

17 February 2012

Mr John Pierce
Panel Chairman
Electricity Supply Industry Expert Panel
GPO Box 123
Hobart TAS 7001

Dear Mr Pierce

RE: Hydro Tasmania's response to the Expert Panel's Draft Report

Hydro Tasmania appreciates the opportunity to provide feedback on the Expert Panel's Draft Report. We welcome a number of the Panel's findings in its Draft Report, and appreciate the recognition by the Panel of the soundness of Hydro Tasmania's management processes, financial structure and its focus on optimising debt.

Hydro Tasmania does not believe, however, that the Panel's analysis of the Present and Future are an appropriate account of where the business is now or where it is going.

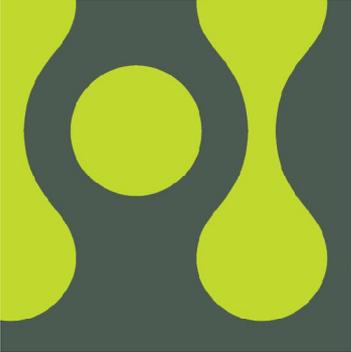
Furthermore, Hydro Tasmania rejects the Panel's analysis of market power as incorrect and unsupported by substantive evidence. Your options, particularly options 2 & 3, are a disproportionately material response to the current state of the operation of the electricity market in Tasmania. I am particularly concerned that the options proposed have not been fully evaluated, are unjustified, are costly in terms of implementation and value destruction and have an unacceptably high level of risk. We have elaborated on these points in our submission and I would welcome the opportunity to talk to you as there is much in the Panel's report that is good but the focus on wholesale market place is unwarranted and unsubstantiated.

I look forward to speaking with you when you have had a chance to digest these comments.

Yours sincerely



Roy Adair
Chief Executive Officer



Submission in response to the Electricity
Supply Industry Expert Panel Draft Report

Date: 17 February 2012

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Executive Summary

Hydro Tasmania welcomes a number of the Panel's findings in its Draft Report, in particular that Basslink has proven to be an efficient and cost effective means of providing security of supply during times of drought, as well as being profitable in operation. Also, the Panel concluded that there is no cross subsidisation of major industrial customers by any other customer group, and that the increase in electricity prices to customers over the last seven years is not due to competitive wholesale market prices.

These findings underpin two key elements of Tasmania's energy reform agenda of the last decade: the choice of interconnection to the National Electricity Market (NEM) as an efficient mitigant of hydrological risk to security of supply, and provision of electricity at nationally competitive prices. In addition, interconnection to the NEM has improved the quantum and certainty of returns from the State's equity in Hydro Tasmania, and positioned the State to leverage upon a fundamental competitive position as Australia's largest clean energy producer.

Hydro Tasmania also appreciates the recognition by the Panel of the soundness of its management processes, financial structure and focus on optimising debt. The acknowledgement by the Panel's Chairman at a public hearing in February of the soundness of Hydro Tasmania's strategy for a commercial business is noted. However, it is disappointing that the Panel has been unable to acknowledge that this is an entirely appropriate strategy for a government business that has been charged with competing effectively in a national market. The sound performance and positive outlook for Hydro Tasmania as creators of value for the shareholders, the people of Tasmania need to be understood in considering any structural adjustments to the Tasmanian Electricity Supply Industry.

It is perhaps because of the Draft Report's limited focus on historical performance (inexplicably excluding the latest 2010-11 financial year) and not on the business direction and returns projected in the current Corporate Plan that the Panel may have failed to appreciate the significant and growing value contributed to the State by Hydro Tasmania's integrated electricity business. This integrated business model comprises both the hydropower and wind generation assets and resources, and the critical access to customers through the Momentum retail business that both provides essential risk mitigation in an increasingly consolidated and vertically integrated market, and the opportunity to optimise Hydro Tasmania's unique low-carbon emission advantage.

The Panel's characterisation of certain activities outside hydropower generation as "non-core" conveys a fundamental misunderstanding of the business model and the commercial management of risk. In restricting its consideration too narrowly to a solely Tasmanian focus the Panel appears to have failed to appreciate the fundamentals of a risk management strategy that has reduced Tasmania's supply vulnerability (including through the development of wind generation), increased the quantum and certainty of dividends from a state-owned business, and positioned Tasmania to achieve the optimum return from generations of investment in renewable energy generation. The Panel has failed to understand the integrated nature of Hydro Tasmania's business. Furthermore it has

suggested in its Report that these areas, wrongly classified as non-core, have been poorly managed. The reverse is in fact the case with a handsome profit being made on the wind business, a vibrant and profitable retail business, and a consulting business that draws optimally on the unique skill base of Hydro Tasmania to leverage a world-wide position and operate profitably.

Hydro Tasmania emphatically rejects the Panel's analysis of market power as incorrect, incomplete and unsupported by substantive evidence. Hydro Tasmania also finds unsound and unnecessary the costly, risky and complex options proposed for wholesale market reform.

In focusing on wholesale market reform as an essential prerequisite for the introduction of Full Retail Contestability (FRC), the Panel has merely relied upon perceptions, and unsubstantiated claims that place the cart of wholesale market reform before the horse of competitive retail outcomes for consumers.

The Panel has relied on unsubstantiated commentary by industry participants as well as relying on the modelling of theoretical market outcomes to propose an unwarranted proposition of major wholesale market reform. This ignores the established history of an efficient wholesale market in Tasmania, and relies upon a theoretical concept of "latent market power" that is at odds with established regulatory understanding.

In fact, the only prerequisite for making Tasmania as attractive as possible for new retail entrants is simply the lifting of regulatory constraint to allow access to customers by NEM retailers on a meaningful scale – i.e. Full Retail Contestability. Hydro Tasmania has the capacity, the incentive and the track record to supply appropriate certainty of supply volume and price, through the ability to hedge spot market exposure in the contract market.

Consequently, any reforms should seek to: maximise the likelihood of competitive price outcomes for consumers; preserve the value of the state-owned electricity businesses; and achieve these two objectives at the lowest cost and risk to the shareholders, the people of Tasmania.

Against these objectives and in the absence of any proven wholesale market issue, the Panel's options are unnecessary, costly and complex, and risk significant destruction of value with no certainty of outcome.

A more measured and commercially pragmatic approach is required in terms of introducing any change to the structure of the Tasmanian electricity supply industry. The benefits of any change need to be carefully valued and should be of sufficient size to warrant the nature of the change proposed.

Structure of Hydro Tasmania's Response

Hydro Tasmania's submission focuses on the major issues with the Panel's Draft Report. In many respects Hydro Tasmania supports the Panel's research and analysis and Hydro Tasmania commends the Panel on its rigorous examination of the Past, particularly in dispelling a number of myths about performance of Hydro Tasmania's business and the Electricity Supply Industry in Tasmania.

Hydro Tasmania does not believe that the Panel's analysis of the Present and Future is an appropriate account of where the businesses are now or where they are going. The Panel's conclusions concerning the present are founded on misunderstandings or incomplete analysis. There has been no assessment of the value contributed by the SOEBs, or the impact on that value of the proposed market reform options.

In providing our commentary we have structured our response as follows:

1. Panel's Draft Report and key conclusions
2. Business performance
3. Competition Analysis
4. Panel's Reform Paths
5. A practical and commercially realistic approach to reform

1. Panel's Draft Report and Key Conclusions

The Panel's Draft Report is structured into three sections: The Past, The Present and the Future of the Tasmanian Electricity Industry.

1.1 The Past

Hydro Tasmania wishes to recognise the significant amount of research and analysis that the Panel has undertaken of 'the past history of decision making and investment in the Tasmanian Electricity Industry'. This is a complex topic that has suffered from significant contention over past years. The Panel's work has been particularly important in dispelling a number of myths about the performance of the businesses and the Electricity Supply Industry in Tasmania.

Hydro Tasmania welcomes the following key findings.

- Basslink has been an efficient and cost effective solution in helping to secure the State's energy supply during times of drought. Basslink has enabled Tasmanian demand for

electricity to be met at a materially lower wholesale energy cost than would have been the case under alternative scenarios.

- Tasmanian non-contestable customers are not paying for Basslink through their electricity prices.
- There is no evidence of cross-subsidisation of MI customers by non-contestable customers or any other electricity users. Further, there is no evidence to suggest that, in contemporary commercial negotiations, Hydro Tasmania accepted lower prices from MI customers in return for whole-of-state benefits.
- The technical performance of Hydro Tasmania's generating plant currently meets the requirements of its participation in the NEM, particularly from a risk management perspective (being able to physically back its market positions).
- Wholesale market pricing is consistent with efficient market outcomes.
- There is no evidence of sustained market power in wholesale spot or contract pricing.
- Hydro Tasmania has had an internal efficiency focus since NEM entry, illustrated by its management of cash through the drought, where it incurred very significant additional costs to source supply from gas fired generation and from the NEM. Hydro Tasmania maintained a sustained focus on reducing operating costs, with three efficiency programs implemented over the past eight years. Reflecting the efficiency measures over the last three years, Hydro Tasmania has repaid \$69 million in debt and funded the Momentum acquisition of \$52 million from internally generated funds.

The historical findings reflect the factual evidence that the Tasmanian generation sector is working and that there has been no problem to date.

1.2 The Present and the Future

Hydro Tasmania has significant concerns with the Panel's analysis of the "Present" and the "Future". This is where the analysis moves from factual evidence into theoretical speculation.

