

FAXED



Office of the
Chief Executive Officer

9 July 1999

Mr John Cosgrove
Presiding Commissioner
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Dear Sir

I refer to the Productivity Commission's Inquiry into the Impact of Competition Policy Reforms on Rural and Regional Australia, which is currently underway.

Your Commission is presently conducting hearings within Tasmania and has heard argument that, effectively, Tasmania is a regional economy affected differently from the metropolitan-based economies of mainland Australia.

As I understand you have been quoted as commenting on the electricity supply situation in Tasmania, I thought it might be useful to provide you with an information paper on the electricity supply industry in this State.

I do so purely to assist the deliberations of your Commission.

Background

Prior to 1 July 1998, the Hydro-Electric Corporation (formerly the Hydro-Electric Commission) operated as a vertically integrated, hydro-electricity based business in the Tasmanian Electricity Supply Industry (ESI).

As such, it was responsible for all elements of electricity production and the transmission, distribution and retailing of electricity to the Tasmanian business and residential communities.

As a signatory to the Council of Australian Governments' agreement to conform to National Competition Policy, Tasmania legislated in 1995 to enable the introduction of competition into the ESI and in 1997 further legislated to split the vertically integrated HEC into three businesses: a generating and consulting business retaining the name 'Hydro-Electric Corporation'; a transmission business named Transend Networks Pty Ltd; and a distribution and retail company named Aurora Energy Pty Ltd.

The HEC is a Government Business Enterprise in terms of the Government Business Enterprises Act 1995, while Transend and Aurora are State Owned Companies established under the Electricity Companies Act 1997 and operated under that Act and Corporations Law.

This disaggregation of the former, vertically integrated organisation into three separate businesses took effect on 1 July 1998.

Current Position - Generation Structure Review

The National Competition Policy *Competition Principles Agreement* requires the Tasmania Government to undertake a review into a range of structural issues prior to privatising a public monopoly or opening its market to competition.

As Basslink, the proposed undersea power cable connecting the Tasmanian and Victorian electricity markets, will bring competition into the wholesale electricity market in Tasmania, the State Government has commissioned a review into this State's power generation structure to meet its obligations under the Agreement.

Terms of reference for this review require it to establish whether there is public benefit in an alternative structure for generation, such as, for example, the further disaggregation of the HEC into multiple generators.

In its submission to the review, the HEC established beyond doubt that there are substantial ongoing costs and penalties in further disaggregation and demonstrated the benefits of a single HEC. The submission showed that disaggregation into several small competitive generators would result in an overall decrease in public benefit by:

- adding organisational costs
- significantly downgrading the rating of Tasmania's electricity system
- adversely impacting environmentally from loss of rating through additional use of fossil fuel
- delivering no improvement in productive efficiency which is already high
- failing to change the market power situation
- delivering uncertain pricing outcomes
- reducing the Tasmanian generator's ability to compete in the National Electricity Market
- reducing capacity to service existing debt.

The HEC concluded in its submission

“that Tasmania’s entry into the National Electricity Market is more likely to make a positive contribution to maintaining successful national competition, to be more successful in terms of the overall public benefit for the Tasmanian market and to meet longer term environmental considerations if the HEC is retained as a single generator”.

The generation review reported to the Tasmanian Government in May 1999, recommending the establishment of three trading subsidiaries of the HEC to create a generation market.

In responding to the review’s recommendation, which it assessed fully against the review’s terms of reference, the HEC repeated its above conclusion and further commented that

- there would be a net loss of public benefit
- a loss to Australia’s renewable energy production would occur
- a substantially increased operating cost would result
- there would be a reduction in the efficient utilisation of the limited supply of water for hydro generation (decrease in system rating)
- an organisation structure which is inefficient, unstable and unmanageable would be created
- there would be a loss of amenity for tourism, fishing and recreational usage of the inland waters through individual and unbalanced management of water storages and flows.

Relevance to Productivity Commission Inquiry

In its comment on the review’s report, the HEC considered that the review did not take account of the Tasmanian context, principally the integrated nature of the generation assets and the scale of the HEC in comparison with National Electricity Market participants.

The Tasmanian generation system is currently physically isolated from the mainland market, is small and serves a market which is dominated by a small number of large customers. It is often forgotten that the entire HEC output is less than that of some of the single generators in Victoria and NSW. Furthermore, unlike mainland thermal generators which rely on carbon-based fuels, Tasmania’s basic energy source, rainfall, is totally out of human control, which introduces a much higher degree of risk.

It is these particularities of the Tasmanian situation which are relevant to both this generation structure review and your Commission’s consideration of the impact of competition policy on the Tasmanian region.

The generation review's recommended structure is focussed on a micro reform approach within Tasmania. However, the real issue is to establish a path for Tasmania's electricity businesses to compete in a national market, a market in which the major utilities of the world are consolidating their positions.

Tasmania needs to focus on gaining entry to the national market. The HEC welcomes the onset of competition brought about by Basslink and is determined to play an active role in the national market. The HEC is developing its skills capability to meet this competitive challenge, and would be rendered incapable of this should the recommendations of the review be adopted. The public benefit is not served by the loss of competitive capacity for the State's publicly-owned utility.

I trust this information paper gives your Commission some insight into the nature of Tasmania's electricity supply industry. I would be happy to elaborate on any matter if it would assist.

Yours sincerely



G.L. Willis
Chief Executive Officer