Submission No 14

INQUIRY INTO GENTRADER TRANSACTIONS

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LIGHTS OFF

If you want to get to the bottom of the NSW energy sell off you'll need to grab your sunscreen and some comfortable shoes, and pack your lunch.

The electricity sell off in New South Wales has played out like the Millers Crossing epic. Remember Johnny Casper's line: "…It's gettin' so a businessman can't expect no return from a fixed fight. Now, if you can't trust a fix, what can you trust? For a good return, you gotta go bettin' on chance - and then you're back with anarchy, right back in the jungle…."

Just how much wining and dining and how many back lane punch-ups have occurred in order to "get the deal done"? Having spent years pushing for "energy reform", did the possibility of a hung parliament in March 2011 cause the "privateers" to hit the panic button? Did they make a couple of calls to get a little more certainty?

The pious ranting we have heard from the leader of the Opposition seems targeted at the way the deal was done and the price paid rather than at the sell off itself. The voluble Barry O'Farrell sounds somewhat disingenuous given that privatisation has always been high on the Liberal agenda.

Electricity: an essential service

Believe it or not some of us think the role of government is to ensure the provision of essential services to the people. If government itself provides the service it does so on the basis that it doesn't make a profit but charges a price for the service at a level where the price we pay generally will cover the cost of providing the service and allow for the extra cost of making sure the service will continue to be provided to the population in the future. Proper modelling and costing can ensure that what we pay now creates appropriate reserves to maintain the infrastructure we inherited and build new infrastructure in the future.

Privatisation of an essential service, on the other hand, focuses on return on investment. Investment capital seeks interest or dividends, and merchant capital

seeks profit. Their objectives are best served if the service is provided at the cheapest possible price and charged for at the highest possible price.

History

As with water, the international march towards electricity privatization appears to have taken root here in the mid 1990s. Sharon Beder in, '*For Sale: The Power of the People*', and with Damien Cahill in '*Regulating the power shift: the state, capital and electricity privatisation in Australia*' provides an informative analysis of how the quest to privatise energy was pushed.

I sometimes wonder whether, in exchange for some kind of bail-out, Australia once signed some sort of structural adjustment program that no-one bothered to tell us about.

Some of the key occurrences include:

- The establishment of the National Grid Management Council (NGMC) in July 1991.
- COAG meetings in 1993 and 1994 which reaffirmed the commitment of most State governments and the Federal government to energy reform.
- Premier Bob Carr and State Treasurer Michael Egan pushing for electricity privatisation in NSW in 1997, a clean-cut sale of retail and generation for $30 to $35 billion. They failed.
- COAG commissioning a review of the energy market in 2001, which resulted in the Parer Report, *Towards a Truly National and Efficient Energy Market*.
- In June 2001, COAG establishing the Ministerial Council on Energy (MCE) to provide energy policy leadership.
- In December 2003, the MCE establishing its energy market reform program.
- In July 2005, two new bodies being established: the Australian Energy Market Commission (AEMC), with responsibility for rule-making and market development, and the Australian Energy Regulator (AER), with responsibility for market surveillance and energy market regulation.
- On 10 February 2006, COAG endorsing the need to continue the structural reform process and establishing an expert group, ERIG, to prepare a report. ERIG found that government ownership (especially in electricity)

> acted as a barrier to entry and an impediment to competition. To improve efficiency in Australian energy markets, ERIG recommended disaggregation and full privatisation of government-owned energy assets throughout Australia, taking place as quickly as possible given the practicalities of the privatisation process. ERIG acknowledged that privatisation may be politically sensitive.

Quite a few people saw what was coming, and some even tried to do something about it. In 1994 independent anti-corruption fighter John Hatton introduced a Private Member's Bill in the NSW Parliament – the *Privatisation of Core Government Services Bill* -- '*to give the people of New South Wales a say as to whether they want the core services as defined by the bill privatised, either in part – to the extent that it is privatisation by stealth – or wholly*'. The bill passed its Second Reading on 22 September 1994 with the support of Bob Carr's Labor Opposition but it was then killed by the Liberals under John Fahey. The Carr Labor Government that followed had an absolute majority and went completely the other way.