- The Panel refers to Entura, Momentum and investment in wind generation as being business diversification activities. Hydro Tasmania disagrees. All activities undertaken by the Hydro Tasmania group are critical and integral to the current and continued success of the business and are focused on delivering the greatest value to all Tasmanians. Each activity exploits the brand advantage of Tasmania in terms of its clean energy and world class renewable expertise.
- Any assessment of sustainability is, by its very nature, an assessment of the current and future position, not simply an historical survey. The Panel ignores the current and most recent financial information (including the 2010-11 financial year) and current Corporate Plan when assessing financial sustainability. The Draft Report cannot fulfil its mandate as a review of the sustainability of the SOEBs, if it does not incorporate the most up to date information available. Hydro Tasmania's 2010-11 annual accounts were available in August 2011, well before the publication of the Draft Report on 15 December 2011. The Draft Report's silence on Hydro Tasmania's business strategy and plan is at odds with the

acknowledgement of its Chairman, John Pierce, at the 2 February 2012 Public Hearing, that Hydro Tasmania's business strategy is sound.

- Hydro Tasmania rejects the Panel's analysis of market power. The Panel bases its analysis on theoretical modelling, which is assumption dependent; offers no empirical evidence to support its proposition; and introduces concepts that have no technical meaning in competition analysis. The Panel's analysis is also inconsistent with the AEMC's recent market power analysis.¹
- There are no barriers to entry / expansion in Tasmania at the generation or retail level. History shows that if profitable opportunities are there, then new investment will occur in response. The issue for potential new entrant retailers is simply that Tasmania is not attractive while a significant part of the customer base remains non-contestable.

1.3 Panel's Key Conclusions

The Panel has identified four elements of the Tasmanian Electricity Supply Industry that it believes are not consistent with the Government's primary objectives of "minimising the impact of the cost of living in Tasmania and ensuring Tasmania's long term energy sustainability and security" (paragraph 7 of the Panel's terms of reference):

1. the methodology used for determining the wholesale energy allowance for non-contestable customers is resulting in non-contestable customers paying prices higher than they ought;
2. the Tamar Valley Power Station (TVPS) is financially unsustainable in that current wholesale market prices are insufficient to cover its fixed costs and this will become even more stark if the wholesale energy allowance for non-contestable customers is reduced or FRC is introduced;
3. the market structure gives Hydro Tasmania market power which in turn shields Aurora from competition by deterring other retailers from entering Tasmania; and
4. effective retail competition and customer choice have not developed as anticipated due to the perception that there is a high level of risk in Tasmania compared to the rest of the NEM (as a consequence of element 3 above), precluding the introduction of full retail contestability (FRC).

The first two elements are a function of nothing more than the current low wholesale market prices due to oversupply (excess generation capacity) in Tasmania and across the NEM, and the likelihood that this oversupply will continue in Tasmania for at least another decade. These problems can be readily addressed by discrete measures.

- The Panel has proposed that the wholesale energy component of the Tasmanian regulated retail price be adjusted to better reflect current market prices. The Panel believes this could reduce prices for non-contestable customers by 5-10%.
- A downwards adjustment in the wholesale energy component of the Tasmanian regulated retail price would precipitate the need to address the viability of TVPS as a stand-alone base load generator. The Panel has proposed that TVPS be re-valued and re-capitalised to reduce its cost base and put it on a commercially sustainable

¹ AEMC Directions Paper, National Electricity Amendment (Potential Generator Market Power in the NEM) Rule 2011

footing as a stand-alone base load generator. It suggests this be done by the transfer of debt back to the Government – and possibly also some supplementary Government funding being provided to support TVPS.

Essentially, as highlighted by the Panel, both involve the Government taking on some cost (directly or indirectly).

On the other hand, the third and fourth elements introduce major issues of risk for the commercial viability of Tasmanian electricity generation and in particular Hydro Tasmania.

What the Panel is acknowledging in the first two elements above is that persistent oversupply means wholesale market prices are materially below the level needed to provide a return on efficient new plant and are likely to stay that way for a long time. Ordinarily, a market with such an outlook would not be seen as having a supply side market power problem. That is the fundamental point about market cycles as recognised in competition law (the so-called “waxing and waning” of market power). When the supply demand balance becomes tight, suppliers temporarily gain market power and prices rise, on the other hand prices fall when there is excess supply and buyers temporarily gain market power – but these temporary situations will correct themselves. The real issue is whether there is anything that stops these cycles playing out their natural course over time giving either suppliers or buyers market power that is more than temporary and will not “wax and wane”.

Hydro Tasmania does not agree with the Panel’s analysis of market power, which fails to address the question of how there can be supply side market power when prices are depressed due to persistent oversupply. The analysis is inconsistent with competition law, incomplete and not supported by any substantive evidence. Further the analysis and conclusions undertaken by the Panel and Frontier Economics are inconsistent with the analysis being undertaken by the AEMC in the Potential Generator Market Power in the NEM Rule Change proposal put forward by the MEU which is currently being considered by the AEMC (MEU generator market power rule change). The analysis is also inconsistent with the work undertaken by Frontier Economics in respect of that rule change.

2. Business Performance

2.1 Exclusion of 2010-11 Results and Corporate Plan

Hydro Tasmania is not in any position to express an opinion concerning the sustainability of other SOEBs, but it would like to emphasise that Hydro Tasmania is a successful business, with a sustainable business model. As the Panel itself observes in its Draft Report and in the supporting Volume to the Draft Report entitled *A Review of the Efficiency and Effectiveness of the State-Owned Energy Businesses*, Hydro Tasmania has appropriate processes for managing its capital expenditure, is optimising its debt levels and financial structure; and has levels of operational expenditure that are geared to positioning Hydro Tasmania as a highly competitive participant in the National Electricity Market.

Hydro Tasmania's current Corporate Plan shows increasing profits over the planning period, as the business sheds the burden of a period of unprecedented low inflows and brings the revenue streams associated with major industrial customers up to market rates. The State of Tasmania will enjoy unprecedented revenue from Hydro Tasmania in the current financial year and will continue to see this maintained and improved over the corporate planning horizon. Hydro Tasmania would urge the Panel to provide the assurance that the public is seeking as to the sustainability of this key component of the State's asset base, the continuation of the now acceptable returns to the State and that Hydro Tasmania is well placed to deal with future challenges that may emerge.

To this end, Hydro Tasmania feels that the Panel's observations on business performance matters are deficient in a number of respects.

The Panel ignores the SOEBs' 2010-11 financial and performance results, citing "that at the time of writing, complete actual 2011 data was not available and therefore not included". This is a peculiar observation. Hydro Tasmania's accounts were signed off in August 2011 by directors and the auditors. Hydro Tasmania also provided the Panel with the appropriate data to update tables and key findings in the Panel's supporting Volume to the Draft Report entitled *A Review of the Financial Position of the State Owned Electricity Businesses*, the Panel chose not to include these in that supporting volume.

Hydro Tasmania's current Corporate Plan estimates and forecasts were also ignored. Consequently, the Panel's financial analysis was 18 months out of date when published.

As a review of the sustainability of the SOEBs, it seems to us improbable that the Draft Report fulfils its mandate if it does not incorporate the most up to date information available.

2.2 Non-core Activities - Diversifications

The Panel focuses throughout the Draft Report on "traditional core business". Traditional core business is never explicitly defined, but the Panel appears to be using the term, with respect to Hydro Tasmania, to refer to both:

- “the delivery of core, on-island services to Tasmanians” (p282); and
- “the functional business activity.... of hydro generation” (p99).

Hydro Tasmania’s reading of the Draft Report, therefore, is that the Panel considers Momentum, Entura and wind investments as non-core or business diversifications. The Panel questions whether SOEBs should be pursuing growth opportunities in national and international markets or whether they should be focused on the delivery of core, on-island services to Tasmanians.

Hydro Tasmania disagrees strongly with this proposition and is firmly of the view that all activities undertaken by the business are, in varying degrees, critical to the current and continued success of the business. We are in the National Electricity Market and have to operate as such. Operating across Basslink brings risks and exposures which our business strategy properly addresses.

Hydro Tasmania’s view is that its operations outside hydro generation and outside Tasmania are core to its business and do not result in additional overall risk. Hydro Tasmania is exposed to the following risks in hydro generation in Tasmania, which are largely uncontrollable:

- exposure to the international business environment of Tasmania’s large industrial customers;
- market dynamics of the Tasmanian region – if Hydro Tasmania only operated in Tasmania it would be exposed to significant market concentration risk including customer credit risk; and
- hydrology which can be partly managed through fuel source diversification such as wind generation.

The connection of Basslink was Hydro Tasmania’s first major commitment outside Tasmania. As the Panel describes in its paper on the topic, Basslink was used extensively as a source of supply during the drought period, reducing hydrological risk, and it gives Hydro Tasmania access to the Victorian region, providing Hydro Tasmania an alternative market into which to sell its energy and reducing market concentration risk faced by Hydro Tasmania. Hydro Tasmania assumes that the Panel does not consider Basslink itself a diversification, although this is not directly stated.

2.2.1 Momentum

Momentum is integral to Hydro Tasmania’s energy trading activities in the NEM using Basslink and is the critical element in managing Hydro Tasmania’s risk exposure. Momentum provides a direct channel to customers whereby Hydro Tasmania can diversify its sales risk, as it now can derive revenue from selling directly to retail customers and is no longer reliant solely on the wholesale market for revenue. This is important in an environment of increasing vertical integration in the NEM, whereby vertically integrated competitors are able to shift profit margins between the wholesale and retail market segments of the market. The NEM is dominated by three vertically integrated participants: AGL, Origin, and TRUenergy. Vertical integration is a long accepted characteristic of well managed utilities operating in liberalised electricity markets.

As the Draft Report observes, Momentum represents a means by which Hydro Tasmania takes to market that portion of its production which cannot be sold in Tasmania, and the retail presence is required to manage the risks associated with exposure to wholesale price risk.

