

MINISTERIAL STATEMENT
HON DAVID LLEWELLYN MP – MINISTER FOR ENERGY

EQUITY RESTRUCTURING OF HYDRO TASMANIA AND TRANSEND
NETWORKS

Mr Speaker,

My statement today will place on the record a comprehensive explanation for a major decision that this Government has taken in relation Hydro Tasmania.

This decision will protect and enhance Tasmania's ability to harness our abundant renewable energy and water development resources – resources which this government believes will be fundamental to Tasmania's future prosperity.

In October last year, the Government commissioned a due diligence review of Hydro Tasmania's capital structure and investment funding requirements.

That review, undertaken by Ernst & Young Transaction Advisory Services Ltd, is now complete.

I am pleased to table Ernst & Young's report titled "*Financial and Strategic Review of Hydro Tasmania's Capital Structure and Investment Funding Requirements*".

The report is a summary document prepared by Ernst and Young which excludes information that is of a commercially sensitive nature, particularly in relation to Roaring 40s.

It reflects advice from both Treasury and Hydro Tasmania that this information could impact on the legitimate business interests of China Light and Power and Roaring 40s.

Mr Speaker, in 1998, immediately prior to disaggregation, the debt of the Hydro-Electric Corporation stood at \$1.362 billion.

Of that total:

- Hydro Tasmania's initial allocation was \$1.013 billion;
- Aurora was allocated debt of \$349 million; and
- Transend was allocated zero debt.

This allocation reflected a balance between the expected capital requirements of the businesses and the sale process proposed by the then Liberal Government.

Having been maintained in public ownership by this Government – consistent with the community's clear expectation at the 1998 election, Hydro Tasmania has been central to the economic transformation of Tasmania.

Since the first Bacon Labor Government in 1998, Hydro Tasmania has delivered a track record of achievement of which its owners, the people of Tasmania, can be proud.

This includes:

- delivering the technical excellence and financial strength to connect Tasmania to the National Electricity Market through Basslink
- supporting Tasmania's connection to natural gas and facilitating the expansion and diversification of Tasmania's electricity generation capability into gas-fired generation at Bell Bay;
- providing an exceptionally reliable supply of electricity that has kept pace with the rapid growth of the Tasmanian economy, despite a decade of low rainfall and the past two years of acute drought;
- returning substantial dividends and tax equivalent payments to the Tasmanian community; and
- creating Roaring 40s - a leading renewable energy business in the Asia-Pacific through our strong partnership with China Light and Power.

All of this has been achieved while retaining Tasmania's energy intensive industrial base and maintaining nationally competitive prices for small business and domestic customers.

Mr Speaker, Hydro Tasmania's borrowings currently total approximately \$1.13 billion.

That means that the entirety of Hydro Tasmania's considerable achievements over the past decade has been delivered with an increase in nominal debt of only 10 per cent.

Whereas Hydro's debt has barely changed, the strategic environment today is very different and it is a matter of public record that Hydro Tasmania has sought an equity injection for several years.

In June 2005, the Government advised Hydro Tasmania that there was no compelling case for a major equity injection following the first capital structure review of the State-owned Electricity Businesses by Ernst & Young.

At that time, Ernst & Young also recommended that the capital structure of Hydro Tasmania be kept under continuous review. The Government has carefully followed that advice.

In particular, the risks and uncertainties highlighted in that report included Hydro Tasmania's exposure to hydrological risk, which would have potential adverse impacts on Hydro Tasmania's water storage levels and to its revenue.

As I am sure all members would be aware, Tasmania has experienced severe drought conditions for much of the past decade.

Mr Speaker, just as Tasmania's farmers and rural communities are doing it tough, the current drought has posed significant financial challenges for Hydro Tasmania.

For Hydro Tasmania, rainfall is revenue.

In 2006-07, with rainfall only 70 per cent of that expected, the hydro system was supported by Basslink imports and the use of the gas-fired Bell Bay Power Station at an additional cost of over \$100 million for the year.

This expenditure, plus the need to draw down existing water storages, was fundamental to Tasmania's energy security.

In recent months, up to 50 per cent of Tasmania's energy demand has been met by Basslink and gas fired power.

This current month is likely to become the driest May since 1913 and Hydro Tasmania's storages currently stand at less than 19 per cent.

It is an undeniable fact that access to Basslink and natural gas has saved Tasmania's economy by avoiding power rationing, which in turn may have resulted in the permanent shutdown of major industry.

It has also saved our wider community from the appalling disruption to our lives which would have occurred if power had to be rationed.

Latest advice from Hydro Tasmania is that inflows for 2007-08 are likely to be similar to last year, placing further pressure on the business.

With very low rainfall inflows and high costs, it is now evident that the Corporation is unlikely to report an operating profit this year.

Mr Speaker, climate change presents opportunities as well as risks for Tasmania.

Most Tasmanians know that Hydro Tasmania is Australia's largest renewable energy business.

We should also acknowledge that it is Australia's biggest water manager. In fact, the average annual inflows into our hydro dams exceed the inflows into the entire Murray Darling basin by around 20 per cent.

While the drought has meant that less rain falls, the value of the water that we can store is increasing by the day.

The State Government's commitment of \$80 million, on top of the Rudd Labor Government's contribution of \$140 million, will secure a massive expansion in irrigated agriculture and help this State reach its full potential as the foodbowl of southern Australia

The work being undertaken by the Irrigation Development Board – backed by a combination of substantial public and private investment, political will and exemplary governance is a powerful example of this Government’s determination to respond to both the challenges and opportunities presented in the current environment.