John Quiggan said in 2001 of the South Australian electricity privatisation experience '*…the South Australian electricity industry has reduced the net worth of the public sector … the interest savings on the sale price will fall consistently short of the earnings foregone through privatisation. This is consistent with most Australian experience of privatisation*". Isn't that exactly what's likely to happen in NSW? Last year the NSW Auditor General reported that the combined profit after tax of NSW electricity agencies was $1.2 billion compared to $847 million in 2008/09. Pre-tax profits of the distributors also increased substantially, from $661 million in 2008/09 to $965 million. Pre-tax profits from generators increased from $307 million to $465 million. Electricity entities' distributions to the Government were $1.4 billion, up $200 million from last year.

No wonder Roozendaal's sale price resulted in the mass resignation of directors!

With that sort of return providing a source of funding for maintaining and upgrading our energy supply systems, how can the NSW Labor government and Eric Roozendaal explain the midnight fire sale of our energy assets? We are all looking forward to their explanations, but in the meantime, back to our history lesson.

The official line: the Owen Report

On the back of the ERIG 2006 report, with its acknowledgment that privatisation might be "politically sensitive", in April 2007 the Iemma Government commissioned Curtin University Professor Tony Owen to report on the need for new generation capacity in NSW. The Greens, along with various environmental groups, unions, and community groups, questioned the terms set for the inquiry and its independence.

The Iemma government set up the Owen Inquiry on the premise that the State would experience a shortfall of electricity supply capacity and blackouts some time in the next ten years if a new baseload plant were not built. The government based their prediction on a report prepared by the national electricity market operator, NEMMCO, called the 'Statement of Opportunities' (SOO), but the report in fact identified a relatively small shortfall in peak demand which it said could be met by better managing energy use and making businesses and homes more energy efficient.

The Owen report then came out suggesting that a new baseload plant – costed at $8 billion - needed to be up and running by 2014 if NSW was to avert an electricity generation crisis. We'd also need another $4 billion to retrofit existing power stations with carbon reduction technologies, and the retail businesses would need up to $3 billion more to remain viable and compete with their private sector rivals.

(As an aside, the current annual Statement of Opportunities by the Australian Energy Market Operator now forecasts that NSW will face shortages in 2016-17, well after the 2013-14 date put forward by Professor Owen in 2007.)

Sell-off spruikers in 2008 told us the State needed money to deliver new roads and new public transport to reduce congestion, more hospitals to improve the failing health network, and more schools. Importantly it also needed the $15 billion for energy reform to meet the demands in the next decades. Funnily enough those needs weren't mentioned by Eric Roozendaal in December 2010: he said the midnight fire-sale removed the need for taxpayers to build new power stations, protected the State's Triple A credit rating and, despite not resulting in a new energy retailer, ensured a more competitive retail market.

One might be forgiven for asking whether NSW retaining its Moody's AAA credit rating was contingent upon the sale of the assets itself taking place, rather than on the money NSW derived from the sale!

So where does all of this leave us?

Causes of cost shocks

Although I don't agree with its arguments or conclusions, there is an interesting analysis of energy cost factors in a 2010 AGL Applied Economic & Policy Research Working Paper "*The Boomerang Paradox: how a nation's wealth is creating fuel poverty - and how to defuse the cycle*".

The authors note that the actual cost stack which makes up an electricity tariff includes power generation, transmission, distribution, retail and other regulated cost components such as metering, renewable energy and government taxes, and make observations on our present energy situation including:

- Australia's great wealth of energy resources, which have historically been sold to energy utilities at a margin above extraction cost, are now being developed at such scale for export that if they link with global energy indices Australia may suffer a fuel cost shock.
- Power plant costs surged materially over the past decade, as did the cost of money after the financial year 2009 global financial meltdown.
- Network infrastructure is now expanding at record rates to keep pace with rapidly rising peak loads.
- Environmental demands of a comparatively wealthy developed economy have led to community demand for the tightening of performance standards which will cause a technology shift in power generation investments from low cost coal to lower CO2 emitting gas, and increased higher cost renewable capacity.
- The main contributions to the price shocks they envisaged come from the unit cost of gas, network charges and generation plant costs.
- Continuously rising household income and low cost power led to rising residential floor-space and vast increases in use of electric appliances including air conditioners. Peak demand has risen exponentially.