However, Momentum also delivers value to Hydro Tasmania in excess of this benefit through providing:

- **a diversified source of revenue** unrelated to the Tasmanian region of the NEM which reduces exposure to Tasmanian downside risks, thereby decreasing future earnings volatility and increasing returns paid to the State of Tasmania through higher dividends and tax equivalents payments;
- **improved trading flexibility** to manage the business' energy portfolio position which provides access to opportunity to enhance trading revenue;
- **access to green margins** on environmental energy products generated through wind and above baseline hydro generation increasing the returns provided by Hydro Tasmania's wind and hydro investments;
- **opportunity to leverage Hydro Tasmania's low carbon competitive advantage** which can be used to attract and retain new customers resulting in greater sales; and
- **Access to the mainland electricity market** which has grown over the last 10 years, on average, by three to five times the growth level experienced in Tasmania.

Momentum is operated as a stand-alone profitable business with wholesale transfer pricing arrangements with Hydro Tasmania entered into at 'arms length' market rates. Momentum's performance has surpassed expectations since its acquisition by Hydro Tasmania, and repeated reference to initial start-up losses provides no indication of the current sustainability of the business. Momentum is on target to return an EBIT of approximately \$8M in the current financial year and to at least double annual profits by the end of Hydro Tasmania's current Corporate Plan. Momentum has increased its customer base, in electricity volume terms, by an order of magnitude over the last four years. The retail business has been able to achieve this outstanding level of organic growth by concentrating on the fundamentals of successful management of retail electricity businesses.

2.2.2 Entura

The Panel's definition of "traditional core business" suggests that Hydro Tasmania's consulting business, Entura, may not be included within that definition, particularly Entura's activity outside Tasmania.

Upon disaggregation, Hydro Tasmania acquired responsibility for the consulting business of the former fully integrated entity. The *Hydro Electric Corporation Act 1995* stipulates that Hydro Tasmania has the power to provide consultancy services in respect of electricity, environmental science, engineering or any other area of expertise in which the Corporation considers it has competence. This is the business undertaken by Entura. This business is run on a stand-alone competitive basis in accordance with the commercial principles of any professional consultancy.

Entura is a significant employer providing employment to over 300 highly qualified professionals. It is a great Tasmanian "export", enabling Hydro Tasmania to leverage off its world-renowned hydro power, wind development and water resource management

capabilities at a time when the world is looking to clean-tech solutions for both energy and water resources. Entura also ensures that Hydro Tasmania retains access to a highly qualified and skilled workforce that can assist in the maintenance and upgrade of its existing Tasmanian renewable energy asset base. This is particularly significant at this time when the mining boom is causing many skilled energy professionals to exit the industry in favour of higher paid mining jobs.

Entura plays a strong part in Hydro Tasmania's integrated market strategy. Entura provides access to the necessary skills and experience required to develop wind farms which provide energy and environmental products to back Momentum's mainland sales, and assists in developing integrated energy solutions for Momentum's customers.

In response to the downturn in consulting activity experienced during the global financial crisis, Entura implemented a new market strategy that is focused on diversifying its customer base through targeting increased Australian and international sales and reducing materially its former reliance on services provided to Hydro Tasmania. This strategy is achieving early success and has seen a significant improvement in Entura's recent financial performance. The corporate governance arrangement, which has recently been overhauled by Hydro Tasmania, ensures that the business is tightly run on commercial principles and on a stand-alone basis that avoids it being a potential distraction to the operation of the main electricity business.

Since disaggregation, Entura has demonstrated its ability to generate modest average profits over the consulting business cycle and has no material impact on Hydro Tasmania's risk profile. Entura is a prime example of Hydro Tasmania successfully leveraging off its international brand value.

2.2.3 Wind

Hydro Tasmania's Ministerial Charter sets out the core functions and principal objectives of Hydro Tasmania. Specifically in relation to wind, the Ministerial Charter states that "The Minister expects that Hydro Tasmania will also undertake the following functions: activities associated with generation of electricity – particularly in water management, development of wind resources, and environmental services."

In addition, the Ministerial Charter sets out high level strategic directions for Hydro Tasmania to: "further develop its strong reputation in the use of renewable energy resources; and prudently and responsibly grow those areas related to, or arising from, Hydro Tasmania's principal purposes which will enhance its position locally, nationally and internationally where such growth will add value to both Hydro Tasmania and the State of Tasmania."

Fundamentally, Hydro Tasmania's involvement in wind farms is consistent with its Ministerial Charter. In addition, as the Draft Report points out, the level of hydrological risk and energy supply security risk has been reduced significantly by the Studland Bay and Bluff Point wind farms as well as Basslink and TVPS.

Hydro Tasmania's involvement in wind farms is an integral component of the business' integrated market strategy. It provides long-term access to competitively priced environmental and energy products to back retail obligations arising under Momentum's mainland sales, which reduces exposure to market price risk. Further, involvement in wind farms enhances Hydro Tasmania's and the State's renewable energy brand and provides the

opportunity to leverage Entura’s significant wind expertise securing additional job opportunities for Tasmanians.

Hydro Tasmania has innovatively created a wind development model that minimises its own capital requirements and produces very healthy profits for the business, as the recent sale of the 75% stake in the Woolnorth Wind Farm demonstrated handsomely.

2.2.4 Conclusion

Hydro Tasmania strongly disagrees with the Panel’s views on diversification and believes those views are misplaced. Hydro Tasmania’s operations beyond hydro generation in Tasmania:

- are integral and core to its business and are critical to the current and continued success of the business;
- do not result in material additional overall risk and in fact reduce/manage the overall portfolio risk; and
- are all profitable which the Panel failed to highlight.

Mainland diversification is a way to simultaneously achieve lower electricity prices for Tasmanian consumers while preserving returns to Government. Mainland investment means that the Tasmanian Government can earn a return on its investment, funded by means other than revenue derived from Tasmanian consumers and businesses. The only other way to maintain returns while decreasing electricity prices is through efficiency gains which the Panel acknowledges Hydro Tasmania has comprehensively addressed and continues to refine further. It is unfortunate, however, that the Panel is focused on this efficiency without considering the similar benefits of mainland expansion.

2.3 Governance

As Hydro Tasmania is a market facing business, unlike regulated entities (Aurora and Transend), its revenue is derived from the market, and is not related to its cost structure. Hydro Tasmania sells electricity at competitive prices, manages its exposure to merchant risk and manages its costs down to the minimum sustainable level. The Board and management of Hydro Tasmania are focused on running a commercial, competitive business with the highest standards of corporate governance.

Hydro Tasmania operates to maximise the return of dividends to the Tasmanian people over time. It does this by delivering dividends for the State Budget in the current year, while also delivering projects that will maintain and enhance the stream of dividends in the long term.

Hydro Tasmania agrees with the Panel that the current governance framework is in line with best practice and is operating effectively. This is demonstrated recently by the positive process for disaggregation of the Roaring 40s JV, the partial divestment of Woolnorth Wind Farm and the Musselroe business case.

Hydro Tasmania notes that the Government has undertaken significant reform of the governance arrangements for Government businesses over the past years. This has included the introduction of a new process for the selection of directors for Government businesses

which has aimed to broaden the talent base and obtaining the right mix of skills and experience. This was primarily aimed at selecting the appropriately qualified directors, setting appropriate performance targets for these businesses (including debt levels, returns and ensuring performance to corporate plans) and allowing these directors to run the businesses. Having appropriately skilled boards for its Government businesses allows the Government to hold these Boards accountable and not be involved in operational decisions.

Hydro Tasmania is broadly supportive of the Governance framework position put by the Panel. However, the chapter strays beyond a framework to include a discussion on diversification. It is this issue with which Hydro Tasmania has significant concerns.

2.3.1 Ownership Policy

The Panel in its Draft Report questions the Government's ownership policy, asking does the Government "wish to forgo short-term returns from the SOEBs... In pursuit of potentially higher returns from commercial investments that have attendant risk" and "these are particularly important questions when considering [decisions] which are not required to maintain security of supply or to deliver lower electricity prices to Tasmanian consumers".

It needs to be recognised that the business undertaken by Hydro Tasmania, of generating and trading electricity in the NEM, is inherently risky. However, the risks of owning a merchant electricity business are exacerbated if the business is artificially constrained to only a portion of the market in which it operates (akin to competing with one hand tied behind its back).

The trade-off presented by Hydro Tasmania's commercial investments is not between currently stable returns and "riskier" returns if growth is successful. It is between lower levels of volatile returns now and potentially higher levels of less volatile returns in the future.

Further, the Draft Report itself provides no justification for the assertion that "diversification has attendant risk", as it states: "The Panel has not considered in detail the nature and extent of the risks being mitigated through each of these various diversification activities, whether the activity has been the best way of managing risk, nor whether it has resulted in an overall lower risk position." If the Panel had taken into account the value of the SOEBs based on their current performance and corporate plan projections, it would see the success and value of these businesses to the State and people of Tasmania. It is the impact on this value that the Panel needs to address when considering the impacts of its proposed reform options.

We note the recommendation that the Tasmanian Government develop a publicly available Energy Business Ownership Policy and are willing to work with the Government to achieve this. We also note that the Panel has recommended "significant input from the SOEBs is necessary and appropriate in understanding the consequences and trade-offs involved in strategic policy direction-setting" and we welcome the opportunity to discuss the benefits to the State of our strategy.

