankful for people thinking that way. You have to be prepared to think a bit long-term, and they are doing that. They are saying to some of the contractors, 'We want you to train some of our people so we can do this in the most cost-effective way and not continue to pay you for the service every time we do it'. Things like that go to the long-term cost-cutting; you don't have to cut costs by not doing things. You get cost-cutting by doing things you want to do in a much more intelligent way and a very well structured way. The world we are moving into is a more digital and digitised world. You can communicate better, deal with people better and all those things drive efficiency. That is the way things are done.

Mrs HISCUTT - On capex and expenditure, any more thought on a second Bass Strait interconnector or anything like that?

Mr GROOM - Yes. As you would be aware, part of the Tasmanian energy strategy commitment of the Government is to explore the preconditions to a second interconnector. Hydro has played a very important role, together with the Department of State Growth and also TasNetworks, in undertaking some technical work to identify some of the technical requirements and preconditions that would be necessary to support a case for a second interconnector. This is a strong commitment of the Government. I know some have questioned it and have thought it is not appropriate to explore this. I disagree with that very strongly. It is very important, with Tasmania's capacity in renewable energy, that we are taking medium-term and long-term views and ensuring the state is positioned to take advantage of any opportunities that may present.

As I mentioned at the outset, the energy sector has changed massively in a decade and very significantly in five years, and it is reasonable to expect it will continue to change. There may well be significant opportunities that present in five or 10 years that can support a second interconnector to Tasmania. That may have the potential to support further renewable opportunities in the state. We want to make sure we are as advanced as we can be in understanding that potential so we are best placed to take advantage of any opportunity that may present.

Mrs HISCUTT - So you have your mind to selling more energy as opposed to bringing it in?

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Mr GROOM - Obviously a second interconnector has the potential to ensure Tasmania is in a position to export to greater effect. That may support further renewable development at some future point. There could also be risk mitigation. We are confident about the future of Tasmania. One of the other things Hydro Tasmania does with the state government is to explore ways we can attract further load to the state, so we hope we are not in a situation where we would need to utilise a second interconnector as a risk mitigant for a loss of load. I do not think there is any doubt at all that, with the right conditions, it could present very significant future advantages for the state. These projects have very long lead-in times. How long did Basslink 1 take?

Mr DAVY - It was a decade from considering the idea to the commitment in 2002, and then power started to flow in 2006, so we are at a stage at the moment which would be similar to the early 1990s.

Mr GROOM - You do not want to be in the situation where, in a decade's time, we are all regretting we were not ready to take advantage of an opportunity.

CHAIR - Let us have a look at the current Basslink. If you are going to consider another one you need to understand this Basslink cable. Whenever I look at the balance sheet, Basslink has a negative number because of the costs associated with it. In 2014-15 the net value of Basslink appears to be a negative \$461 million. In your annual report on page 80 it says the asset equals a \$403 million liability for the facility fee, and \$521 million, and the penalty for the fixing fee over 25 years of \$342 million. Is that the reality of what we are looking at with Basslink? The Auditor-General makes similar numbers in the cost of having it there.

Mr GROOM - There are certainly significant costs, but right now we are seeing the value.

CHAIR - I am just talking about the costs of having it.

Mr GROOM - Yes, but right now we see the value of Basslink. It is an important asset for the state to manage hydrological risk, as the chairman has also referred to.

CHAIR - The expert panel said the cost was \$875 million, and 10 years later we still owe \$864 million because of the facility fee we pay. I will get you to address that because we seem to be treading water, even though it is underwater, so to speak.

Mr DAVY - The financial report says the asset is \$400 billion [? 8:40:19] and the liabilities are \$860 million. I think the \$875 million refers to the construction cost of Basslink in the first place.

CHAIR - Yes, that is right. That is the Expert Panel's cost, \$875 million.

Mr DAVY - Hydro Tasmania was not the constructor of Basslink. That was National Grid. What is in the annual report is our estimation of the payments against the receipts. This is done from an accounting sense. In the years they assess, the Expert Panel concluded - given the fees Hydro Tasmania had to pay for Basslink - that Basslink was a net positive for Tasmania, in the arbitrage across the link, the mitigation, and avoided cost of other mitigation when we went through the low inflows period in 2006-07 and 2008. The Expert Panel concluded for the years they were looking at it, that it was a good deal for the state.

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What is missing in the financial results is the other money we make from having Basslink, which is the profit at Momentum. Because we have Basslink, we have a profitable retail business, which last year contributed \$37 million to the bottom line. This also has a static view of the future, where the future is likely to be more volatile. We have been experiencing that now, where Basslink is creating advantage for the state by being able to operate on full import while we go through this low inflows period. That benefit to the state is not captured in the financial accounts.

CHAIR - We have noticed Basslink has its limitations. For a start, it can only flow one way. Also, it can shut down in times of high temperature. When that happens, Tasmania is operating on its own. This leads to the question about energy security. Basslink is part of the government's energy security process. As you say, if you want to attract more industry, and particularly, energy users to the state, they have to have energy security. The issue of sovereign risk for an entity to come and invest in the state, particularly in terms of energy pricing, is significant.

I commend the Hydro for flogging the business, making it work hard when we had the carbon tax, and doing a good job. But we are now possibly paying the price of that by running down our water storages, which was sensible to maximise your opportunities when the carbon tax was there, not question -

Mr GROOM - It is all part of the management over time.

CHAIR - That is what I am saying, but now we have low water storages. There was decision or a proposal put by you, minister, to close or sell the Tamar Valley Power Station, which is essentially part of the energy security of the state. Basslink has had problems in recent times. We have seen huge increases in the spot market, and significant increases that have resulted in high power prices for Aurora and for all the energy users. Some might say Hydro is influencing the market in that approach that has been taken.

Mr GROOM - I am not being disrespectful, but there are some loaded comments in some of that. I would appreciate the opportunity to have the chairman respond to it. I continue to be of the view that Basslink has worked effectively in providing the energy security for the state. It represents a significant advantage to the state in attracting additional load. One point of clarification I will give you is, it was not the proposition of the Government to look to sell the Tamar Valley Power Station asset. That was a proposal put forward by the company and the Government agreed, based on the advice we received that it is not necessary from an energy security perspective. We can hear from the company on that point, but that is the advice.

CHAIR - Recently, there was a media release from you, was it not, saying that it is back on the table - just keep going?

Mr GROOM - If you can let me explain the full thing. We might work through this. I am making a point of clarification. It was not a proposal put by the Government, but we have agreed the company can explore this on the basis that it is not a required asset from an energy security perspective. By virtue of the fact that has not been sold, it continues to be in its portfolio. The company is not going to sell that asset unless it can achieve a fair price, and it would be inappropriate for it to do so. That asset continues to sit in its portfolio.

CHAIR - What would be a fair price if it is running at a loss all the time?

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Mr GROOM - I will the chairman talk to those matters. The point I am making is, as long as it continues to exist in its portfolio, it is prudent that the company look for the best way it can utilise that asset and make sure that has an optimal outcome.

Mr FARRELL - A point of clarification. When you say, 'Selling the asset,' is that the asset completely, as it is now, or would you consider selling bits and pieces of Tamar Valley?

Mr GROOM - This is the combined site. It is quite specific.

Mr EVERY-BURNS - If I might go back to where those comments started. You have touched on about 50 subjects. I am trying to work my way through this.

CHAIR - Sorry, we only have two-and-a-half hours. There are a lot of things that need to be covered.

Mr EVERY-BURNS - Your earlier comment about Basslink only flowing one way, I did not quite understand that.

CHAIR - You cannot buy and sell at the same time.

Mr EVERY-BURNS - You can. You can do anything you want. There is a physical flow of electrons across Basslink and there are financial instruments that go around that. You can do anything you want in reality, but the fact is Basslink will flow each way whenever you want it to,

CHAIR - At the same time? At any one time it can only go one way. You can either import or export.

Mr EVERY-BURNS - Yes, that is perfect. You would not want it doing anything else. It is perfect.