It was in the context of these risks and opportunities that in October last year the Government again commissioned independent expert consultants Ernst & Young to:

- Review the appropriateness of Hydro Tasmania’s capital structure in the context of its ongoing capital expenditure program and funding for growth opportunities, specifically its participation in the Roaring 40s joint venture;
- Determine the conditions needed to ensure any equity restructuring is consistent with maintaining the State’s Aaa/AA+ credit ratings; and
- Consider the scope for withdrawing equity from Transend Networks should a decision be made to transfer some of its equity to Hydro Tasmania.

Ernst & Young delivered the report that I have tabled on 14 May 2008. The key findings include:

- under a range of inflow scenarios, Hydro Tasmania requires an equity injection of between \$185 million and \$495 million to repay debt;
- the additional borrowing capacity for Transend networks is limited to a maximum of between \$220 million and \$270 million, under a range of scenarios for the outcome of the next regulatory determination by the independent Australian Energy Regulator; and
- the capital structures of Hydro Tasmania and Transend should be reviewed again in mid 2009, given the uncertainty attached to Transend’s revenue determination and the hydrological conditions that will be faced by Hydro Tasmania.

Ernst & Young’s analysis also confirms that Transend currently has an exceptionally strong balance sheet, well in excess of what is required for an “A” rated transmission company.

Mr Speaker, this observation confirms that the leadership team at Transend has been particularly effective in managing the company’s assets during a period of rapid and sustained growth. Their efficiency has allowed the company to refurbish and extend Tasmania’s transmission network, while preserving significant headroom on the balance sheet.

This prudent management has preserved the Government’s capacity to adjust Transend’s balance sheet by lifting its ratio of debt to equity to permit additional equity to be contributed to Hydro Tasmania.

Mr Speaker, raising new capital, or reallocating debt or equity within a portfolio of companies, is relatively straightforward and routine in the corporate world.

In the public sphere, there are additional considerations and I can assure the House that Cabinet's deliberations have been appropriately meticulous and comprehensive.

In addition to Ernst & Young's current report, Cabinet has now also considered advice from Treasury and the Boards of Hydro Tasmania and Transend.

Having carefully assessed the full range of advice, the Government accepts that there is a need to strengthen Hydro's balance sheet.

Three major arguments support this approach:

- firstly, an equity transfer will allow Hydro Tasmania to reduce its debt and better manage the volatility of its commercial environment;
- secondly, lower debt will allow the corporation to lift its decision horizon beyond the short term focus that is necessarily adopted when finances are tight; and
- finally, in addition to strengthening the core business, additional equity will allow Hydro Tasmania to optimise its position in Roaring 40s.

In November last year, a unanimous resolution of this Parliament supported the Government in the decision to transfer \$50 million from Transend to Hydro Tasmania to support Roaring 40s projects. Of that \$50 million, \$19 million has already been transferred to Hydro Tasmania, with the remainder to be transferred during June 2008.

The figure of \$50 million had been struck in anticipation of the imminent approval of two major Roaring 40s Australian projects, at Mussleroe in North East Tasmania and Waterloo in South Australia, each of around 120 megawatts. While there has been some delay in the finalisation of these projects, they are expected to be presented to the Hydro Board shortly.

Since November, the strategic rationale for Hydro Tasmania's involvement in Roaring 40s has continued to strengthen.

The Rudd Government has reaffirmed its commitment to ensure that the equivalent of at least 20 per cent of Australia's electricity supply is generated from renewable sources by 2020. To achieve this, Federal Labor will increase the Mandatory Renewable Energy Target to 45 000 gigawatt hours per year.

In response to the strength of this commitment, the price of Renewable Energy Certificates has surged from a low of around \$12 to around \$50 for every megawatt hour of new renewable energy sold today.

The unique skills and intellectual property developed in Roaring 40s means that the company is ready to harness the substantial opportunities that are rapidly emerging in the Australian market.

Mr Speaker, the Government has therefore decided to transfer \$220 million of equity from Transend to Hydro Tasmania.

This is within the range recommended by Ernst & Young for Hydro Tasmania.

It is also at the bottom end of the equity available on Transend's balance sheet according to the Ernst & Young recommendations.

According to Ernst and Young, Transend's stand alone credit rating, after a transfer of \$220 million, would still be single-A, in line with the Transend's Board objectives. It would also be above the BBB+ rating deemed appropriate for transmission companies by the independent Australian Energy Regulator.

Notwithstanding the exceptionally strong position of Transend, the Government believes it is prudent to be cautious given uncertainty around the outcome of the revenue determination for Transend by the Australian Energy Regulator in mid 2009 for the five years until 2014.

The national electricity market is a dynamic environment and the Government will continue to monitor developments.

If rainfall continues to be below average and Hydro continues to support the Tasmanian economy through Basslink imports and gas power generation, then the capital structure of one of our most important government businesses may need further support.

Consistent with the recommendation from Ernst & Young, the Government will reassess the capital structure of the businesses in 2009.

The outcome of the Australian Energy Regulator's determination will also clarify the potential for any future equity withdrawal from Transend.

Mr Speaker, the equity transfer will be achieved by means of a transfer of debt from Hydro Tasmania to Transend.

The mechanism for this will be a transfer notice under the *Electricity Companies Act 1997*. Earlier this morning, in recognition of the significance of this initiative, I moved a motion approving the Treasurer's intention to Gazette the necessary transfer notice.

This will provide both Houses of the Parliament the opportunity to debate the issue and signal their approval or otherwise of the Treasurer's intended action. In the event that these motions are not passed by both Houses, the Treasurer will not proceed with the gazettal of the transfer notice and the equity transfer will not proceed.

Once approved by Parliament in this way, the transfer notice will be gazetted with effect on 30 June 2008.

Mr Speaker, this decision reflects this Government's determination to build a secure and prosperous Tasmania and will allow us to make the most of emerging opportunities in a changing world.

I look forward to debating the motion at this time tomorrow.