2.3.2 The Principles

A number of references are made to the Panel supporting the implementation of the Government's reform principles for the oversight and accountability of Government businesses. The Panel focuses on the benefits of these guidelines in terms of strategic

direction setting (as above) and accountability for performance. Hydro Tasmania also supports these aspects of the guidelines. However, the Panel's discussion in the paper does not support all of the contents of the guidelines: "formal contact between the Shareholders and the SOEB Boards should be kept to a broad strategic level in order to preserve management autonomy and facilitate accountability".

2.4 Competition for Capital

The Panel's Draft Report (page 283) asserts, in relation to energy investments which are not required to maintain security of supply, that "Irrespective of how these kinds of investments are funded, be it any combination of retained earnings from the business or additional debt – or, as has been observed, the direct provision of equity by the Government - the capital has an opportunity cost in terms of its ability to support General Government Sector service delivery."

Hydro Tasmania notes that the SOEBs are Government businesses and not Government departments. SOEBs should not "compete" directly for funds with Government departments. This has been one of the key outcomes of two decades of sector reform across Australia. The focus for the SOEBs should be the contribution of the SOEBs to state budget revenue in the manner that any business focuses on returns to its owners. Shareholding Ministers should specify the sustainable return they require from each business and the business can prioritise investments within available funding and consistent with strategies as agreed in the Corporate Plan.

Even assuming the opportunity cost comparison to be appropriate, the extent of the opportunity cost should not be overstated. As the Government itself has observed, debt funding should not be used for General Government Sector service delivery. However, debt funding is appropriate for an investment that is forecast to generate a commercial return, as the returns can be used to service the debt. Consequently, debt that is used to fund investments is not doing so at the expense of funds for General Government Sector service delivery.

2.5 Sustainability and Volatility

One of the six energy policy outcomes identified by the Panel to deliver its Policy Objective is an energy supply industry that is sustainable. Hydro Tasmania notes that sustainability is not clearly defined in the Panel's Draft Report, nor in its supporting documentation. At the Expert Panel Public Hearing the Panel acknowledged that there was room for improvement in this area and that this was an area for further reform.

Hydro Tasmania defines a sustainable business as one that can always cover its costs and deliver to its owners an appropriate return on their equity investment. Hydro Tasmania would welcome the Panel's views on how sustainability should be defined, but it is disappointing that there is little scope to explore this question at this late stage of the Panel's process.

3. Competition Analysis

The Panel believes that there is a market power problem in Tasmania, that structural reform is needed to deal with the problem and that this is a precondition to implementing FRC.

Hydro Tasmania does not believe that there is a market power problem.

Hydro Tasmania believes that the Panel's proposition lacks evidence, is based purely on theoretical modelling and the assertions of some market participants, relies on the creation of a new concept of "latent market power" and represents a theoretical concern about future prices, not current prices.

The Panel's work on market power is also inconsistent with the mainstream Australian work undertaken by the AEMC in its consideration of the MEU generator market power rule change.

3.1 Evidentiary Issues

In coming to its conclusions concerning market power and barriers to entry, the Panel relies on:

- evidence that retailers in Tasmania are unable to take spot market positions;
- an assumption that Hydro Tasmania may seek to pursue an uncontracted position to enable it to create and exploit spot opportunities; and
- the views of anonymous "nationally based retailers".

Each of these points is not actually supported by available evidence. Thus, if the Panel wishes to adopt an evidence based approach, Hydro Tasmania cannot see how it could conclude that wholesale arrangements represent a barrier to retail entry in Tasmania.

3.1.1 The Assertion that Retailers are unable to take a Position to Spot

In support of the Panel's spot exposure proposition, Aurora Energy makes the following claim in its submission to the Panel's Issue Paper:

"In light of Aurora's past experience, Aurora cannot risk exposure to the spot market in Tasmania. As a consequence, Aurora is forced to put in place excessive hedging when compared to interstate norms or Aurora's own approach to hedging within the other regions of the NEM. These issues have significant consequences not only for current market participants but also for potential new entrants".

Aurora's assertion is incorrect, at least, in respect of the demand side as a whole, and Hydro Tasmania has provided the Panel with analysis of its own sold Tasmanian contract position compared to Tasmanian consumption and generation, showing that retailers and other

market participants are purchasing a significant volume of energy directly from the pool without corresponding hedging cover. This factual evidence submitted under confidential cover completely refutes the point made by the Panel on retailers being unable to take spot positions.

Rather than retailers' spot positions evidencing some form of barrier to entry, the fact that it is a viable strategy for purchasers (retailers and other market participants) to purchase a proportion of their energy requirements directly from the pool without corresponding hedging arrangements, provides empirical evidence that there is no wholesale market problem to solve.

3.1.2 Hydro Tasmania's Ability to Reduce its Contract Position

The Panel notes that there is no evidence of sustained market power in wholesale contract market pricing, but states (without any evidence) that this is a result of internal restraints from Hydro Tasmania, rather than external influences.

The Panel concludes that "with a high level of contracting Hydro Tasmania's incentives to engage in strategic behaviour in the spot market by withdrawing capacity are very low". However, the Panel then concludes that, given that Hydro Tasmania has a high degree of discretion over the quantity and characteristics of contracts, it could easily reduce its contract cover to increase profitability by raising the spot price if it so wished. This latter conclusion is arrived at without any substantive evidence or analysis and the key assumption concerning discretion is wrong.

The Panel and Frontier Economics imply that Hydro Tasmania can be fully uncontracted if it chooses to be, but Hydro Tasmania's current contracting behaviour is not simply a result of restraint. Hydro Tasmania cannot commercially afford to behave in the manner in which Frontier Economics and the Panel suggest it could choose to do and Hydro Tasmania would be irrational or "foolish" to behave in the manner posited.

There are low barriers to entry for new generators in Tasmania, if profitable opportunities for entry are present. Normal NEM dynamics apply. If pool prices are low retailers may want to take spot exposure and generators could theoretically reduce their contract position but this is precisely when generators need to be contracted (to insulate them from the low pool prices). On the other hand, when pool prices are high, there is strong demand for contracts and, if this is not met by incumbent generators, there will be a profitable opportunity for new entry. Any attempt by Hydro Tasmania to reduce its contract position, leaving unmet demand for contracts, will create such an opportunity. New entrants will enter (potentially facilitated by contractual arrangements that insulate them from risks of low pool prices post entry) and the resulting excess supply will push prices down. Thus, any attempt by Hydro Tasmania to reduce its contract position will result in Hydro Tasmania feeling the pain of a market response.

The nature of commercial constraints on Hydro Tasmania means that regardless of size it does not have market power.

As a hydro-electric generator, Hydro Tasmania has high fixed costs, limited output capability (in terms of energy generated) and limited discretion as to the use of its water resource (only one quarter, approximately, of Hydro Tasmania's annual inflows are into large storages, the rest must be used promptly to avoid spill and consequential loss of revenue). Even a relatively limited quantity of peaking generation (e.g. OCGT) represents a significant threat of over-supply. Further, Hydro Tasmania is excluded from retailing electricity in

Tasmania, and so is vulnerable to retailers using their own generation reducing demand for Hydro Tasmania’s output.

In drawing its conclusions, based purely on modelling and not on any evidence or analysis, the Panel acknowledges that it held constant the operation of Basslink, the TVPS and the demand side response in light of high spot prices. This ignores actual historical evidence and makes the modelling outcomes entirely unreliable. It also results in the Panel seeking to justify recommendations concerning dynamic efficiency by relying on a model that is incapable of reflecting dynamic responses.

It is wrong for the Panel to assume that Hydro Tasmania’s highly contracted position is the only competitive constraint on its incentives. The true position is far more complex. For example, in addition to Hydro Tasmania’s highly contracted position (both short and long-term contracts), the following are a number of immediate competitive constraints on Hydro Tasmania that apply at all times:

- significant demand side responses (>150MW) in short run dispatch (including by major industrial customers whose contract structure provides a financial incentive to do so);
- Hydro Tasmania’s obligations with respect to prudent water management;
- co-optimisation of energy and FCAS and the significant inefficient water use arising from non-optimal FCAS dispatch;
- the likelihood that persistent high spot prices will encourage new generation to be built;
- the likelihood that any trend to a perceived risk of high prices will result in more customers contracting and Hydro Tasmania continuing to have a highly contracted position (It is important to note here that, because Hydro Tasmania’s contract prices reflect Victorian contract prices and not current or future Tasmanian spot prices, this constraint operates independently of any spot strategies. The Panel specifically notes that there is no evidence of sustained market power in contract pricing².);
- the need to manage hydrological risk and the inflexibility of a considerable proportion of Hydro Tasmania’s hydro generation capacity – small storages and run-of-river stations;
- the behaviour in spot dispatch of Victorian generators and other Tasmanian generators;
- the delivery risk associated with being able to back a contract, including the risks associated with the availability and dispatch of Basslink; and
- the need to secure sustainable future revenues through longer term contracts.

3.1.3 Evidence of Nationally Based Retailers

The Panel relies on the unattributed and unsubstantiated assertions of “nationally based retailers” and the allegation that retailers in Tasmania are compelled to avoid exposure to spot prices.

² At page 140 of the Draft Report. In comparison, the Panel’s language at page 173 is less emphatic (“...no clear basis for concluding...”). Hydro Tasmania cautions against the use of inconsistent language, as this can lead to misinterpretation.

The Panel's reliance on the assertions of unidentified retailers is in direct contradiction of the evidence of the new entrant retailer currently active, and successful in the Tasmania contestable customer sector, ERM. The Panel has received an emphatic submission from ERM indicating that:

"ERM has not seen the structure of the Tasmanian market as a barrier to entry for retailers."

"ERM remains confident that derivative pricing provided by Hydro Tasmania enables us to compete on a level playing field."