CHAIR - We can explore that further when you look at the spot price, impact on that, the impact on Tasmanians. I am not worried about the others on the big island, but when you see huge spikes in the price on the spot market that could be mitigated, to some extent, by using the gas from the power station -

Mr EVERY-BURNS - The huge prices you see in the electricity market are something that capture the imagination of people, because it makes headlines. These are momentary things in reality, but particularly high prices are flagging other technical issues in the marketplace that requires response. The market gets its response, usually in half-an-hour or less, as a result of those signals. That is what they should do. That is the market doing what it ought to do. The fact that Basslink is used to import or export - if you want it to be able to do it both ways, you would spend another \$1 000 million to build another one. You would be talking to us about whether that was worthwhile. Realistically, we have a very reasonable piece of engineering. It is a pipeline that can carry more than 500 megawatts, usually in each direction as you turn it on and off, which is very substantial compared with the generating capacity of Tasmania. It is enormous. The benefit it brings is very good.

CHAIR - You talked about the other instruments, the frequency controlled ancillary services.

UNCORRECTED PROOF ISSUE

Mr EVERY-BURNS - I was talking about financial instruments that you can use to buy and sell power in either direction, but there are all the things you are talking about - ancillary services.

CHAIR - There was an issue in late December-January this year, where this really high price for the FCAs were significant over a period. Not just for half-an-hour. They were not recognised. It was over Christmas and that early new year period. Some companies were hit hard with high costs. This is the sort of thing they are talking about when you have an interconnector that only flows one way at a time, and the services flowing. I am not an expert. You are the expert in this, not me. If I am wrong, you can correct me.

Mr EVERY-BURNS - I will not go into the detail, but that high pricing event on Basslink, as I understand, is something that had not occurred before. The interconnector had effectively operated for five years, seven years. A set of circumstances arise - we all sit back, just like the customers are saying they are not happy, we are not happy. We did not like that outcome.

CHAIR - It has happened before - a few years ago.

Mr EVERY-BURNS - Some things happened around that time of year that were responded to differently by the market operator. We have had to sit back and say we don't like this, the customer doesn't like it, and when the management reported this to the board it had to do a lot of work with the Australian market operator, the energy market operator and the regulators and say we don't like this, this is not right.

CHAIR - Do we know what caused it?

Mr EVERY-BURNS - Then you have to put other protective mechanisms in place to reduce the loan component, and we are motivated to do that.

CHAIR - The question is going back to that point of energy security. Do we know what caused it? If we do know what caused it, can we prevent it happening again?

Mr EVERY-BURNS - We are on track to do that.

Mr DAVY - There certainly were a lot of different questions, but if I could go to that last item first, which was the high FCAS pricing in Tasmania in December and January - probably almost a year ago - what was occurring then was that the Australian Energy Market Operator - AEMO - had decided that because Basslink had not ridden through some system disturbances in Tasmania they would apply different considerations about how the Tasmanian region would operate. It took a few weeks for the market operator to land on a new configuration of how the Tasmanian region would operate and that new configuration has been in place since January. That configuration means more ancillary services are required to be supplied in Tasmania to allow Basslink to flow south at its full rate but that has all been put in place. We are not entirely happy with the situation but it has been resolved in a way where the system is back to pretty much where it should be.

CHAIR - What I am hearing you say, and correct me if I am wrong, is that the new system has been put in place but there isn't a guarantee that this won't happen again. Do we have more FCAS flowing south to Tasmania?

Mr DAVEY - No, the FCAS and the tripping services that we need to support Basslink flowing south are all supplied in Tasmania.

CHAIR - So if Basslink fails we will be right, is that what you are saying?

Mr DAVEY - Yes. This is to ensure that if Basslink is flowing south and it happens to trip, which it does from time to time - 10 or 20 times a year there is a short-term interruption to the supply, one way or the other - the Tasmanian system can respond safely and stably.

CHAIR - And maintain that price at an even level, or is the price independent of that?

Mr DAVEY - The price is whatever it happens to be at the time. We are talking about the system stability. AEMO is concerned with the system stability and they changed the way that worked in December and January.

CHAIR - Can we go back to energy security? This is the issue that needs to be addressed.

Mr DAVEY - We are very confident that with our hydro resources, the wind resources on the island and Basslink there is sufficient generation and supply across Basslink to meet Tasmania's electricity demands into the future. The way we have looked at it is that under the widest range of possible scenarios we can forecast we do not require the operation of the combined cycle unit in Tasmania. That is why we have recommended to the Government that we should explore the sale of the combined cycle unit at Tamar Valley.

That said, it is still there and many of the costs we are seeking to avoid by selling the combined cycle unit, which include transportation of gas to the site and the ongoing operations and maintenance at the site, we still have to do all that. The gas supply and transportation contracts are in place until the end of 2017 and while we have the combined cycle unit on the site it has to be ready to operate. A buyer is probably going to want to see it operating so we need to keep it in an operational state. While we are paying all the costs of having it in an operational state and also have all the other contracts in place that have not expired yet to be able to operate the combined cycle unit, we have to continually test for ourselves whether operating the combined cycle unit might not be a more economically effective way of managing the situation at the moment.

We have put energy security as the highest priority this year during this low in-flow period. You made a comment earlier that we have drawn storages down. In fact, at the end of June this year storages were sitting at 29 per cent, which is pretty much where we would want them. What we have experienced through September, October and November is the driest three-month period that Tasmania has seen. This situation unfolded pretty quickly and we are now fully utilising Basslink on full import. We will be fully importing over coming months, probably until it starts raining next winter, but if it is cheaper to operate the combined cycle unit than import that hard, that is what we should do because our job is to manage the situation in a cost-effective way for the state.

Mr FARRELL - What percentage of electricity is coming to Tasmania through Basslink at the moment as compared to what we are generating here?

Mr DAVY - It would be in the order of 40 per cent to 50 per cent coming across the link at the moment.

Mr FARRELL - In relation to the Bell Bay plant, it was identified that it is not crucial to electricity security. Is that correct that it is not vital?

Mr DAVY - All of our calculations and modelling tell us that the wind, the hydro and Basslink are sufficient to meet Tasmania's demand.

Mr EVERY-BURNS - The point Steve was just making was that while ever the combined cycle machine is sitting there capable of operating, then despite the fact we do not need it for energy security, we are freighting power across Basslink and at some point you go to the Chair's question of whether the power on the other side of that link will be very expensive, and it might. While we have the alternative of a gas-fired plant sitting there, not for energy security but for simply reducing cost, you may well take the choice of operating this plant that produces power more expensively than a person at home pays for their power. We cannot sell it for the money it costs to make it, but it still may be far cheaper than the alternative.

Ms FORREST - The cost of generating that energy from the power station is higher than what you get; is that what you are saying?

Mr EVERY-BURNS - Yes. If the alternative is spending a lot of money bringing power in over Basslink because it tightens for some reason - I do not expect that it will, but it might - then Steve or the management will be able to take a simple economic decision to say we have enough power from this source and enough power from this source, but this one is far more expensive, so while we have this here we might just exercise that option. That is what we are doing and we are trying to be very careful about it.

Mr GROOM - It is prudent management of the portfolio as it currently exists. The important point that has been made here is that the company has confirmed again that the combined cycle unit is not a required asset from an energy security perspective. While we have touched on the issue of energy security, it is very important that we put that in perspective as I alluded to earlier, and I would not mind Steve expanding on this a little. As Steve has just confirmed, energy security is a key focus of the company right now, as it should be, because we have come off a very dry patch. So it is absolutely incumbent on the business that it is vigilant and prudent in understanding all the tools it has at its disposal to effectively manage through this process. It has been around for 100 years and it does this well, but it is important that we don't get into the space of predicting the worst-case scenario going forward. There are broader climatic conditions that the experts have indicated have given rise to this dry patch, which may be coming to an end. I would like Steve to speak to that.

Mr DAVY - You would probably think because we have had three very dry months that the forecast will be for that to continue. We do not have weather forecasting expertise to any great extent at Hydro Tasmania so we rely on experts. We are told by the Bureau of Meteorology that the conditions that were causing the very dry conditions over the last few months, which was the temperatures in the Indian Ocean, have relaxed back to something far closer to normal and their forecast for summer is that the west coast of Tasmania should receive something like a normal rainfall pattern for summer.

