



TASMANIA'S ENERGY REFORM FRAMEWORK ENTRY TO THE NATIONAL ELECTRICITY MARKET

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Tasmania's Energy Reform Framework

The Tasmanian energy sector is facing its most significant period of change since the development of the State's electricity system based around hydroelectricity generation assets. A number of nationally significant projects are transforming the sector, and through it, the Tasmanian economy.

Basslink

Basslink is an undersea high voltage direct current cable that will connect Tasmania with the national electricity grid. The project was confirmed in late 2002, and is being constructed by the project's proponents Basslink Pty Ltd (a subsidiary of National Grid Transco plc) and its commercial partners. The completion of Basslink, currently anticipated to occur in November 2005, will enable electricity to be traded with other states for the first time.

Tasmania Natural Gas Project

The Tasmania Natural Gas Project is delivering a new and competitive energy source to Tasmania as part of the integrated national market. The Tasmanian Gas Pipeline was constructed by Duke Energy International, and gas is flowing from Victoria through this high volume transmission system to foundation customers, including the Bell Bay Power Station. The Government is pursuing gas distribution, which moves the gas to consumers, and in December 2002 announced Powerco Ltd as the preferred developer of the gas distribution network.

Wind

Tasmania has one of the best wind resources in the world, which is presently largely untapped. The first stage of Hydro Tasmania's Woolnorth Wind Farm commenced operation in August 2002. The next stage at Woolnorth is under construction and wind farms at other sites (with various proponents) will be progressed in coming years subject to commercial considerations and relevant planning approvals.

These important projects represent a combined investment of around \$1.25 billion. Together, they will diversify the State's energy sector and, with the transition to a market environment, will introduce competition and maximise the potential for Tasmania to secure major industrial and manufacturing developments. This will create an environment for sustainable economic development and will mean continued investment and job growth for Tasmanians.

Entry to the National Electricity Market

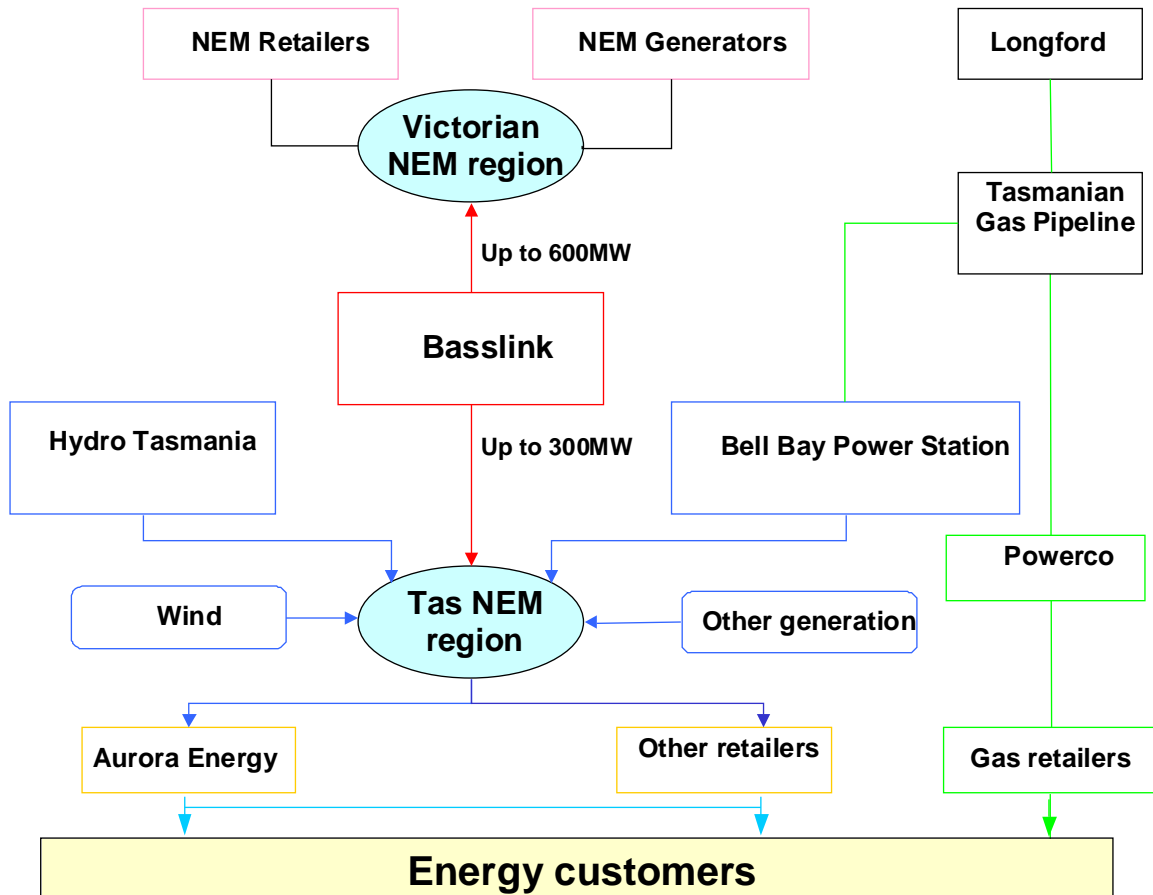
A key element of the energy reform framework is Tasmania's entry to the National Electricity Market (NEM). The Government is committed to the State becoming a fully participating jurisdiction in the NEM six months ahead of Basslink.