The official line: The Auditor-General's Review and Reports

In 2008 then Premier Morris Iemma asked NSW Auditor-General Peter Achterstraat to review the privatisation plan after the opposition said it would oppose the sell-off unless that scrutiny was carried out.

The Auditor-General examined a model that would see the sale of electricity retailer EnergyAustralia by the end of that year, and included a proposed public share offering of a combined entity made up of Integral Energy and generator Eraring Energy in the second half of 2009. The other retailer, Country Energy, was to be sold off, while generators Delta Electricity and Macquarie Generation would be leased out under long-term agreements.

The Auditor-General recommended the NSW government set a reserve price before selling or leasing out its electricity retailers and power generators, saying that no transaction should proceed unless that reserve price was met. He also said the NSW government should look at selling individual retailers and leasing out its individual generators all at the one time, rather than sequentially as had been proposed. Did Roozendaal consider those recommendations?

A new report from the Auditor-General last year noted significant uncertainty about the value of the power-station sales because of the potential future introduction by the federal government of a carbon pollution reduction scheme (CPRS). The Auditor-General said, "I did note significant uncertainty that may affect the value of power-station assets due to the unknown impacts of any future carbon pollution reduction scheme and the government's proposed electricity industry reforms".

Roozendaal obviously didn't worry about those concerns when he did the deal!

The official line: Roozendaal's midnight special

Although in its death throes in December 2010, the NSW Labor Government pushed through its notorious late night sell off that prompted mass resignations from the boards of corporations involved and is now the subject of an Upper House inquiry.

TRU energy paid $2.035 billion for retailer Energy Australia, the right to trade the output generated by Delta West and access to three development sites (Mt Piper extension and two of the Marulan development sites).

Origin Energy bought smaller retailers Integral Energy and Country Energy and the electricity trading rights for Eraring Energy for $3.25 billion.

The next phase involves the output from Macquarie Generation and Delta's Central Coast power stations being sold early this year.

Roozendaal conceded that although the sale is worth $5.3 billion the proceeds have to pay for the $2.3 billion Cobbora Coal Mine, which the private sector demanded so the sale would go ahead. It is designed to prop up the "currently state owned" power generators whose electricity trading rights were sold.

It was reported that *"….one of the big risks was the issue of liquidated damages payable by the companies if they failed to supply the required amount of electricity when it was demanded by the traders, sometimes with less than one day's notice. By one estimate the damages could amount to $200 million over the life of the 30 year contract for a single generator*." Does $6-7 million per year sound like much of a risk in the scheme of things, given the sums being bandied about?

So the end result of the fire sale seems to be that our assets have been sold at a price that may leave a paltry $3 billion to disappear into consolidated revenue, the State has lost a substantial source of recurrent revenue and the people of NSW have been left with public ownership of the ageing assets - existing power stations and electricity transmission and distribution networks (the poles and wires) that still need to be upgraded or replaced. According to Premier Keneally the NSW Government is investing more than $9 million every single day in maintaining and upgrading the state's power supply, and over five years the NSW Government will spend $17.9 billion on electricity infrastructure to support our growing population and to secure the NSW power supply for the state's families. Where's that money going to come from now?

The official line: The coal mine

The NSW government last mined coal in NSW through its Powercoal entity in 2002. But an unincorporated joint venture between State owned Macquarie Generation, Delta Electricity and Eraring Energy recently bought up 25,753 hectares of land in the Cobbora and Lahey's Creek area to launch mining at Cobbora for 21 years. It aims to produce 30 million tonnes of run on mine coal and 20 million tonnes of thermal coal a year to ensure the cost of coal for the state's electricity generators is capped.