The Panel's citation of "nationally based retailers" is also at odds with Hydro Tasmania's own commercial discussions with such retailers. These retailers generally state that they have little interest in establishing Tasmanian operations at current levels of contestability, but would be interested after FRC with the range of wholesale products offered by Hydro Tasmania.

This brings us to the suggestion by the Panel that its approach is based on confidential evidence (possibly from discussions) from "nationally based retailers". Hydro Tasmania does not know what lies behind this attribution, which makes it very difficult on which to comment. It seems unlikely that the conclusion can be based on the position of AGL, Origin, TRU or Alinta given their public views on the issue of generator market power in the NEM.

For example, looking at the NEM Private Generators' response to the AEMC Directions Paper (to which AGL, Origin, TRU, Alinta and LYMMCo were a party), all have taken the position that bidding "strategically" (i.e. above SRMC) is just part of the market at work. It is hard to see how they can argue that this is just the market at work in relation to some parts of the NEM while at the same time being a signal of punishment strategies sufficient to create a strategic barrier to entry in another part of the NEM.

These nationally based retailers also *"caution against the use of forward looking analysis (the outputs of which are inherently imprecise and uncertain) as the basis of regulatory intervention"* (which pretty much describes the Frontier Economics work and what the Panel has done with it). It's hard to see why that concern should apply to some parts of the NEM only and not the Tasmanian region. This would seem to imply that it is acceptable to use inherently imprecise and uncertain outputs as the basis for regulatory intervention in Tasmania but not other regions.

Finally, these retailers warn about *"the desire to alter the market's dynamic to minimise risk exposure for a specific category of participants"*, which would appear to be exactly what the Panel wants to do.

TRU, in its additional solo response to the AEMC's Directions Paper in relation to the MEU generator market power rule change, goes further and says (as a retailer) that regulatory intervention to address generator market power undermines legitimate hedging strategies it has invested time and resources into developing, including demand side responses.

This is consistent with the evidence of all market participants in the AGL case as to the fundamental role of risk management in the NEM, essentially being how firms in the NEM compete.

In other words, there has been a clear message from these market participants in the NEM matters outside Tasmania that high spot prices and volatile spot prices are not a deterrent. They are, in fact, a normal part of market dynamics – indeed, how one manages these risks is

how firms compete. Thus, removing these risks stifles innovation and actually impedes competition. It might bring in more players, but it will result in a less competitive market. That message is critical to their interests. It's hard to see how these market participants can continue to maintain that message outside Tasmania if they back the Panel's analysis.

3.2 The AEMC Market Power Test

The AEMC has, in the last 12 months, undertaken a substantial assessment of market power in response to a rule change proposal from Major Energy Users, Inc. This assessment drew submissions from a broad range of market participants and reflects best current practice.

The AEMC test (set out in the September 2011 Directions Paper in respect of the MEU generator market power rule change) defines “**substantial market power**” in the context of the NEM to mean the ability of a generator (a) to increase “price” above a defined measure of cost and (b) to sustain prices at that level for at least a defined period of time, (c) due to the presence of significant barriers to entry / expansion (which can be structural or strategic).

In applying (a) and (b) of this test, the AEMC has proposed that:

- “price” means the annual average wholesale price and that must include consideration of both spot and contract (because the initial price increase might be seen in just one of these but eventually it will have to be reflected in both to make the price increase ‘stick’ for long enough to meet the substance of what the test is trying to capture);
- the relevant measure of cost is LRMC; and
- the high prices have to be sustained for at least 2-3 years (because the test is looking for a response that should happen within this timeframe but does not happen i.e. high prices at such a level that they should ordinarily have triggered new investment, but even though it would be profitable, this new investment has not occurred).

In line with the case law, the AEMC test recognises that the crucial element of the test is (c), namely the presence of barriers to entry / expansion (because in the absence of such barriers, the threat of new entry or expansion would be expected to prevent sustained high prices ‘sticking’ for too long. i.e. there can only be temporary market power which is not a matter for concern).

Thus, even if a generator had a theoretical ability to increase prices for a sustained period absent a market response, the generator would know that it is unlikely to get away with doing so because it cannot reliably count on there being no market response.

The AEMC test accords with the case law and the NEO³ and (with one point of exception) is in line with the position argued by the NEM Generators (which includes AGL, Origin and TRUenergy) and a paper prepared by Frontier Economics for the National Generators Forum.

³ The NEO is the National Electricity Objective which is to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to 1) price, quality, safety, reliability, and security of supply of electricity; and 2) the reliability, safety and security of the national electricity system

3.2.1 The Panel's Test

The Panel's definition of "**sustained market power**" broadly corresponds with the AEMC test of "substantial market power". The Panel describes "sustained market power" as the ability to drive prices higher than economic costs for a sustained period, the Panel making it clear that this can only be possible when there are barriers to entry.

The Panel notes that the current average wholesale spot price in Tasmania is around \$30/MWh. This is insufficient to cover the total (variable and fixed) costs of the lowest cost form of generation in the NEM.

Ordinarily, conditions of persistent oversupply (where market prices are below the level needed to provide a return on efficient new plant) would not be seen as compatible with the existence of a supply side market power problem.

This is why the Panel refers to Hydro Tasmania having "latent" market power. However, this term has no technical meaning in competition analysis. "Latent" just means that the Panel has not been able to point to observable price outcomes that indicate evidence of market power. The following statements corroborate this.

"... there is no evidence that Hydro Tasmania exercised sustained market power in the spot market during this period." (page 172)

"... there is no clear basis for concluding that these average contract prices indicate that Hydro Tasmania has exercised sustained market power across its overall contract book." (page 173)

However, when it comes to applying this test to Hydro Tasmania, the Panel introduces a new concept of "**latent market power**" (which it describes as sustained market power that has not been exercised) and this is where the Panel seriously departs from the AEMC's approach and the case law.

To be explicit about what it means to say that Hydro Tasmania has "latent market power": It is an assertion that Hydro Tasmania could, if it wanted to, raise Tasmanian prices to a level that would make investment in new generation profitable and then keep prices there, for longer than it would take new investment to come in, without any dynamic response from the market to bring prices back down. As this assertion is crucial to the Panel's findings and recommendations, any departure from the AEMC's approach and the case law must be cause for concern.

Basically the Panel's approach to why it believes Hydro Tasmania has "latent market power" differs from the AEMC's approach and the case law in two critical respects (which the Panel needs to address given the enormity of the consequences that flow from the Panel's approach). These two critical points of difference relate to –

- a) assumptions about barriers to entry / expansion; and
- b) the need for evidence of the actual or likely exercise of market power.

3.2.2 Assumptions about Barriers to Entry / Expansion

The AEMC test makes it clear that the essence of the test is a market response that should happen but cannot happen because some barrier to entry / expansion is blocking or delaying this response. Courts (especially the Australian High Court) have warned against the error of reasoning backwards and inferring that such barriers exist based on observation of high prices or conduct that looks similar to what one might predict of a firm with market power.

This point was picked up by the Private Generators in their response to the AEMC Directions Paper. The Private Generators take the position that barriers to entry / expansion must be identified as a pre-condition to any market power analysis and argue that the history of the NEM undermines any suggestion that such barriers exist, because whenever price signals show new investment will be profitable, new investment has occurred (a point made in the AGL case). The history of the Tasmanian region is consistent with this.

It is important to understand that lack of new investment when prices are low (i.e. too low to justify new investment) is not, under any test used anywhere around the world, regarded as indicative of barriers to entry / expansion. Normally, that goes without saying but it is a point that seems to have been missed or ignored by the Panel.

The Panel does not undertake any analysis of barriers to entry (and certainly not as a pre-condition to any assessment of “latent market power”). Basically, the Panel’s case rests on modelling by Frontier Economics which shows Hydro Tasmania having a theoretical ability to increase prices all else being equal (i.e. if nothing else changes and assuming no dynamic responses). This modelling, described by Frontier Economics as the “Latent Case” modelling, purports to establish a reference point from which to assess “latent market power” on the part of Hydro Tasmania.

The “Latent Case” modelling is circular, as was demonstrated in *AGL v ACCC (No 3) [2003] FCA 1525* (the “AGL case”). All such modelling shows is that **if** barriers to entry were sufficiently high then market power would exist – but that proposition is axiomatic and it does not address the question of whether such barriers exist.

In the AGL case, the ACCC presented modelling which showed that, in the absence of new entry / expansion, Victorian generators could raise the average spot price in Victoria and thus also raise Victorian contract prices (as contract prices were linked to spot prices). Thus, the modelling showed the Loy Yang Power Station (LYP) possessed the type of “latent market power” Frontier Economics’ modelling attributes to Hydro Tasmania. Specifically, the modelling presented “evidence” that, all else being equal, if LYP reduced its contract level by 140MW, it could profitably raise the average Victorian spot price by 20%. (Similarly, the Frontier Economics “Latent Case” shows how far Hydro Tasmania could raise the Tasmanian spot price, all else being equal, if it reduced its contract position to zero.)

However, outcomes based on “all else being equal” have no relevance in the real world because, as explained in section 3.1.2 above, this assumes away dynamic real world responses. This is the point AGL made to the court in the AGL case and the court agreed. The court made it clear that the point is not what LYP could do to prices assuming there is no market response, the point is what the market could do in response if LYP caused prices to rise and how quick and predictable that market response would be.

In the AGL case, the court was keen to know whether there were any barriers that would insulate LYP from such a response (effectively it wanted to know about the reliability of LYP being able to get away with such a price rise; could LYP count on knowing the price rise would 'stick' because something is blocking or delaying the market from responding). The court had the benefit of being able to look with hindsight at what actually happened after LYP drove prices high in the summer of 2000-2001, so there was a 'natural experiment' which the court could look at to get an answer. The clear answer was that the market could, would and did respond to sustained high prices.