We take some comfort that there may be a return to normal conditions, and over the past two weeks things have improved considerably. We have had a lot of rain on the west coast. It is rain on dry ground but it has also meant the distribution of water across our shorter-term storages is

now fairly healthy. We take hope that the rainfall could return to normal for the next three months but we do not just rely on hope. We are prepared for the most extreme circumstances and we are planning so that if those extreme circumstances continue, we will still make it through.

Mr ARMSTRONG - Is it true that some of the components of the Tamar Valley Power Station are being repaired in the United States and that the plant could not operate at the moment if it was needed?

Mr DAVY - There are five units at Tamar Valley. The combined-cycle unit we have been talking about is the largest. It is on site and operating well. There are three Pratt and Whitney units that are being used actively at the moment on a daily basis. There are parts of those units we are having fixed from time to time. They are older units and there are bits being fixed and maintained all the time. There is also a 60-megawatt Trent unit, which was a brand from Rolls Royce. That unit is off site at the moment being repaired, so that may be the unit you are referring to. It was not able to be used because of the repair that was needed and is now off site receiving that repair.

Mr FARRELL - On the energy security issue and the advice provided to the minister that Bell Bay is not a vital part of energy security, are we able to have a copy of that advice? We have had representations from other groups that feel that is not the case. It would be good to have some facts on that.

Mr GROOM - You have just heard the advice, Mr Farrell, and if there is any further information you require we would be happy to provide it. It has been strong and consistent advice that Hydro Tasmania is able to manage the current circumstances. There is no present energy security issue confronting the state. We have come off a very dry few months and it is incumbent on the business to be vigilant and prudent and to treat energy security and the proper management of its assets very carefully to ensure we can manage our way through that.

This company has 100 years of accumulated experience in managing these risks and I have every confidence they are able to do that, and specifically in the context of the Tamar Valley combined-cycle unit. The advice that has been provided by the company is that that is not a required asset from an energy security perspective. However, because it continues to be in the portfolio it would be prudent of the business to consider whether it is appropriate to operate that with regard to security and optimal financial outcome for the business.

Mr GAFFNEY - You would understand we were addressed yesterday by a number of stakeholders. The person I am referring to is very supportive of the Government but has some questions. It is worth putting those on the table to hear the response. They operate in the area you operate in. They have some specific questions which I think are worth asking. They gave a preamble and said that excessive exported water storage for Hydro in the past two years has resulted in record dividends being paid to the state Government and that is good business, leading to past, current and future electricity costs increases to all users. They went on to say that Tasmanian electricity users see no real benefit from the Government's recent windfall, quite the opposite, where we have seen wholesale electricity prices increased during the carbon tax period and currently, by 17 per cent to 2016, since the June 2015 pricing. Their questions are along this line and they are good questions for you to put on the record for the public to hear.

I will do them one at a time and you might like to respond to each of them, otherwise it will be too convoluted. Is that all right?

Mr GROOM - Yes.

Mr GAFFNEY - Why is it sound business practice for Hydro to sell off or export excessive amounts of water or state-owned assets to prop up state government consolidate revenue to the detriment of increasing electricity costs for all users?

Mr GROOM - From a Hydro perspective, there are judgments that need to be made in how best to use assets. Through the period of the carbon tax there were opportunities for the company to secure revenue. That is fair and, as a consequence, the water levels were lower. As Steve has indicated, that is not the present circumstance. There were some additional rains that brought it back to something like normal at the top of this year, but we have had a very dry patch over the course of the last three months. Managing those things is the business of Hydro.

From the Government's policy perspective, one of the points we made was that we were concerned about the impact that policy position could have to households and business on Tasmanian power prices. That is not a Hydro point; that is a broader policy point. I would continue to maintain that view and do not think it was ever explained to Tasmanian households or small businesses why they were paying a carbon tax on what was a renewable energy. Since we have seen the removal of that policy position, we have seen significant reduction in power prices. They came down by almost 10 per cent to household and small business on the removal of that policy.

These are difficult issues and I have every confidence that Hydro Tasmania manages its assets for optimal outcomes for the people of Tasmania. When it was in a position to secure additional revenues, not only from the carbon tax but, importantly, also from RECs, it was doing that. We are now in a different environment where we have to manage our water resources very carefully and that is what they are doing. They are being vigilant and prudent.

Mr DAVY - With the higher than usual generation and export through the carbon price, I want to dispute the notion that we have run our storages down too far. On 1 July this year, our storages were at 29 per cent, which is completely in the normal range for where we want to be at that time of year. We consciously built our storages up before the beginning of the carbon price with the express intent of generating harder than usual, during the carbon price while Victorian prices were high, as a result of the carbon price. That was a conscious strategy to maximise revenues for the company with the intent of returning higher returns to the state.

CHAIR - Which you did a very good job of.

Mr DAVY - Yes. In addition, 2013 was a particularly wet year and we had extra generation as a result. We did our best to maximise generation through that period but also to leave our storages for this year at a place where they were within the safe operating range. As we were unable to completely predict the future we did not foresee that the period September/October/November was going to be particularly dry, but even though it has been we are confident we will deal with that very well with the resources we have.

Mr GAFFNEY - We will just finish off on Basslink because we have had a discussion on that and I will come back to the other ones after the break. Why is State Growth and Hydro wasting money on the feasibility of a second Basslink cable - and you have identified that - rather than looking at using the capacity within Tasmania where there is a greater multiplier effect?

UNCORRECTED PROOF ISSUE

They are saying there is a greater potential to use what is already within Tasmania to create more work and a multiplier effect, I suppose, on businesses. They are even saying that some significant businesses will leave the state because of the strategies that Hydro is currently exploring. That is a concern for us, as it would be for you. They say at the moment that unless something is done within the next six months there are going to be some real issues for some of our big businesses because of the -

CHAIR - They are also alluding to the \$325 000 allocated for the feasibility study, as I understand it.

Mr GROOM - I could not disagree more with this proposition put there. I think there is an assumption that a second interconnector would be for importing power but that is not an assumption I would support. If we were to have the pre-conditions that support a second interconnector it is likely to be in circumstances where there is the opportunity for further renewable development on island, so that has the multiplier effect. In addition, the Government continues to be committed to doing all we can to explore additional load to the state. Hydro Tasmania is a partner of the Government in exploring that. There are some assumptions in that comment that somehow the second interconnector is suggesting that you will not have load and it is about importing power.

Mr GAFFNEY - To their credit, they were suggesting there is the capacity within Tasmania itself to be able to have all the energy we need for the future besides looking out there and you should be exploring ways and means of increasing those possibilities more than looking for some outside.

Mr GROOM - At present we have enough generation to meet our requirements, but as a government we have a positive perspective about the future of Tasmania and it is our expectation that we will see further load growth and that is why we are exploring the potential for additional generation capacity. We have been working with Hydro to identify the potential to increase the existing hydro capacity by 10 per cent. There are also other potential renewable development opportunities being pursued, not by Hydro but by other parties, and we would be supportive of that. We think that is appropriate.

The second interconnector is a different proposition entirely. That is about doing the work now that might position Tasmania well in a decade's time to seize an opportunity for the state. Those comments seem to imply it is all about creating opportunity on the mainland and not in Tasmania. That is absolutely not the perspective of the Government. Our perspective would be that if that were to be pursued at some point in the future it would be very much in a circumstance that operates to the best interests of Tasmania.

Mr GAFFNEY - People who presented, to be fair, also saw the need for that for 10, 15, 20 years. They are concerned that in the next six months to two years they may not get through that period because of the issues they are experiencing at the moment.

Mr GROOM - We understand there are difficult circumstances that people confront, but we are doing all we can as a government to work with businesses. That is a strong commitment of the Government that happens on many fronts. If you are conceding that there is a potential opportunity for that to be for the benefit of the state in 10 years' time, you must do work now. You cannot wait for a decade because that opportunity will pass you by. This is important work

and is not inconsistent with the Government continuing to work with businesses in this state to make sure we have a positive future.

Mr GAFFNEY - That is good. They say that they met with the group in the last three to four months and have not heard anything back from them.

CHAIR - They were talking about the review of the energy strategy. It was a six-month review they requested in the energy strategy.

Mr GAFFNEY - And two months ago they also met but they have not had any other feedback.

Mr GROOM - I am very happy to follow that up. No-one has brought that to my attention. In the development of the energy strategy, a key part of it was ensuring that we consulted widely right across the force -

CHAIR - There was no criticism of that?