The mine site is to include a coal handling and preparation plant, ancillary infrastructure and a 25 km rail spur line connecting it to the existing rail network. Two water pipelines, 25 and 50 kilometres long, will link the site to the Cudgegong River and the Ulan Coal Mine respectively. An estimated 4 GL of water from multiple sources will be required by the mine each year, with negotiations under way to obtain high security water licences on the open market for some 1.5 GL of water.

In May 2009 the then Minister Ian MacDonald said that the Cobbora resource would deliver security of coal supply to the generators and affordable power for NSW homes and businesses. Yet in December Treasurer Roozendaal said it is not for the government to stay in that business, and once the business is developed the government will on sell it.

The mine was intended to supply state-owned power generators with coal at $35- $40 a tonne, well below the export market price of $60-$70 a tonne. In November last year The Australian reported that *"…sources close to the deal say that the State has promised 17 years of supply from Cobbora at prices of about $32 a tonne, rising to $35 a tonne when transportation costs are included. That compares with recent published estimates by Merrill Lynch of a spot export price of about $US95 a tonne, a long-term export price of $US74 a tonne, and a long-term domestic contract price close to $60 a tonne…."* Sounds like a good deal for the generators, or those who own their output!

The Nature Conservation Council has enlisted the support of the Environmental Defenders Office to look at potential breaches of the Trade Practices Act. Critics also say that by subsidising coal the NSW government is undermining a federal

price on carbon, as well as distorting the national electricity market - through which more than $10bn is traded across the eastern states - because subsidised power from NSW could be exported interstate.

The Cobbora Coal Mine consortium acquired two high security licences totalling 2371 megalitres (almost 2.5 billion litres) from Warren, downstream from Burrendong Dam. Many residents naturally are extremely concerned about the environmental impacts of this mine. Although the Final Report has not yet been published the Preliminary Environmental Assessment justified their concerns by noting the high risk ratings for each of surface water, groundwater, ecology, heritage, air quality, and noise and vibration.

The official line: the future for energy consumers

The 2010 AGL "Boomerang Effect" Working Paper suggested that rising wealth is driving substantial increases in peak energy demand, which causes the power grid to require vast amounts of incremental generating and network capacity. Its authors considered it predictable that fuel poverty – a situation where the combined energy costs of a household exceed 10% of income – would emerge in Australia for the first time amongst low disposable income households.

Earlier this year the NSW Government extended rebates, and now one in three households in NSW are eligible for assistance with their energy bills.

The unofficial line: there are other options

The logical first step: solar

It's fairly obvious from this brief historical conspectus that privatisation is an agenda that's been force fed by the self interested to NSW Labor governments over the last 15 years, and swallowed wholeheartedly. Even Blind Freddy could see that proper consideration has not been given to viable, sustainable long-term alternatives like solar energy. And if the boobs in Macquarie Street can only be transfixed by the siren song of the Wall Street players, what about paying a little attention to what Warren Buffett's "senior" associate, Charlie Munger of Berkshire Hathaway, has said about the future of solar energy.

But no, not in New South Wales: if it's clean, renewable and socially and environmentally responsible, let's axe it. Pardon? Given the prevailing mentality I guess it's only natural that such a commodity should actually be blamed for rising electricity bills!

What the government also fails to trot out are figures to show us how special deals for large users of electricity add to our quarterly bills? How many of those large energy users are on negotiated, guaranteed fixed prices for their electricity, at rates which mean they're effectively subsidised by householders? Are we given details of those users and their effect on the system's capacity? Oh no, we can't disclose information like that: it's "commercial in confidence"!

NSW started with very positive schemes to encourage alternative energy sources, but those of us who install solar panels from now on receive only 20c per kwh to feed energy back into the grid, whereas those whose installations occurred between Jan 1 and October get 60c kwh for seven years. And the gloomy prediction from the big side of town is that paying for those already receiving 60c kwh will add an extra 10% to bills, on top of increases of up to 16% consumers will be facing anyway! They don't mention that 20c is much less than the conventional payment of a little over 40c per kwh, and no plausible reason has been given for such a complete about-face

Giles Parkinson of the Climate Spectator has written a detailed and informed series of articles about NSW's Solar Scheme.