However, there is no analysis by Frontier Economics or the Panel as to why it has been assumed that such a response cannot occur – what is the basis for assuming that Hydro Tasmania could reliably count on making such a sustained price rise (spot and contract) 'stick' for at least 2-3 years without triggering a dynamic response from the market. On the contrary, as described in section 3.1.2 above, any attempt by Hydro Tasmania to behave in the manner modelled by Frontier Economics would also invite a market response, and that response would be very damaging to Hydro Tasmania's long term interests.

It would appear that the Panel and Frontier Economics have simply assumed that "strategic barriers" to entry must exist in Tasmania in order to support an unfounded assertion of market power.

The existence of "strategic barriers" in the NEM is a contentious matter. There has been discussion (most recently in relation to South Australia) as to whether incumbent generators can create "strategic" barriers by using spot price volatility to "signal" the "possibility of punishment strategies" to deter new entrants from responding to sustained high prices (for example, see the paper by SFS Economics submitted by the AER to the MEU rule change process).

This discussion is based on economic theory about how credible threats of punishment can create "strategic barriers" which deter new entry. However, the international literature and case law recognise that this economic theory is very difficult to apply in practice because of the high risk of mischaracterising genuine competitive behaviour as anti-competitive punishment. Competitive markets can and will punish firms for all sorts of reasons.

Fundamental to this economic theory of strategic behaviour is the concept of the incumbent firm doing something that makes no economic sense other than as an investment in creating market power (effectively sacrificing profits today to achieve monopoly prices tomorrow). For example, in the case of South Australia, one of the issues raised by SFS Economics was a concern about investment in apparently unnecessary excess capacity.

However, the Panel has not identified any conduct in Tasmania that makes no economic sense. The most the Panel can point to is occasional spot price volatility – but there is always a rational economic explanation for this. Further, as pointed out by market participants in the MEU rule change process and recognised by the court in the AGL case, volatile spot prices are a normal part of the NEM market dynamics – indeed, managing this risk is how firms compete.

3.2.3 Evidence of the Actual or Likely Exercise

The AEMC test requires there to be evidence of the actual or likely exercise of “substantial market power” as the appropriate trigger for some form of intervention (rather than mere possession of such power with no evidence of it being exercised). The AEMC approach is in line with what is regarded as ‘best practice’ for Governments and regulators and, as the AEMC points out, no NEM participants have disagreed with that approach (even the MEU which proposed the rule change).

Under the AEMC’s approach, as a threshold matter, there needs to be evidence that current prices are above the relevant measure of cost used in the test. The AEMC proposes that it should not be necessary to have to wait for these high prices to persist for several years without a market response before intervening; but to intervene earlier there would need to be robust evidence that the high prices are here to stay and that there will not be any market response. Typically this would require a combination of high prices plus the identification of barriers to entry / expansion.

What is absolutely clear is that if there is no evidence of prices being above the relevant measure of cost, then there is no basis for early intervention.

The Panel acknowledges that there is no evidence that Tasmanian prices are too high or that Hydro Tasmania has exercised “sustained market power” looking at both spot and contract prices. Further, Frontier Economics acknowledges that the outcomes shown in its “Latent Case” modelling are extremely unlikely ever to occur. Therefore, there can be no legitimate justification for recommending any structural reform at the generation level regardless of any debate about the existence or otherwise of theoretical barriers to entry.

3.3 Impact of Full Retail Competition

Although it is not expressly stated, one reason why the Panel seems to conclude that there is a competition problem at the wholesale level is the lack of competitors at the retail level. This is a non-sequitur, since it does not take into account the likelihood that the lack of new retailers entering Tasmania to date is simply because it has not been worth their while (given there is no Full Retail Competition (FRC)), rather than a consequence of any concern about wholesale arrangements. To attribute the failure of retailers to do something they are not permitted to do, to a cause other than the prohibition, is to put the cart before the horse.

In Hydro Tasmania’s dealings with nationally based retailers, the retailers have indicated a willingness to enter Tasmania if FRC is introduced. Further, Hydro Tasmania has facilitated the incremental entry of the major new entrant (ERM) to date and has not experienced any approaches by major NEM retailers that evidence any concern by them as to Hydro Tasmania’s contract offerings.

Hydro Tasmania seeks to offer effective and efficient risk management options to retailers - a fact identified by ERM. Hydro Tasmania would also consider options for improved risk management. In its submission to the Panel’s Issues Paper, ERM notes that it “has not seen the structure of the Tasmania market as a barrier to entry for retailers and generally believes that market is operating efficiently”.

In conclusion, therefore:

- the evidence that the Panel identifies to support its market power conclusion does not stand up to scrutiny;
- key assumptions underpinning the Panel’s conclusion are contradicted by consideration of the available evidence; and
- the Panel’s market power reasoning does not reflect proper competition analysis, or regulatory practice.

4. Panel's Reform Paths

The Panel has proposed three potential reforms to address its concern in respect to the wholesale electricity arrangements in Tasmania. All are predicated on the assumption that Hydro Tasmania has substantial market power and that structural reform is needed to address this problem.

Hydro Tasmania's view is that that these reform options are unnecessary, they give rise to a range of significant and unacceptable risks and are unlikely to achieve the objectives the Panel sets for them.

One of the key risks surrounding all of the reform options identified by the Panel is the impact of them on the efficiency and effectiveness of the generation and trading activity currently undertaken by Hydro Tasmania.

All three proposals put forward by the Panel ignore or disregard key aspects of Hydro Tasmania's integrated business model that include:

- generating significant revenues from trading energy across Basslink;
- profitably servicing the electricity needs of its large Tasmanian industrial customers;
- encouraging the entry of new, and servicing the needs of Tasmania retailers;
- managing key aspects of wholesale market risk; and
- leveraging its low emissions generation portfolio by actively growing a retail business on the mainland.

Hydro Tasmania is very concerned that the Panel's reform proposals are bespoke mechanisms, not tried and tested, and so carry massive implementation risks, including:

- the creation of new and unforeseen issues in the wholesale market that lead to higher wholesale market prices;
- a reduction in the overall volume and availability of firm contract instruments from Hydro Tasmania (a particular concern with all three reform proposals);
- gaming by market participants, whereby the benefits of reform are captured by these participants and not passed through in an economic sense to end-use customers;
- the loss of Hydro Tasmania's current capability to trade energy across Basslink, leading to the Basslink arrangements becoming a cost centre with no offsetting revenue generated; and
- the creation of a situation where there is no wholesale market counterparty with the capacity to negotiate or service the requirements of the Tasmanian major industrial customers. An outworking of this risk could be the departure of one, or more, large industrial loads from Tasmania.

An apt example of implementation risks associated with novel market reform proposals can be found in the Tasmanian frequency operating standards review undertaken by the Reliability Panel in 2008. The decision by the Reliability Panel to change the operating standards was marginal, and was predicated on AETV providing 30MW of fast raise⁴. This never materialised and has caused additional expense in providing FCAS services that outweigh the benefits of the changed standard. The Reliability Panel suggested that the benefits might be secured through a rule change process, but when Hydro Tasmania initiated such a process it was rejected.

The following sections raise some of the material issues around each of the proposed reform proposals put forward by the Panel on a stand-alone basis. In order for this to be an effective exercise, it needs to be informed by the objectives of the reforms, namely to address a market power “problem” in order to produce choice of supplier, better service and lower prices for household and business customers.

4.1 Auction of Contracts

An auction of contracts appears to be a very unsuitable method of meeting the hedging requirements of retailers. Auctions are suited to meeting the needs of many competing purchasers for standardised products. Thus it would appear that an auction model is unsuitable for delivering complex risk management products to a small number of participants.

Hydro Tasmania views this as an impractical proposal with a high risk of failure. The Tasmanian Government ran auctions for several years for the Basslink inter-regional revenues at not insignificant cost and elicited one bid. Some specific issues are discussed below.

4.1.1 Auction Timing

Quarterly auctions are the most frequent that could be contemplated. This rigid timing is at odds with the dynamic nature of the retail market, where customers are signed up constantly, and will not allow retailers to be flexible in meeting customers’ needs. This rigid timeframe is most likely to benefit large incumbents who can manage volume risk within a portfolio, and act as a barrier to small new entrants.

4.1.2 Reserve Setting

Frontier Economics, in its report to the Panel, notes that “having a robust process for determining the reserve price for the wholesale contracts will be important to ensuring that the auction does not result in an inefficient wholesale energy price”. However, there are two fundamental difficulties here.

The appropriate and usual regulatory solution where the supplier of an essential product or service has market power would be a regulated price that reflects efficient supply cost (on the basis that this mimics what a competitive market should deliver). It is recognised that a regulated price that is higher or lower than this level will lead to inefficient outcomes.

⁴ See Alinta Submission to Reliability Panel 24 July 2008 page 8 of Roam Consulting report “The Alinta CCGT has been configured to provide around 30MW of raise and lower services into all but the five minute FCAS market.

However, auctions are price discovery mechanisms to allow sellers to find out who will pay the most. Setting the auction reserve at efficient supply cost is likely to push prices above efficient supply cost. That might be appropriate in circumstances where some form of economic “scarcity rent” can be justified, but that makes no sense in a situation of oversupply. On the other hand, setting the auction reserve below efficient supply cost risks jeopardising Hydro Tasmania’s commercial viability and exposing it to the problem the Panel identified with respect to TVPS, namely prices too low to recover fixed costs.

For a pay-as-bid auction, it is virtually impossible to achieve a price outcome that reflects efficient supply cost (no more and no less).