Mr GROOM - No, so I am happy to take that up, Mr Gaffney.

Mrs HISCUTT - With Basslink, I know it is a silly suggestion, but what about a little bit of an extension to the islands? Have you thought about the Bass Strait islands, diesel and that sort of stuff?

Mr GROOM - There have been a number of activities the company has been looking at in the context of the Bass Strait islands. Hydro Tasmania has worked with Government over many years to look for ways to reduce the cost of generation and explore the opportunity to power the islands with new renewable generation that can be sustainable. Some of the work they have done on this is right at the cutting edge. It is cutting-edge, innovative, cleaner energy solutions for the Bass Strait islands.

What has evolved and been designed is a world-leading, renewable, energy integration project on King Island. The King Island Renewable Energy Integration Project aims to displace the use of diesel fuel to supply energy needs by using a combination of renewable and enabling technologies. Last month the project supplied all of the island's energy needs through renewables for a continuous period of nearly 33 hours, which is significant. That had not happened before. This is significant not only in that renewable energy was used to support the needs of an entire community, which includes residential and industrial loads, but is also a great demonstration of the skill and expertise of Hydro Tasmania.

The Australian Renewable Energy Agency - ARENA - provided \$6 million of funding to support the \$18.25 million King Island project, with the rest of the funding coming from Hydro Tasmania and the government. To achieve this world-leading result, Hydro Tasmania used its own advanced automated control systems and dynamic load control technology, coupled with energy storage and a standard flow or uninterruptable power supply system, commonly used in hospitals and telephone exchanges. This system enables all diesel generation to be switched off when there is sufficient wind and solar power to meet customer demand. The transition from using the diesel power station to 100 per cent renewables and back again when and as required is entirely automated and allows the station to achieve significant diesel savings by operating unstaffed.

This technology is now also being rolled out to Flinders Island. The \$12.88 million Flinders Island project will be capable of displacing up to 60 per cent of the annual diesel fuel used on the island to generate electricity within two years. ARENA is supporting the project with \$5.5 million of funding. In the case of the Flinders Island project, Hydro Tasmania has worked with Tasmanian manufacturers to develop a series of modular units to house and check the enabling technology essential to the energy solution. Hydro Tasmania is currently commercialising this off-grid energy solutions package and exporting these to customers on the mainland, and in due course to the Pacific and south-east Asia region.

CHAIR - There is a wonderful business in Wynyard directly involved in this.

Mr GROOM - There is. There are some great flow-on benefits to local businesses. This solution has assisted Hydro Tasmania to land a contract to help reduce the amount of diesel fuel needed to generate power and produce clean drinking water at one of Western Australia's tourism jewels, Rottnest Island. The Rottnest Island water and renewable energy nexus project will deliver both electricity and drinking water for Rottnest Island at lower cost and with lower emissions through the innovative use of renewable energy and smart controls.

CHAIR - Visit King Island and have a look.

Mr GROOM - Yes. It is a great example of where Hydro Tasmania is utilising its expertise in delivering clean, renewable solutions to the islands but also exporting that capacity to mainland Australia and around the world.

CHAIR - Thank you, minister. We will have a 10 minute break.

The committee suspended at 9.21 a.m. to 9.38 a.m.

CHAIR - I wanted to ask a few questions to understand how the electricity business works and then look at the RECs and how they work, because, to me, it is trying follow the value through the energy entities. Unfortunately Aurora is not here but they were here yesterday. Hydro Tasmania has contracts, as I understand, with four large users and sells the balance of its electricity by the AEMO.

Mr DAVY - This is for physical power.

CHAIR - Yes. Does Hydro contract with TasNetworks to transmit to our two to four large users? Is that how it works?

Mr DAVY - At a very high level, all of the electricity that any generator produces in the national market - Hydro Tasmania included - gets sold into the national physical market, and AEMO runs that national spot market for electricity. Customers either buy their electricity directly from the market through their retailer or directly by themselves; very large customers sometimes choose to buy directly by themselves. If you buy through a retailer, the retailer pays for the transmission and distribution costs as well as the costs of purchasing the energy from the market operator and then passes that on to the consumer. In a case where a very large customer is buying directly from the spot market, they will pay their own transmission charge directly as well.

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We have contractual arrangements with the transmission company to connect our plant to the transmission network, but we don't pay the transmission network ourselves or transmit it for transporting the power to customers. Customers pay that charge as part of their power bills.

CHAIR - With the power exported via Basslink does Hydro pay TasNetworks to transmit that, or is that paid separately?

Mr DAVY - Basslink operates as an entity itself. It buys in one region and sells in the other region and vice versa.

CHAIR - They charge the transmission costs?

Mr DAVY - They are called a market network service provider, so they buy in one region and sell in another region. They would pay connection charges to the transmission owner at both ends of their asset. We then have arrangements with Basslink where we pay them an annual fee, which is the fee you see valued in the annual report. Then we receive from them anything that comes from buying in one region and selling in the other region. We have effectively adopted Basslink's market position by paying them an annual fee.

Mr EVERY-BURNS - We have to pay the transmission company to get to the terminal points. That is our normal -

Mr DAVY - We pay the transmission company to be connected.

CHAIR - When power is imported, do you import it?

Mr DAVY - Technically the state imports power. The state imports power because AEMO have, in ranking all the offers that different generators have put into the market, decided it is cheaper to supply Tasmania with Victorian generation than it was with Tasmanian generation. In real time it is the market operator that decides which way power flows, but it is the generators and how they place their offers to sell electricity that require AEMO to make that decision. When we are trying to generate as little as possible, which is what we are doing at the moment during low in-flows, we would price our generation higher than Victoria's generation so that the link flowed southward. Does that make sense?

CHAIR - Yes. When you say the state imports power -

Mr DAVY - Not the state as the Government -

Mr EVERY-BURNS - The jurisdiction.

CHAIR - Who pays for the transmission across -

Mr EVERY-BURNS - That is different. The Basslink company owns the whole link and we have a leasing arrangement with them, in effect.

CHAIR - That is picked up in the leasing arrangements?

Mr EVERY-BURNS - No transmission company has to pay that because that link is owned by Basslink and by law it gets the right to come in and out of each market.

Mr DAVY - Essentially whichever direction the power is flowing Hydro Tasmania has paid for that facility to be there, so there is no charge per unit flow. There is an annual charge for the facility to be available and the power will flow, dependent on market prices in the Victorian and Tasmanian regions.

CHAIR - Does Hydro Tasmania get any payment from third parties who then on-buy the power?

Mr DAVY - We get back from Basslink what they get from buying it in a cheap region and selling it in an expensive region. We get that back. That is the positive line in the annual report.

CHAIR - In your revenues?

Mr DAVY - The Basslink asset is those receipts from buying in one region and selling in the other.

CHAIR - I do not think there are many people in Tasmania who actually understand this and that is why I am asking the question. I hope the minister is learning something too.

Mr GROOM - It is important to have these discussions because it is complex and it is important that people understand it.

Mr ARMSTRONG - What is the capacity of Basslink?

Mr DAVY - Nominally it is 500 megawatts. So 500 megawatts can flow either north or south. What that means in practice is that southward flows tend to average near the 450 megawatts at the limit. Northward flows can be higher than that continuous limit.

Mr ARMSTRONG - That is megawatts per –

Mr DAVY - Megawatts means that 500 megawatt hours can flow each hour. The Tasmanian demand averages around 1 100 megawatts. It can supply a considerable proportion of Tasmania's demand.

CHAIR - Just going back to the generation and looking to the RECs, in your annual report on page 112 - and I am one of those sad individuals who read it - I understand the generation of power is 8 180 gigawatt hours, but this does not include wind. Is that right?

Mr GROOM - That would be held through that minority statement through wind. It is more of a financial interest.

CHAIR - But that is the right figure. That is what is generated by Hydro without the wind and imported 2 141 gigawatt hours. That total is 10 321 gigawatt hours. In TasNetwork's annual report they note the total amount delivered in Tasmania, including exports, was 10 984 gigawatt hours which is a difference of 663 gigawatt hours. Is that the electricity from Woolnorth Wind Farm? There is a gap in the totals.