If one were to take a cynical approach one might think the scrapping of the NSW Solar Scheme was somehow connected to and contingent on the electricity sale proceeding

But just look at what is happening on the solar front notwithstanding our government's best efforts.

Innovation

2008 data for Australian households indicates that 67% used spatial cooling and 77% used spatial heating. Spatial heating/cooling comprises 41% of household energy costs. Water heating accounts for 24% and other appliances about 13%. Plasma televisions consume almost three times more power than older versions.

We have already read about the development of extremely efficient solar-powered air-conditioning systems that will not only lighten the load on the mains transmissions grid, but also address the huge amount of greenhouse gas emissions generated by the use of air conditioners. It won't be long before systems like that are on the market here, whether Australian made or from China.

There's also the CSIRO Brayton Cycle system that doesn't need water, and uses natural gas to overcome weather/sun variability. The CSIRO project will incorporate the option of a future solar thermal storage system that will allow extended operation during peak demand times in the evening and address the challenge of continuous operation from renewable energy sources.

Whether the NSW government knows it or not, believes it nor not, supports it or not, or likes it or not, solar is coming.

Another objective: containing peak demand

It's preposterous to simply accept that vast sums of money have to be expended to boost capacity just to accommodate peak demands. Apart from being more tolerant of occasional interruptions in supply, which I accept may not be politically acceptable, there are many steps that can be taken to contain or reduce peak demand. It's been done successfully in other countries, but not really pressed here yet. Some suggestions that have already been made include:

- Giving power distributors the ability to turn up the temperature in shopping malls and office blocks by one or two degrees.
- Promoting only the most energy efficient appliances by making manufacturers and retailers of appliances provide preferential pricing to customers in hardship and restrict access to credit (in all forms) for the purchase of less efficient appliances.
- Investing in home energy displays and the distribution of technology, particularly for low income households, to help people monitor and reduce their energy use and expenditure.
- Reinstating the solar bonus scheme at the generally accepted rate of 40c/kWh

Measures like these only have to work in the short term to be effective. In the longer term, with a bit of foresight and planning, more fundamental changes should come into play that will get us out of the mess we're sliding into now. The US Rocky Mountain Institute bemoans our current electricity systems as "inefficient, wasting both capital and electricity"; its scientists Amory Lovins and Bennett Cohen describe the acceleration of micropower in taking over the global market long dominated by central thermal stations.

The Institute hopes to eliminate fossil fuel use in the electric system by 2050 and is working on a model of the "next-generation utility" (NGU) which "replaces traditional "baseload" coal and nuclear power with dynamic demand and supply-side resources to create a low-carbon utility system that is both cost-competitive and highly reliable". They're taking a clever approach to problem solving, whereas back in NSW our government is creating new problems and solving none.

Conclusion

Thanks to political gullibility, economic stupidity and intellectual vapidity we're in a tight spot.

More than a decade ago, in "*Advice from Abroad on Restructuring Electricity*", renowned systems theorist Donella Meadows said the advice of international experts was "BEFORE privatization" (her emphasis) to make prices tell the truth; protect small users; enforce anti-trust measures; require honest advertising; hold investors generally responsible (she said the press should be in the room when any amounts of public recompense are decided, with ratepayers having veto power: our current government would love that!); and above all keep the system flexible because "*the (then) current changes are only the start of a huge technical shift in electricity production. … Ten or twenty years from now … households may join that trend, generating their own electricity with rooftop solar, fuel cells, and even mini-generators in electric cars. The wildly decentralized system, still connected in grids, could be much more democratic, environmentally friendly and resilient to breakdown*." Such voices of reason - now supported by well documented local and international experiences with power privatisation, almost universally bad - resonate against everything that's been done in restructuring and selling off our electricity assets.

Maybe what's been missing from the energy reform (ie privatisation) debate is the voice of the citizens of New South Wales.

Kellie Tranter is a lawyer and writer. She declares her interest as an independent candidate for Maitland at the next NSW State election. She proudly accepted an unsolicited endorsement of her candidature by anti-corruption fighter John Hatton AO.