The second difficulty is that, in circumstances of chronic oversupply, a price outcome that reflects efficient supply cost will raise the same issue the Panel has identified with respect to the methodology used for determining the wholesale energy allowance for non-contestable customers, because oversupply means market prices are lower than efficient supply cost.

The Panel canvasses using water value as the reserve price. This is too low to be sustainable for Hydro Tasmania. “Water Value” as modelled by the Panel is analogous to the SRMC of a thermal generator and does not provide for recovery of fixed costs, debt servicing, depreciation or equity returns.

The Panel acknowledges (page 160) that “Strictly speaking, Hydro Tasmania’s economic costs in a long term sense include not only the opportunity cost of water, but also the recovery of its water infrastructure costs (e.g. dams, pipes). However, the Panel has assumed that, given their age, the cost of Hydro Tasmania’s assets has already been recovered and so the economic costs of its output are limited to the value of its water”.

Basically, the Panel is writing off much of the fixed costs of the hydro system. It is critical to note that the *depreciated* value of Hydro Tasmania’s asset base is around \$4bn. That is, even taking into account the age of the hydro system, the value of the assets is still \$4bn. If the Panel suggests that Hydro Tasmania’s economic cost is only the cost of water, it is indicating that shareholders in Hydro Tasmania should not get any type of return on what is still a substantial investment in assets. In addition, this asset base requires a significant annual investment to maintain. For on-going security of supply the economic cost must include recognition of this annual investment. Without sufficient funds to maintain its asset base, Hydro Tasmania’s ability to produce electricity will decline over time.

Hydro Tasmania has previously provided detailed analysis to the Panel as to why water value cannot be used as the Panel has done. Hydro Tasmania’s conclusions were that:

- water value as proxy for marginal cost may be useful in assessing the rationality of Hydro Tasmania’s pricing decisions but does not provide any indication of efficient supply cost;
- marginal cost is not meaningful when there are returns to scale (as is the case with hydro generation); and
- therefore LRAC may be a more useful measure for considering price and output decisions relating to long lived hydro plant.

For that reason, any structural reform of the generation sector in Tasmania that assumes a market power problem would need to be accompanied by some form of financial support guarantee to Hydro Tasmania by the Government. A reserve price would thus need to reflect the LRAC of the hydro system.

4.1.3 Auction Volume

The Panel acknowledges that calculating a volume to auction will be complex. The market has become very sophisticated in developing a broad range of financial instruments that allow flexibility for retailers to meet their existing portfolios as well as catering for the specific risks of their customers.

Any volume setting calculation for the auction process will be less efficient than the current dynamic marketplace.

As Hydro Tasmania will need to reserve some capacity for the auction process, as well as the uncertainty of clearance at the auction process, the reservation of volume for auctions will lead to a reduction in the total amount of firm contract instruments that Hydro Tasmania will be able to offer from its existing portfolio. This will lead to a significant loss of liquidity of contracting instruments in the Tasmanian region and a reduction in Hydro Tasmania's ability to contract in the NEM more broadly.

As well as undermining customer cost objectives, these outcomes would see a significant loss in commercial value for Hydro Tasmania's generation and trading activity.

In addition, Hydro Tasmania is currently able to optimise its contract position over all NEM regions. A contract auction in Tasmania will impact on contract limits for Hydro Tasmania in other regions, leading to more inefficiency. If, as the Panel proposes, the available volume is defined by hydrology, the volume is dynamic and subject to change as a result of outages and other events.

The Panel presents the volume required to be offered as yield minus contracts with MIs, but appears to fail to take into account contracts already sold by direct negotiation. It would also present a major impediment to any new major industrial customer wishing to engage directly with Hydro Tasmania.

4.2 Gentrader

There are a number of issues with the gentrader approach proposed by the Panel which make it unworkable, although the absence of a detailed design makes specific comment difficult.

In general, the Panel is concerned about whether an approach can work in a technical sense. This approach ignores the commercial incentives that will exist for the parties which will drive their behaviour under a specific option. Significant value and efficiency will be lost if the drivers are not right.

Further, there is a strong likelihood that the arrangements would require authorisation by the ACCC.

4.2.1 Implementation will be Complex and Costly with no Efficiency Dividend or Guarantee of Success.

A gentrader model will be expensive, time consuming and complex to implement. At best the gentrader model is likely to produce competitors with the same cost structure and incentives – so the outcome is numbers of competitors but no real competition (which may become a problem in any ACCC authorisation). The arrangements will need to replace the discretionary control currently exercised by Hydro Tasmania over efficient allocation of

resources with a prescribed set of rules to operate in perpetuity. These rules will need to match the complexity of the hydro system and the only certainty is that they will fail to do so.

As the gentraders will all be Government owned, it is unlikely that new retailers will take any comfort as arrangements can be changed at any time by the Government. This regulatory risk is likely to be increased if the model proves ineffective or inefficient in practice. It will also not lead to lower prices as the spot and contract prices in Tasmania are already competitive, as the Panel itself recognises.

The implementation cost will be significant due to the need to interface the Hydro Tasmania asset owner between the gentraders and AEMO. This will introduce operational delays and lead to significant market losses when market events happen on the mainland.

4.2.2 Incentives have been Dislocated Leading to a Huge Loss of Value

The current Tasmanian wholesale arrangements have a set of interlocking incentives which have developed over five years since the NEM started in Tasmania. These have led to very efficient outcomes to the benefit of Tasmania. Most of these inefficiencies would be dislocated under a gentrader model and will represent a loss of value, or increased cost for Hydro Tasmania and Tasmania:

- **Basslink operations.** Hydro Tasmania is incentivised by the market to maximise the performance of Basslink. Maximum import and export levels maximise Hydro Tasmania's arbitrage opportunity. This is achieved through a combination of contract management of the Basslink Services Agreement, introduction of innovative arrangements (e.g. negative Basslink bidding under some circumstances) and the management of FCAS so that Basslink reversals maximise Tasmania's position.
- **Use of IRRs.** The IRRs have a cash value but they are much more valuable as risk management tools in an integrated portfolio operating across the Victorian and Tasmanian regions. This is how Hydro Tasmania uses them currently. Under the Panel's gentrader model, the IRRs are essentially a cash income to the "regulated" Hydro Tasmania, with no ability to maximise this revenue stream by trading.
- **Interruptibility.** To maximise the performance of Basslink, Hydro Tasmania negotiates contracts with major industrial customers for interruptibility. This is ideal as it reflects the value of the interruptibility service in energy price contracts. Under a gentrader model, it appears Hydro Tasmania would negotiate interruptibility with major industrial customers, but the Panel is silent on how the major industrial contracts would be negotiated. It is hard to conceive a gentrader model in which a single party negotiates MI contracts, negotiates interruptibility and is the beneficiary of the IRRs.
- **Efficiency Improvements.** Hydro Tasmania has embarked on a series of efficiency improvements in response to the challenge of the market over the last 10 years. The gentrader proposal separates Hydro Tasmania from the market and will remove market prices as a signal to our cost structure. In addition the employees of Hydro Tasmania will suffer the same fate as those of the contracted NSW generators, their experiences in a non-market generation company will be irrelevant in the employment market and will lack stimulation.

Under a gentrader model, no party will have the incentive to maintain these arrangements and the performance and capacity of Basslink, as well as its value to Tasmania, is likely to degrade.

4.2.3 Major Industrial Contracts

If the MIs are allocated out to the gentraders so that each gentrader has one Major Industrial (MI) contract, this represents too significant a risk for one of the gentraders as the MI load will be a very large proportion of that gentrader's load. These risks will need to be shared across all gentraders, bearing in mind the competition issues that would need to be considered in effecting such shared arrangements across these competitors.

If the MI contracts are left with Hydro Tasmania, then Hydro Tasmania will need to be active in the market and will become a competitor of the gentraders. As a result, its dispatch of the other gentraders will be compromised.

4.2.4 Scale Economies

Just as the Panel acknowledges that an energy retail business delivers returns to scale, so do generation businesses. These businesses need to maintain trading systems, including complex IT and risk management systems, expert trading teams and supporting corporate structures, including boards. Each additional entity that is created results in additional costs that need to be recovered from consumers or via reduced returns to owners.

The trend throughout the NEM has been the consolidation of participants in pursuit of returns to scale. This includes the reduction of four Queensland generation and trading businesses to two, and the continued consolidation of the NSW distribution businesses (down from six in 1995 to three currently, with a further consolidation being considered). In Tasmania the Government is currently seeking to achieve efficiencies through the consolidation of four water and sewerage entities into one.

The negative impact of multiple gentraders is not limited to additional cost. Efficiency through competition between multiple competing suppliers is not achievable when this requires the creation of competitors who are too small to be efficient. Each gentrader will be too small to be a robust competitor in the NEM. As they will also be identical, this is likely to dampen competition between them insignificantly.

Further, by splitting the gentrader businesses, the total firm contract capability of Tasmanian generation will be reduced. The sum of the parts will be less than the whole and Government revenues will be lower from the businesses than under a single Hydro Tasmania.

4.2.5 Loss of Value in Basslink Arrangements

As the Panel's work on Basslink shows, Basslink represents a very significant annual cost, and this cost will not disappear under any reform option. What the Panel's Basslink work also shows is that Hydro Tasmania is able to utilise the opportunities that Basslink affords it on the mainland to generate revenue to cover those costs and deliver a return to its owners. The gentrader option appears to be fundamentally incompatible with Hydro Tasmania continuing to do this, and does not present any vision of how another entity might step into the role.