Mr DAVY - In our figures?

CHAIR - Yes. Your generation figures, and then you look at TasNetwork's transmission figures there is a difference of 663 gigawatt hours.

Mr GROOM - There is a difference between the direct generation of Hydro Tasmania and a financial state in a subsidiary joint venture that itself generates.

Mr DAVY - What we put in our annual report is what Hydro Tasmania has generated. The reason the wind generation is not in our figures any more, as the minister says, is that the wind is now contained in the Woolnorth Wind Farm Holdings' joint venture which contains the Woolnorth Wind Farm and the Musselroe Wind Farm.

I think TasNetwork's report is the total amount of power they transmitted on their system so that can include exported power and imported power depending on the flow of the year. Plus the calculation can be different at different points. If you calculate as sent out from generation units as opposed to calculated at the central point, there are losses in between that. If you measure at the customer for example as opposed to measuring at the generator, the small amount of electrical losses that occur from one point to another are not included.

I could not exactly reconcile for you the 600 gigawatt hour difference but between those three things, the difference in wind farm operations, the difference in how TasNetworks may account for flows across their system is what we are accounting for as generation from our power plants, and the third one being how losses are accounted for, may well be the difference.

Mr EVERY-BURNS - I could confidently say it will not reconcile. I would be amazed if it reconciled.

CHAIR - Last year there was a difference of 552 gigawatt hours.

Mr EVERY-BURNS - There might be a big reason for it but, as Steve said, with losses on the transmission system, you would have to know upfront whether they had even -

CHAIR - You would have a loss over the system. You would have a figure at the beginning and a figure at the end.

Mr EVERY-BURNS - No. You have lost something. You have transmitted a certain number of gigawatt hours of energy but in the same time you have heated the atmosphere with a certain amount of gigawatt hours of energy. I have no idea if they are saying they put that much in and got this much out at the end. I do not know what they have accounted for.

CHAIR - I am not saying that. I am saying that Hydro generated x amount, TasNetworks transmitted x amount. That is the question I will ask TasNetworks. That is the question for them but this is my question for you. I am trying to put a puzzle together and you are part of the puzzle. You cannot answer the TasNetwork's question but the minister will get another question later.

Mr GROOM - But you absolutely would not expect that to reconcile for all the reasons that have been identified, not the least of which is that some of the generation in wind is not accounted in that.

CHAIR - That is what I am saying. If the question is the wind, the majority of that wind -

Mr GROOM - That is a financial statement for Hydro. They have a minority interest in a subsidiary joint venture that generates.

CHAIR - That they do not count as part of their generation?

Mr DAVY - In these figures we don't.

Mr EVERY-BURNS - I don't know how the solar generation on the roof is counted because that is still into the system, then it is probably less -

CHAIR - That is TasNetwork's issue, not your issue though?

Mr EVERY-BURNS - You are still talking about energy they have transmitted through their system.

CHAIR - Now they have the whole distribution network as well as the transmission network.

Mr EVERY-BURNS - I understand the question is quite sensible but I don't know how you reconcile it. You will not get it down to the last numbers.

CHAIR - I was not intending to. It just seemed a fairly big number overall.

With the renewable energy credits this is another area I do not understand all that well, and I do not know if other members do. The renewable energy credits are contributing a third of the electricity revenue of Hydro and I would assume it is critical to the future, as the carbon tax was when you got that.

Mr GROOM - Has been, and this year would be different.

CHAIR - What is the cost of sales relating to the RECs as mentioned by the Auditor-General? In the Auditor-General's report on page 54 - this is for the parent company, not the consolidated company - he talks about the revenues from the spot industrial ancillary revenues, RECs and other revenue. I went searching through your annual report to find this information and it is not there. His office told us yesterday he got that from internal working documents, which is fine. I would like more information about the cost of sales and the other revenues that are listed in the Auditor-General's report.

Mr DAVY - I do not understand exactly how the Auditor-General got to those figures. They are not calculations we did directly but Miles can talk to what the costs of sales for RECs means.

Mr SMITH - I will need to study those figures to work out where they came from. You are specifically asking about the cost of sales for RECs?

CHAIR - Yes.

Mr SMITH - There are two ways we put cost of sales in our books. If we generate them internally, we can put them in at the cost of registering them, and if we buy a REC from somewhere else we will put them in at the cost we have bought. It is simple. There are a few

ways you can add all that up in accounting land which we discuss at the year end. That is the basic answer to your question.

CHAIR - On page 60 of your annual report it says Hydro Tasmania earns the revenue when it registers the product. When you earn the renewable energy credit, that is when you recognise the value?

Mr DAVY - We recognise the revenue when we register the last gasp certificate.

CHAIR - How we can register them. A renewable energy credit is a certificate issued following the generation of 1 megawatt hour of renewable energy above a baseline for pre-existing generators, for the energy from new facilities. Is that right?

Mr DAVY - Yes.

CHAIR - As at 30 June 2015, there were \$41.7 million worth of RECs still on Hydro's books. How many RECs does this represent?

Mr DAVY - I do not think we have that number.

CHAIR - I am interested in how many RECs there are.

Mr EVERY-BURNS - There is a market for RECs and it varies.

CHAIR - I know there is.

Mr EVERY-BURNS - It fell as low as \$24 at one stage. At the moment it is hovering around \$60 to \$70.

Mr DAVY - Did you want an explanation of what that phrase was saying, or are you interested in how many RECs adds up to \$41 million?

CHAIR - Yes, how the RECs are valued.

Mr DAVY - The balance of RECs at the end of the year are valued at a combination of the forward contracts we have to sell those RECs. If the forward contracts are exhausted and there are more RECs left, they are at the prevailing market prices. Today the prevailing market price of a certificate is just above \$70 but they were of the order of \$50 at year end.

CHAIR - What influences the price - the number available, supply and demand?

Mr DAVY - Yes.

Mr EVERY-BURNS - Probably policy certainty would also have been a big factor. It has been a dramatic shift.

Mr DAVY - You will recall there was a review of the target that took place over the last 18 months and about six months ago it was confirmed the target would become 33 000 gigawatt hours per year and through the efforts of various people, the large users in Tasmania received a tremendous benefit from additional exemptions from the renewable energy target. The large

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customers in Tasmania have dramatically reduced their liability under the renewable energy target.

CHAIR - Has that reduced the value of the RECs, then?

Mr DAVY - The value of RECs in the market had dropped because of the uncertainty that was created by the review process.

Mr GROOM - You will recall there was speculation that effectively it would be scrapped at one point so that uncertainty fed into the market price. As part of the deal there were exemptions granted for major industrials, which was very much to the benefit of some companies operating in Tasmania. With that policy position having been secured that has obviously created a flaw in that market which has caused the price to go up. I think it is probably fair to say more recently that there has been a bit of a 'Turnbull effect' in that market.

CHAIR - More certainty.

Mr GROOM - I think broadly renewable energy has a greater level of confidence currently.

CHAIR - When you said that the RECs are not going to provide perhaps the same amount of revenue -

Mr GROOM - Or not generating as much. In order to generate the RECs under the baseline arrangement you have to generate over the baseline.

CHAIR - One of the issues with the Tamar Valley Power Station in terms of the image is that it is not renewable. Hydro was given it, very kindly by Aurora, along with all the debt and everything else, because no-one else would have it. It is bad luck, really, about that.

Mr GROOM - A previous government did pay \$160 million more than it was worth.

CHAIR - Correct, exactly, and it has been a disaster from one leap to the next. It is now with Hydro. It does not really fit well with the renewable energy image of Hydro. Is that one of the reasons you would prefer to see it as not a part of your portfolio?

Mr EVERY-BURNS - You have raised a couple of issues. It was a commercial energy security issue that we addressed. I do not think we put our mind to it a great deal, honestly.

Mr GROOM - It might not be renewable but it is clean.

CHAIR - In terms of Tasmania having totally renewable energy with Hydro, we have always had that 'look at us' sort of approach.

Mr EVERY-BURNS - You were asking earlier about the tension in the REC market and we did not answer that, I suspect. The requirements for people to buy RECs comes from the requirement that the retailer who sells power has to acquit the number that is set in regulation.

CHAIR - Aurora, Momentum.