The central features of Tasmania's NEM entry framework are that:

- Hydro Tasmania will be retained as a single hydro generation business in State ownership;
- Hydro Tasmania's Ministerial Charter will be amended to ensure that the reliability/security of the State's hydro system is maintained;
- additional competition will be created through the conversion of the Bell Bay Power Station to natural gas and its separation from Hydro Tasmania to a new State-owned generation business;
- the market will be operated in accordance with the National Electricity Code (NEC), with the National Electricity Market Management Company Ltd (NEMMCO) responsible for market operations and system security;
- the Australian Competition and Consumer Commission (ACCC) will be given responsibility for transmission pricing, initially under Tasmanian arrangements and then under the NEC;
- retail contestability will be progressively introduced in Tasmania;
- the Tasmanian Electricity Regulator will retain responsibility for distribution network pricing on an ongoing basis and retail price regulation for non-contestable customers;
- a vesting contract between Hydro Tasmania and Aurora Energy Pty Ltd will underpin energy sales for non-contestable customers during the roll-out of retail contestability;
- arrangements will be implemented dealing with how Basslink will be bid into the NEM and the framework under which Hydro Tasmania will make available for commercial sale inter-regional revenues arising from the southward flows on Basslink; and
- Tasmanian derogations (ie. amendments) to the NEC will provide for some local technical, procedural and administrative matters in the transition to the full NEM arrangements.

When the remaining infrastructure projects are completed and NEM entry has been accomplished, the State's energy sector will be significantly different to the present, as shown by Figure 1.

Figure 1: Tasmania's Future Energy Sector



Within the NEM, transmission network service providers (such as the State-owned Transend Networks Pty Ltd) play an important role by transmitting electricity through their high voltage networks to electricity distributors (such as Aurora Energy). In Tasmania, some large energy consumers are connected directly into Transend's network.

Benefits for Tasmania

Joining the NEM will allow electricity from Hydro Tasmania and other local generators to be exported across Basslink to Victoria during high priced peak demand periods, while still meeting the needs of electricity customers in Tasmania.

Conversely, the NEM will also enable low priced electricity to be imported from Victoria during off-peak periods, allowing Hydro Tasmania to reduce generation and conserve its water resources for use during later peak demand periods.

Entry to the NEM will provide a range of benefits for the State. Specifically, it will:

- provide access to a flexible additional source of electricity supply that can meet future increases in electricity demand in Tasmania;
- allow the introduction of sustainable competition and customer choice in the supply of electricity in Tasmania;
- improve the security of supply of electricity for Tasmanian customers;
- safeguard Tasmania's electricity supply from the impact of drought;
- reduce the exposure of the State-owned electricity entities and the State Budget to the financial risks associated with the loss of one or more of the State's major electricity users;
- provide a robust and competitive regulatory framework to encourage new investment in Tasmania's electricity supply industry; and
- allow Tasmania to develop its high quality wind energy resources and thereby make a further contribution to meeting Australia's international commitments to reduce greenhouse gas emissions.

The National Electricity Market

The NEM commenced in 1998 and comprises New South Wales, Victoria, Queensland, the Australian Capital Territory and South Australia.

The NEM allows trading in electricity between generators and wholesale customers, including electricity retailers. It enables electricity to be traded both within and between States at a wholesale level and facilitates competition at a retail level.

A number of mechanisms have been put into place to regulate the NEM and ensure that it runs fairly, securely and safely, with the wholesale market being operated by NEMMCO and supervised by the National Electricity Code Administrator Ltd (NECA).

Unlike other markets, electricity cannot be stored and it is impossible to distinguish which generator produced the electricity consumed by an individual customer. As a result, the wholesale market uses the concept of a pool in which electricity from generators is centrally dispatched to meet electricity demand.

In the NEM, retailers purchase the electricity that they sell to customers from the wholesale pool, whilst generators sell directly into the pool and are dispatched to meet customer demand, using the lowest priced generator first.

The wholesale price of electricity in the pool can vary on a half-hourly basis, depending on the prices of bids submitted by generators and the level of customer demand for electricity in each half-hourly period. As demand rises relative to supply, so do prices, and vice versa.

As the wholesale price (spot price) of electricity can be volatile, generators and retailers enter into financial contracts (hedge contracts) outside the pool. The financial contracts allow generators and retailers to manage the risks associated with fluctuation in half-hourly spot prices.

These financial contracts are totally separate from the spot market and perform an essential function in the market by enabling retailers to manage price fluctuations and thereby offer customers greater price certainty.