The cost of the gentrader option for Tasmanians is, therefore, not simply the cost of establishing and maintaining additional trading entities within Tasmania (itself not insignificant). It includes the inability of any entity under the gentrader model to effectively use the Basslink arrangements to generate further revenue and the loss of income for the State that arises from Hydro Tasmania being able to employ its natural advantages as a peaking generator and a low emissions generator in the broader NEM.

4.2.6 Price Setting

As with reserve setting for contract auctions, a gentrader model requires the price to be paid by each gentrader to Hydro Tasmania to be set within the arrangements. Not only does this involve the issues identified for contract auctions, but the inefficiencies referred to above will inflate this price further as the arrangement will have to cover Hydro Tasmania's (unchanged) fixed costs. A significant proportion of these fixed costs are currently recovered by Hydro Tasmania across its NEM portfolio. This proportion would have to be recovered from Tasmanian customers under a gentrader model. In addition, despite the purpose of these arrangements being the delivery of market competitive prices to retailers, the government will set minimum prices when setting the fees paid by the gentraders to Hydro Tasmania, to which the gentraders will need to add their other costs.

4.2.7 Probable Outcomes

Hydro Tasmania expects that gentraders will seek to make profits and this will incentivise gentraders to set even higher prices, as the gentraders will not be considering long term asset values in their decision making. Given that the generation sources and technical capabilities of the gentraders will be undifferentiated, such behaviour may develop very quickly, requiring a new round of review.

In summary, the gentrader option requires a complex set of arrangements which do not meet customers' needs, create a new set of major risks, invoke major uncertainty and cause a significant loss of value for Tasmania. The experience of the gentrader model in NSW does not make a compelling case for a new untried model to be used in Tasmania. All the risk will be placed upon the Tasmanian taxpayer, with the probability of failure and its associated significant cost being extremely high.

4.3 VicTas Region

The idea of a single NEM region is, at first glance, undeniably attractive, and was examined by Hydro Tasmania early in the Panel's process. Unfortunately, the Basslink constraint means that it simply does not work.

4.3.1 Major Physical Dispatch Issues from having a Major Constraint within the VicTas Region (Basslink).

The NEM design assumes there are no major congestion points within a region. The design allows for prices to separate between regions when an inter-regional constraint binds.

Having a single region for Victoria and Tasmania will include a significant constraint, namely Basslink. Apart from general dispatch problems, this will lead to no Tasmanian generators wanting to be dispatched in off-peak at the typically low Victorian price. For a secure dispatch, some plant in Tasmania will need to be run. This will be achieved by a Network

Support Agreement which will be tendered by Transend or AEMO. Generators will tender to run in specified (generally off-peak) times and will receive compensation which will be paid for by customers in Tasmania.

This approach will ensure a secure system but will effectively lock in the off-peak generation profile and lead to inefficient outcomes. The additional cost to customers of this generation will be problematic and the value involved will not be small.

4.3.2 Perverse Incentive on Demand Side Response

A combined region creates a perverse incentive on customers when they shed load in response to high prices caused by high demand on the other side of a constraint (i.e. Tasmanian customers when air-conditioning load is high in Melbourne). Currently about 150MW of load responds to high spot prices in Tasmania. This is very high at around 10% of average demand and is a significant competitive dynamic. Theoretically, this number could increase by three or four times given sufficient price incentive.

Under VicTas, when the VicTas price is high because of high Victorian demand, Basslink will typically be constrained and flowing north. Some customers in Tasmania will reduce their load which will cause Tasmanian generators to have to reduce their output (since Basslink is constrained). There are two resulting impacts. Firstly, the reduced load will do nothing to reduce the VicTas price which is what would be expected in an efficient market (as Basslink is constrained). In contrast, with two regions the Tasmanian price will typically be reduced by the customer load decreasing. The second impact will be a loss of revenue for Tasmanian generators as their generation volume will be decreased during the high priced times and the volume of contracts that could be backed and thus written is vastly reduced.

Thus we have the worst of both worlds with an inefficient market outcome and a loss of revenue for Tasmanian generators.

4.3.3 Investment Signal for New Entry Generation for Tasmania Severely Distorted

Due to the relative sizes of Victoria and Tasmania, the effect of a single region would be effectively to move Tasmania to the Victorian price. One implication of this is that there will be no new investment signal in Tasmania as the price will not respond to supply shortages in Tasmania, or that new and unnecessary plant may be built in Tasmania in response to a Victorian driven price signal.

With the current supply/demand balance, this is unlikely to be a problem in Tasmania but if generation is required in Victoria, the signal will be in Tasmania and it highlights the lack of sustainability in the proposal.

4.3.4 Requires Complex Basslink Conversion from MNSP to a Regulated Link with Loss of Value to BPL

AER would conduct the process to convert Basslink from an MNSP to a regulated link. Before this can start, a commercial negotiation with CitySpring, Basslink's owner, would need to be undertaken to establish the commercial arrangements for Basslink once it is regulated. This is likely to include a significant top up payment if the regulated income from Basslink is below the facility fee, which is what the experience for previous conversions has been.

A complex proposal would then be developed to assess the value of Basslink under the NER. The AER would assess that proposal and decide on the value which it would allow if Basslink is regulated. CitySpring, in consultation with Hydro Tasmania, could then decide whether to proceed.

This process is very risky as the cost benefit is very difficult to assess. The close co-ordination and long timeframe of the process means that the costs and benefits could well move significantly during the process. For example, the loss of a major industrial customer would reduce the regulated value of Basslink significantly. It is likely that, whatever happens, some additional value will flow to CitySpring.

4.3.5 Uncertainty of the Rule Change Process for Boundary Change and FCAS Management.

To implement this solution, two complex processes with different national bodies need to be co-ordinated. The first process is with the AEMC. A rule change to change the region boundary will be required together with some changes to the ancillary services market to allow the specific requirements of Tasmania to be accommodated. This rule change can only be made if it satisfies the National Electricity Objective. The AEMC process means that once the rule proposal is submitted, the proponent has no control over its passage.

The second process is the one described above for Basslink regulation. Co-ordination of the timing of these two processes will be very difficult and could well lead to one process being successful and the other not. In any event, the long time frame of several years is really unattractive to all parties.

Hydro Tasmania has some experience of these problems. In 2008, the Reliability Panel recognised that the beneficiary of the improved frequency standards in Tasmania should ideally pay for the increased FCAS requirements but such a result was not possible via the AEMC's rule change process.

5. A Practical and Commercially Realistic Approach to Reform

Hydro Tasmania agrees there are aspects of the Tasmanian Electricity Supply Industry that warrant reform, but does not agree with the Panel's definition of the problem.

Hydro Tasmania agrees that the wholesale pricing arrangements for non-contestable customers are inappropriate given the outlook of on-going oversupply. Hydro Tasmania has no particular observations on the Panel's reform options for changing the methodology used. This reform will impact on Hydro Tasmania's future revenue, but is consistent with market outcomes.

Hydro Tasmania does not agree with the Panel's observations on wholesale supply arrangements. Hydro Tasmania considers that there is no evidence of market power or competition issues and that FRC could be effectively be introduced without any wholesale level reform, just as has occurred for larger customers. Introducing FRC first is a low risk means of testing whether there is actually any need for wholesale level reform.

Hydro Tasmania does observe that any move to FRC under current retail and wholesale supply arrangement may result in a more gradual or organic distribution of benefits as new retailers incrementally enter the sector. The Panel observes that such an approach may also be quite damaging to the sustainability of Aurora Energy's retail business. Consequently, Government may prefer to facilitate a more accelerated approach to FRC.

Given that Hydro Tasmania has a commercial incentive to support retail competition, it may be that there are additional commercial activities that can assist in facilitating an accelerated move to FRC, but such commercial business decisions are beyond the scope of the Panel's terms of reference.

An attribute of any reform must be that the totality of its benefits outweighs the associated costs and that those benefits can confidently be secured. It is disappointing that the Panel has not been able to assess this balance for its reform options. The business that is undertaken by Hydro Tasmania, and the assets of which Hydro Tasmania is the custodian, clearly have significant value to Tasmanians. This value is crystallised through Hydro Tasmania's contribution to State revenues and the impact of any reform on that contribution needs to be carefully understood.

Hydro Tasmania is not intrinsically opposed to reform, but any reform must seek to maintain the ability of those assets to generate an appropriate return for Tasmanians as their owners. Hydro Tasmania is concerned that this is not the case for the reforms identified by the Panel.

A more pragmatic approach to reform is called for that recognises the value inherent in the existing system. Any potential change needs to be taken after full consideration of its associated costs and benefits together with the risks attaching to that change. A more measured commercial approach is necessary that enables testing of the implications along the way and does not require the Tasmanian Government to take a materially high risk course of action with no certainty of success and having burned its bridges, thus preventing an effective remedial strategy and having lost that value permanently. We believe that

considerable progress can be achieved by a more measured sequential approach that is more aptly described as fine tuning than major structural reform.

Glossary

ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AETV	Aurora Energy Tamar Valley Pty Ltd
BPL	Basslink Pty Ltd
DIER	Department of Infrastructure, Energy and Resources
EBITDA	Earnings before interest, taxation, depreciation and amortisation
FCAS	Frequency Control Ancillary Service
FRC	Full Retail Contestability
GW	Gigawatt
IRR	Inter-regional Revenue
LRAC	Long Run Average Cost
LRMC	Long Run Marginal Cost
MEU	Major Energy Users
MI	Major Industrial (customer)
MNSP	Market Network Service Provider
Momentum	Momentum Energy Pty Ltd
MW	Megawatts
NEM	National Electricity Market
NEO	National Electricity Objective
NER	National Electricity Rules
OCGT	Open Cycle Gas Turbine
SOEB	State Owned Energy Business
SRMC	Short run marginal cost
TVPS	Tamar Valley Power Station