Mr EVERY-BURNS - Yes. Even if large customers get involved, as Steve said directly, then they have a responsibility as the purchaser of energy to acquit the number of RECs that come from a regulation and the number of RECs that have to be acquitted - Steve can probably bring you up to speed - vary year by year. This is how the REC target ramps up over time and the pressure comes onto the market to supply them. There is a market that makes them, and as Steve says, registers them, and then they equip them in February each year, or whenever it is, but the target keeps changing, the target ramps up, so it encourages more generation to come into the market with RECs.

CHAIR - Hydro would have sold a number of RECs to Aurora and Momentum.

Mr DAVY - Yes.

CHAIR - Do they pay the market price, or how does that work?

Mr DAVY - Generally we trade RECs with a number of counter parties at market prices. As it happens, Aurora has entered into an arrangement with one of the wind farms that we own and the joint venture with Woolnorth Holdings. Between ourselves and Momentum we enter into contracts internally to make sure the customers Momentum has are paying the market price for the certificates at the time they enter into contracts. That is the way we have done our internal transfer pricing. We supply all Momentum's.

The critical point about RECs and why it is a variable amount of revenue for us from year to year is that each power station has a baseline. For the power stations that existed before 1997, those baselines are based on historical energy production. If you produce lower than your historical production, for that year you do not get awarded any certificates. If you produce more than that historical production, for that year you get whatever that difference is between your actual production that year and the historical production.

[10.00 a.m.]

CHAIR - So in a dry year our old stations are not going to be able to generate above and beyond their baseline.

Mr DAVY - That is correct; that is exactly what happens. The amount of revenue Hydro Tasmania gets from the certificates, over time averages out to be what an average is but is very much dependent on the volume of generation. It is quite a volatile revenue stream for us.

Mr GROOM - As I said, it is going to be a difficult year.

Mrs HISCUTT - I have noticed the Auditor-General's report mentions Hydro Tasmania South Africa Pty Ltd and that Hydro Tasmania's investment in the joint venture was \$3.559 million of balance to date. With our joint ventures and also Hydro China, can you explain what returns Tasmania will get on this money, and especially with Entura and Hydro China how that is going to benefit our state? What benefits do you see coming here?

Mr GROOM - In relation to the South African one, the position of the Government had been to encourage the business to exit those arrangements, but that will happen over time. As to the Entura relationship with Power China and Hydro China, I have indicated before that it has been recognised within the business that Entura has a difficult circumstance in being able to have a sustainable future. There has been a very significant drop-off in the national consulting market

and that has had a significant impact, so one of the things the Government has encouraged the business to do is explore ways we can identify a more sustainable path for that business. It employs a not insignificant number of people and we are very conscious of that in how we can identify a path. It is not easy in these types of businesses but there is considerable expertise that exists there and there are markets where there are opportunities that present.

One of the things Hydro has done is explore the potential to leverage off Power China and Hydro China's market reach and potential. There have been some positive outcomes recently off the back of that relationship. They won a contract in Queensland, which was an example of that relationship, therefore there is potential to deliver additional work and provide a path for that business. It is in that context that we said to Hydro we agree they should have discussions with Power China and Hydro China to explore the potential for a joint venture arrangement on the proviso it is about securing a growth path for the business.

Mrs HISCUTT - With the Chinese wind turbine generator technology that is to be explored in Australia, what is the idea of that? Are we going to build them here?

Mr GROOM - That was a different one. There was an agreement entered into when the Chinese president was in town at the end of last year about exploring the potential for a testing wind farm. That was another example of where there was cooperation between Hydro and Shenhua in that instance. There has been a bit of a shift in the market for the reasons we were identifying before, and there has been a re-emergence of confidence in the renewable energy market nationally so there are some other opportunities that partnership is now exploring through the wind farm joint venture arrangement.

Mr DAVY - Back in 2011 we entered into arrangements with Shenhua to sell 75 per cent of the Woolnorth wind farm holding - the wind farm at Studland Bay and Bluff Point. We did a couple of things in that agreement. We talked about giving them the opportunity to invest in the Musselroe wind farm, which was underway at the time, which they subsequently took up. Also, this overarching agreement to develop 1 000 megawatts in total, so another 700 megawatts, to help them invest in more renewable energy in Australia.

The Shenhua Group was a very successful investor in renewable energy in China. It has built a lot of wind farms in China. Hydro Tasmania was joint venture partner of theirs in China 10 years ago or so.

Mrs HISCUTT - So their capital is necessary to get up and going?

Mr DAVY - Yes, they are keen to diversify their portfolio into renewable energy in China, and also to make that diversification international.

We have been working with them for a while on how to meet that objective of an additional 700 megawatts of investment. While the renewable energy target uncertainty was around a year ago, we were focusing on how we could lower the cost of wind farm development in Australia by importing Chinese technology. Now that the confidence has returned, our focus is returning to that overall target of another 700 megawatts.

We are talking to Shenhua about one of the developments that we have in mainland Australia. We are hopeful of reaching an agreement on that with those people. If it is possible to incorporate Chinese technology into that development, that is what we will be doing.

Mrs HISCUTT - The South African one - I am looking at the figure here - Hydro Tasmania has invested \$3.599 million. Is that money that is spent here, or spent there? How has that benefited Tasmania?

Mr DAVY - We have been working with joint venture partners in South Africa to build the Neusberg Power Station.

Mrs HISCUTT - It is a mini hydro.

Mr DAVY - Yes. It is not a mini Hydro, it is a small Hydro. If you saw it, you would not call it 'mini'. The Orange River flows near the border of Namibia and Western Cape Province. It has a number of weirs where irrigation is taken out. South Africa is dramatically increasing the amount of renewable energy by having a renewable energy scheme that we have participated in with the Neusberg development.

CHAIR - The benefits for Tasmania?

Mr DAVY - The benefits for Tasmania are that all the design work that was done for the Neusberg project was done by Entura. Entura has been working on that. Of that \$3 million investment, the good part of that was the work that Entura did. We have paid for our investment by paying Entura to do a lot of the design work and construction management. We were also responsible for part of the construction of the facility. Our people are involved in that.

Mrs HISCUTT - Do you think it was a good investment? You received return?

Mr DAVY - The project started operation at the start of this calendar year. We are getting our returns on that investment. Our targeted return on the investment was in excess of 20 per cent. We think that we will achieve something like that.

Mrs HISCUTT - That is what I wanted to hear. Thank you.

Mr FARRELL - In relation to Entura - I believe Entura is striking today. Is that the case?

Mr DAVY - Not that I have heard.

CHAIR - Twitter must be wrong.

Laughter.

Mr DAVY - Do you want me to talk to the Entura situation?

Mr FARRELL - Yes, please.

Mr DAVY - As the minister said, Entura has some fantastic skills and abilities to make available to the world. The world is focused on decarbonisation, and renewable energy is a big part of that decarbonisation. The people at Entura have a great amount of ability to offer the world in helping, particularly with hydro projects, but renewable energy projects in general.

At the same time, Hydro China and Powerchina Huadong, the two companies that were investigating the joint venture are also interested in building, investing, and consulting to power projects internationally - hydro projects and other renewable projects. There is a fantastic opportunity.

At the same time, we have been negotiating the enterprise agreement with Entura staff. While we think it is a fantastic opportunity, and most people at Entura share that, I can understand for someone working at Entura it does create a little bit of uncertainty, so we have been negotiating the Entura enterprise agreement. The offer we put to the vote last week was not successful. Entura staff, generally, have questions about how their careers will progress under a joint venture. We are doing as much as we can to satisfy those questions. What we are going through is the normal process of an enterprise agreement negotiation in a context where, for people, there is a little bit of uncertainty.

Mr GROOM - The important point from the Government's perspective is that in agreeing for Hydro to explore this potential joint venture, we are very focused on securing good outcomes for the employees at Entura. The current business model of Entura is difficult because of the circumstance of the national market. This is something that Hydro has grappled with for some time. To its credit, it has sought to find a solution and a path that can deliver a sustainable growth opportunity for that business. That is what is driving exploring this potential opportunity.

CHAIR - I have a question on the joint venture. I refer to page 112 about your generation earlier. It says that the generation load factor for Hydro Tasmania's generators was 43 per cent. What was the percentage for the joint venture wind farms?