The prices charged for high voltage electricity transmission and low voltage distribution are regulated by the ACCC and State regulators respectively. The ACCC also regulates the manner in which generators and other participants can access the transmission network.

More information on the NEM and its operation can be found at:

<http://www.nemmco.com.au>

<http://www.neca.com.au>

<http://www.accc.gov.au>

Steps to NEM Entry

Legislative and administrative reforms by successive State Governments have ensured that Tasmania is well placed to join the NEM.

The Tasmanian Parliament has already passed the *Electricity — National Scheme (Tasmania) Act 1999*. When this Act takes effect, Tasmania will be able to participate in the NEM by applying the NEC. This will be accompanied by the winding back of those elements of the Tasmanian Electricity Code that are inconsistent with the NEC.

A number of significant milestones have been achieved on the path to NEM entry, including:

- the ACCC authorised, in November 2001, the transitional arrangements required to allow Tasmania to join the NEM;
- agreement was reached in December 2001 with NEM jurisdictions on Tasmania's entry to NEM; and
- Tasmania became members of NEMMCO and NECA in May 2002.

Legislation to further progress the Government's program of bringing Tasmania into the NEM and introducing retail competition was tabled in Parliament on 18 March 2003.

The key remaining milestones for Tasmania are outlined in Table 1.

Table 1: NEM entry milestones

Milestone	Date
Tasmania enters the NEM (six months ahead of Basslink)	May 2005
Basslink commissioned and in-service	November 2005
Contestability rollout commences	July 2006
Contestability rollout concludes	July 2010

Customer Choice

At a retail level, retail competition will give Tasmanian electricity customers the opportunity to choose suppliers who offer the best price and service in the same way that they can purchase telecommunications services from a number of suppliers. That is, electricity customers will become contestable.

To allow the orderly development of the NEM in Tasmania, classes of customers will be declared contestable in a phased arrangement over several years, in a similar manner to that which occurred in mainland NEM jurisdictions.

Customer Safeguards

The existing customer safeguards in the Electricity Supply Industry Act and the Tasmanian Electricity Code will be largely retained.

In particular, the Tasmanian Energy Regulator will continue to be responsible for retail price regulation for non-contestable customers and distribution network pricing on an ongoing basis.

The Electricity Ombudsman will continue to adjudicate in disputes between customers and electricity retailers.

Additional safeguard measures will also be introduced, including a “retailer of last resort” (ROLR) scheme that will protect consumers in cases where an independent retailer unexpectedly exits the industry. The designated ROLR will be Aurora Energy, which will assume responsibility for supply to consumers of ‘failed’ retailers for a limited period. This period will provide sufficient time to allow affected consumers to establish alternate arrangements with a new supplier of their choice.

Retail Contestability

As outlined in the table below, electricity retail competition will be introduced for larger customers first and progressively phased in over four years. This timeframe is in line with the timetables adopted in other NEM jurisdictions.

The State has, however, reserved a final decision on whether contestability should be extended to the final tranche of customers, such as small businesses and households, until an assessment is made of the associated costs and benefits of doing this.

This timetable will ensure a smooth transition to a competitive electricity market in Tasmania. In particular, it will allow sufficient time for customer education and the development and implementation of the metering arrangements that are required for customers to become contestable.

The rollout of retail contestability will commence approximately six months after Basslink has been commissioned and is in commercial service. Customers will be classed according to their actual or estimated annual power consumption, measured in gigawatt hours per year (GWh/yr). The proposed contestability timetable and the number of customers in each class is shown below:

Table 2: Retail contestability timetable

Introduction of contestability*	Electricity consumption	Approximate number	Indicative customer type
1 July 2006	20 GWh/yr	10	Mineral processors
1 July 2007	4 GWh/yr	54	Large industrial facilities and commercial complexes
1 July 2008	0.75 GWh/yr	295	Medium factories and smaller commercial complexes
1 July 2009	0.15 GWh/yr	1,030	Small factories and large offices
1 July 2010	Under 0.15 GWh/yr	230,000	Small business and domestic customers

* Dates are subject to completion of Basslink in late 2005

An independent review mechanism overseen by the Tasmanian Energy Regulator will be available for customers that disagree with assessments of their power usage.

Until they become contestable, most customers will remain on regulated tariffs. Once declared contestable, customers will be able to remain on regulated tariffs for a maximum of 12 months. This will provide sufficient time for customers to negotiate appropriate contracts with retailers. A number of industrial customers have existing contractual arrangements that will not be affected by this roll-out.

Contestability will not apply to the Bass Strait Islands. Hydro Tasmania will continue to be responsible for the provision of electricity to customers on King and Flinders Islands and the Government will continue to subsidise the cost of electricity to these customers through the payment to Hydro Tasmania of a Community Service Obligation.

More Information

More information can be obtained from:

Electricity Markets Branch
Department of Treasury and Finance
GPO Box 147B
HOBART TAS 7001

Telephone 03 6233 6554
Facsimile: 03 6233 5646

Alternatively, information is available from the Treasury website at:

<http://www.treasury.tas.gov.au/>