Mr EVERY-BURNS - There is no comparison. One is the water generators that will be on demand for that particular facility, and the other is the wind. Wind has a completely different load factor and capacity factor, because the wind does not blow two-thirds of the time. I am not quite sure how you would make the comparison. Steve, you might add to that.

Mr DAVY - The capacity factor of our hydro plant is the amount of energy. We decide when to dispatch the energy, effectively through the offers that we make to the market from our hydro plant. Over a year we can only generate, on average, the inflows. Dividing that by the installed capacity, that works out to be around about 40 per cent. That is how that calculation works.

CHAIR - That is how you work that out.

Mr EVERY-BURNS - If you needed a lot of power, you would be able to generate the full amount of capacity for the hours that you required it. You have enough -

Mr DAVY - The wind resources in Tasmania are very good. Around the world, a very poor wind resource might have a 25 per cent capacity factor. A fantastic one might have a 45 per cent capacity factor. The wind farms we have in Tasmania average in the low 40s.

CHAIR - Was that the same case when Shenhua joined the joint venture? Generation factor has basically stayed the same?

Mr EVERY-BURNS - You design on that.

Mr DAVY - As with rain, different years have different amounts of wind, but performance has been strong from the Tasmanian wind farms.

CHAIR - They have not bought a pup then?

Mr DAVY - I do not think so.

Mr EVERY-BURNS - That is a critical design input. You do all the estimates to work out what the wind resource is. Then, you put your wind turbines there, knowing you will do the best you can out of it, but you estimate it as 35 to 40 per cent if you do very well and you are on a good resource. That is the way it works out.

Mr FARRELL - I have a release from Professionals Australia that said:

Staff from Hydro Tasmania's consulting division, Entura, are planning industrial action after overwhelmingly rejecting a recent offer for a new enterprise agreement.

That came from Professionals and it is dated today. That is where that information came from.

Mr EVERY-BURNS - They have the legal right to take what is called protected industrial action. That may be what that is referring to in terms of the civic operational question. We have no idea. I have not heard anything about it.

CHAIR - It has not filtered through. You have been stuck in here, haven't you?

[10.15 a.m.]

Mr EVERY-BURNS - No; I do not read that to say they taking industrial action today.

Mr DAVY - Professionals Australia has put out a release saying they are able to take industrial action because, as the chairman said, having gone outside the enterprise agreement and voted in favour of taking some limited industrial action they are now in a position where they can take industrial action. We have received no notice that this is what they intend to do. They need to give notice.

Mr GROOM - It is appropriate to say that the company has a very strong commitment to ongoing engagement with all employees in relation to the current circumstances confronted by that business, and their future. As I have already indicated, from the Government's perspective we commend Hydro for looking to ways to provide a sustainable future for employees of the Entura business. The current model is problematic and the Government shares Hydro's concern to ensure that we do all we can to find a sustainable path for that business and for the employees of that business. These discussion are about providing a sustainable growth path for the business and for the employees of the business.

CHAIR - My understanding is that the gas contract that Hydro has ends in 2017. If you sold the Tamar Valley Power Station, would that contract be part of the sale? Would a new owner need to recontract?

Mr EVERY-BURNS - No, because if you sell the power station it will go somewhere.

CHAIR - The gas would go somewhere?

Mr EVERY-BURNS - No, the power station will go somewhere. The unit that absorbs the gas will go somewhere physically. It will be used in another country, I assume. No, the gas does not go with it.

Mr DAVY - At the moment we are selling. We are not running the Tamar Valley Power Station combined-cycle unit at the moment and we are selling that gas into Victoria in the wholesale market and the retail market.

CHAIR - Yes, because it has a take or pay contract. You really have to use it or sell it, otherwise it is a huge liability.

Mr DAVY - Yes, and we are successfully trading that gas into Victoria.

CHAIR - Hydro being one of the bigger customers of the gas transportation, if Hydro does not renew that contract in 2017 one would expect that the additional cost imposed on the transporter would have had to be defrayed across the rest of the customers. Some of the big customers are people like Grange. Its energy costs, particularly gas, make up a huge percentage of their costs. If we saw a significant increase in that cost as a result of Hydro not renewing, particularly when you look at the iron ore price is at the moment, which is sad and tragic, that could push them and others into an unprofitable operating position which may see them have to close Port Latta, for example. That is just one example.

This is one of the issues with the potential sale of the Tamar Valley Power Station and the gas contract as a result. Do you take a broader view of this in looking at the impact on the economy of Tasmania as a whole? Hydro has to offer as a commercial business, that is their requirement, but you as the Minister for State Growth, Energy and several other things would have a responsibility to look at the whole economy of Tasmania and what this could mean. Do you do that and what discussions do you have with key stakeholders in this?

Mr GROOM - You do have to take a broader perspective. We have to be very careful about jumping to a conclusion that it would be appropriate for us to encourage Hydro Tasmania to continue to hold this asset and retain a position in the gas market off the back of that, where that can potentially bear significant cost to the state. It is important from Hydro Tasmania's perspective to make those judgements. The advice we have had from Hydro's perspective is that, over the medium to longer term, Hydro Tasmania would be better placed without that asset. As we alluded to before, that asset has had a troubled history. It is fair to say that the state, under the previous government, paid significantly more than they should have for that asset and that has had cost implications for Tasmania ever since. It is important that Hydro make that judgment and that is the advice they have provided to us.

We fully recognise there are difficult issues in the broader gas market. I do not think there is any doubt about that. I understand people would be expressing their concerns to government, and that is appropriate. It is important we allow the market to respond. Markets do respond to these circumstances. The notion that transportation costs can be put up to an unlimited extent is not realistic. In an operating market there will be natural constraints. It is important we allow that opportunity to emerge.

The other thing relevant here is that the most significant issues people have in terms of future gas prices are broader than the transportation costs.

CHAIR - That is one aspect of it.

Mr GROOM - Yes. They very much relate to broader market conditions nationally. It is one of the things I will be discussing later tonight and tomorrow at the COAG energy meeting. There is no doubt this is having potential implications for businesses that rely on gas. The forward projections for what might happen to gas prices are not as dramatic today as they were a little while ago, but they are still significant. These are cost pressures but it is important that Government does not overreact. It is important we allow the market to play out because markets have a way of constraining outcomes.

Mr DAVY - I want to put on record our plans for the Tamar Valley site. From time to time the words 'Bell Bay Power Station' are used. Bell Bay Power Station is an older power station that was closed in 2009. It is completely decommissioned and will eventually be demolished.

The Tamar Valley Power Station is the new site that was initially established by Hydro Tasmania with the Pratt & Whitney units. More recently, under Aurora's ownership, there was a Trent unit and a Mitsubishi unit established there. There are five different generation units on the Tamar Valley site. It happens to be next door to Bell Bay, so there is confusion between the two. The Tamar Valley site is a separate facility.

We are contemplating and investigating selling the combined-cycle unit on that site. There will still be four operational gas-fired units on the site. There will still be a need for some kind of gas transportation arrangements to be in place with the Tamar Valley site after 2017. The current contract does expire at the end of 2017.

CHAIR - On page 114 of your annual report - consultancies. TasPorts uses a definition of consultancies - contracts versus consultants - but you do not. I notice there is a lot of money being paid to consultants in regard to information technology and associated software costs are fairly high. What is all that about?

Mr EVERY-BURNS - You are probably referring to the renewal of the main computing platform for Hydro Tasmania, which was the implementation of the SAP-based system.

CHAIR - Page 71 of your annual report.

Mr EVERY-BURNS - We implemented that construction implementation over more than a year-long period, but it was virtually the complete replacement of the business platforms with SAP. There are higher software licensing costs that go with that.

CHAIR - Between 2014 and 2015 it went from \$205 000 to \$15 million.

Mr EVERY-BURNS - That is correct.

CHAIR - We are not looking at Aurora here and their billing system, surely?

Mr EVERY-BURNS - No, no.

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Mr GROOM - Very definitely not, Chair. This is well on the public record and I will say it has been very effectively managed.

Mr EVERY-BURNS - It is a completed project, on time, on budget - it is done and dusted.

CHAIR - So we budgeted for this level?

Mr EVERY-BURNS - Yes. There is no issue in that sense. These are things that are critical for business to continue operating. Even if you do that, you still sit back and the business knows that it has customer relations systems and a whole lot of other things that are not yet at the space and the place they have to be. This is an ongoing, ever-changing need to improve the system. We cannot continue back in the dark ages in a way, but it is not like any other out-of-control program. It was very tightly managed and a credit to the management. They had steering committees in place and it was watched very carefully.

CHAIR - These consultancy fees are only the ones over \$50 000. There are 233 others less than \$50 000, which is \$3 million worth of consultancy, so we are using a lot of consultants. It is a complex business and I understand it is very specific.

Mr EVERY-BURNS - You have commented that maybe some others are dividing consultancy and contracts differently. Before you go any further, I will say Hydro has tried to do it based on the widest possible definition. They have done it in a way that takes up a whole year of activity, when it was only required to report from a date. They have done that in the interests of transparency, because it means comparisons will be possible in the following year. You will not get a fraction of a report this year followed by a full report next year.

CHAIR - That is good.

Mr EVERY-BURNS - I think it is good.

Mr SMITH - There is a policy Treasury put out and we use that policy but also augmented it with our own where there was more detail required. We had a signed-off policy so that we could be very consistent in collecting this.

CHAIR - It is a very nice change for members of parliament to have a consistent comparator from year to year.

Mr SMITH - We plan to use that every year, and this is a full year, so next year you can compare year to year.

CHAIR - Let us look at this last year. You have a significant number when you add them up in terms of consultants around legal advice and using a number of different companies, and financial consultants as well. With all due respect to the CFO at the table, I know there are complex different areas that obviously you need expertise in, but don't we have a lot of this financial consultant capacity and legal advice in-house? We seem to be buying a lot of it in.

Mr GROOM - There is great capacity in-house, but as you have already alluded to, Chair, this is an extremely complex business environment and it would be unrealistic to expect you could deliver all of it in-house.

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Mr SMITH - The one you referred to, the top one, they perform our internal auditing function. We have an outsourced internal audit function and they come in and check the controls. That is one of the things you would see in a normal business. I am probably not in a position to check my own controls.

CHAIR - I accept that. That is only one line item though.

Mr SMITH - There will be an external audit in there as well, and there are other things we need to get, such as tax advice, from time to time. A lot of this is engineering consultancies.

Mr DAVY - In running the business efficiently, we need to make choices about the amount of capacity that we hold in-house to handle the peaks and troughs of internal work we have. Often it is more efficient to have a lower level of internal capability and contract in the capability from consultants if we need to. In addition, there are many cases where we need independent eyes on the work we are doing. We want to have external verification at times that we are doing exactly the right thing. This is particularly the case with complex legal and contractual matters. We want to use the broader experience of external people at times to augment the internal capacity. The use of external help is managed within the budgets people have and generally business areas only use that external help when it is necessary or where it is cost-effective compared to the alternatives.

[10.30 a.m.]

CHAIR - As to executive remuneration, I do not have any issue with senior executives being paid these amounts of money to run very complex and important businesses for the state. Perhaps our CEO does not get paid enough in terms of some of the other GBEs, but that is a matter for somebody else to look it, maybe the minister.

Mr GROOM - Are you trying to create trouble there, Chair?

CHAIR - No, but look at this and the other GBEs that do not have anywhere near the balance sheet Hydro does. Anyway, we are looking at the short-term incentive payments and we note that Mr Davy - and no reflection on his capacity at all - received a short-term incentive of \$72 000 last year and \$84 000 this year, while the chief operating officer, Mr Albertini, got a short-term incentive of \$115 000 last year and only \$60 000 this year. Obviously there are KPIs that sit behind this, so what determines these sorts of incentive payments? What are the expectations that will see incentive payments paid?

Mr GROOM - I will hand over to Mr Every-Burns in relation to the detail behind that, but I will reaffirm this from our perspective. We understand this is a complex business and therefore you have to pay people appropriately. However, it is our expectation that there will be constraint in the context of broader circumstances that everyone is having to deal with and also that the corporation engages in these matters consistent with the Government's guidelines. We have had strong engagement with the business in relation to that and we have every confidence these matters will be managed appropriately.

Mr EVERY-BURNS - It is always unfortunate when you have to talk about people by name because it hurts them in the annual report.

CHAIR - I know, but it was a government decision to have this published.

Mr EVERY-BURNS - Your initial comments about the levels of pay I think are refreshing. It is difficult when you are in a government business to pay what might be fair in the commercial world. If you do not pay what is fair then you do not attract the people. This business does attract good people; they are wedded to it, but we also respect where the Government is with the pay and restraint. The case you mentioned is one where we had to considerably reduce the incentive at risk, the amount of money at risk. In the case of someone who is one of the highest performers in the company, it is not reflective in any way of poor performance; it is reflective of the fact that we have responded to our discussions with Government and have reduced incentives.

CHAIR - Have you changed the KPIs?

Mr EVERY-BURNS - No, mostly the quantum. The KPIs are something we vet carefully. The incentives relate to matters of importance to the corporation in a general corporate model and importance to us as to what the individual does in their section and what is achieved. The KPIs use models that are used in the corporate world that relate to corporate outcomes, individual outcomes and team outcomes.

CHAIR - Minister, your chair has indicated it is really a government pressure to reduce the level of incentive. Does that potentially disincentivise these well-performing executives to achieve these outcomes?

Mr GROOM - From our perspective we have spoken to the corporation about exercising appropriate constraint, but it is incumbent on the corporation to make sure they are managing those issues and I have every confidence they are doing that appropriately and responsibly.

Mr EVERY-BURNS - These are very fair questions but they are the most difficult questions in this corner of the world.

CHAIR - The publicly listed companies have had open disclosure for a long time and it is time our GBEs did, but it does put the spotlight on them. I have made my comments on that. This is such an important business for the state.

Mr GAFFNEY - It seems to me that when someone is taking on an acting role, which is usually a higher role, that increase comes up as an incentive. There are two or three people there, including Mr Davies and Mr Flack, who have taken on acting roles, so there is an incentive, whether it is on performance or the fact that they have just taken on extra responsibility, which is fine. I think a lot of people find it hard to grasp the concept that if you are in a position you should be doing the best job you possibly can, so therefore people wonder, 'What is this incentive?'. You understand corporate law but for the record it might be good to explain that a little further because most people think they should be doing this anyway. Why don't you just raise their salary and remove the incentives and say, 'This is what you have to achieve'? That is the debate. People see that this person is on \$380 000 and has done a good job but there is another \$110 000 and where does that come from? It is big money and that is why it creates some angst, I suppose, especially when you are saying you are trying to reduce your costs.

Mr EVERY-BURNS - We are all out of time, but I can say to you that if the model of not paying incentives was a good model then the corporate world would hardly exist. In the corporate world - which my super fund holds shares in and you probably hold shares in all these things - we are all driven to see good performance of these businesses and incentives are part of it. I think incentives are valuable, I really do. There are arguments about how much you incentivise people.

It is respected when it is paid and it is paid for performance that really happened and people know it is true and properly measured. That is the way it works.

Mr GAFFNEY - Through the organisation how far does the incentive go down? Does it go all the way down?

Mr EVERY-BURNS - Yes, it is fairly equitably applied. Steve, I am sure this is right, but everyone in the company has some access to some incentive. It might be relatively lesser at the lower levels, but it is not an elitist system that only has incentives for a few people, so it works well.

Mr DAVY - Generally Hydro Tasmania's executives are on an incentive program and the program is definitely on achieving things that are in excess of business as usual. In the Hydro Tasmania Enterprise Agreement, enterprise agreement staff also receive a corporate component that is linked to performance.

Mr EVERY-BURNS - Which links them to the business's outcomes.

CHAIR - Thanks, minister, we have gone over time.

Mr GROOM - I take this opportunity to thank Mr Every-Burns and Mr Davy and also Miles Smith and all the management and staff of Hydro Tasmania for all the efforts they have undertaken through the course of the last year and their ongoing efforts in managing, I believe very effectively, this very important business of Hydro Tasmania on behalf of the people of Tasmania. I thank the committee.

CHAIR - Thanks very much. We will reconvene in about 10 minutes.

The committee suspended at 10.39 a.m.