Submission No 25

INQUIRY INTO GENTRADER TRANSACTIONS

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SUBMISSION RE INQUIRY INTO THE GENTRADER TRANSACTIONS

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1. Firstly, the holding of this inquiry by the Committee is appreciated and it is submitted that it is important that the recent transactions be reviewed as soon as possible, and if possible, some transactions reversed. The transactions include:

• $3.25 billion for the combination of Country Energy, Integral Energy and the Eraring Gentrader contract to Origin Energy, and

• $2.035 billion for the combination of EnergyAustralia, the Delta West Gentrader contract bundle and the Mt Piper Extension and two Marulan development sites to TRUenergy.

Appendix A has an article *Seller's remorse hits as power station buyers jump for joy* by Ian Verrender from the Sydney Morning Herald for 18 December 2010.

2. Secondly, whilst the writer is not opposed to some privitisation of public assets, it is submitted that too many power retailing and generation assets have recently been sold off by the NSW Government.

The NSW electricity generating and distribution network in very important to both economic and standard of living terms of the people of not only NSW but other parts of Australia. Before any sale, it would have been desirable for the terms of sale to be debated in Parliament.

In 2006, the experience of moving to sell off the NSW interest Snowy Hydro without recourse to Parliament was not a good one. In the end, the sale process was terminated.

There are many factors in selling or leasing long term power generating facilities. The sale of some generating facilities in other states, and overseas, has not always lead to provision of appreciably extra power generation capacity but in some cases has been accompanied by both power shortages at peak load times, and increased charges for power.

The issues have been well addressed by Professor Sharon Beder of the University of Wollongong in her widely acclaimed 2003 book *"Power Play: The fight for control of the world's electricity."* This book was followed with a 2004 Korean translation, a 2005 Japanese translation and a 2005 Spanish translation. The arguments advanced give support to keeping most (if not all) electricity generation and distribution and retailing in the public sector.

Particularly aspects of concern of the Gentrader sale (apart from the price which is addressed later) include:

A. Not retaining at least one of the retailers in the public sector. As demonstrated by the banking industry in Australia one wants true competition, this is best served by having the public and private sectors competing, with a reasonably level (but not necessarily perfect) playing field.

Country Energy, by virtue of its large service area (and with fewer customers per square kilometre) would have been well placed to remain in the public sector. In addition, those people who prefer to deal with a public sector utility could have remained with this choice.

B. Lessening competition between retailers. If, after all factors were fully considered (and this is doubtful) if it was deemed that both Country Energy and Integral Energy were to be sold to the private sector, they would have been better sold to separate companies.

Apart of lessening competition, the Australian experience of packing together public assets for sale has not been a good one for the wider community, as demonstrated by the sale on 21 February 2002 of both the National Rail Corporation (from the Australian, NSW and Victorian governments) and the Freight Rail Corporation of NSW.

Initially, the plan was to sell these assets separately, but then at the insistence of the NSW Government in late 2001 (Treasury driven?), the two rail freight operators were sold as one to a joint venture of Toll and Patrick to form Pacific National. So instead of two well functioning rail freight operations being owned by separate companies, to provide competition to the market place, they were sold as one.

The first year of two was then taken up with integration of two systems into one, and this took to about 2004 to complete. A year or so later, Patrick was subject to an initially hostile takeover by Toll, thus further diverting managements attention from the business of getting more freight on rail. Including inter-capital city freight. Which since the sale in 2002 has led to 'more loads on roads' with its high community costs (road wear and tear, road crashes, congestion, air and noise pollution plus increased greenhouse gas emissions).

A recent example of shifting freight from rail to road is that of in late 2009 with the discontinuation of moving some liquid fuel by rail Pacific National from Sydney to certain regional facilities.

C. Lessening pricing protection offered by the Independent Pricing and Regulatory Tribunal. A case in point is the price of rail travel in Sydney; RailCorp fares are subject to regulatory oversight whilst the Airport Stations (plus Green Square and Mascot) are not subject to the same oversight. Hence fares set so high that there are calls for the stations to revert to public ownership.

D. Integral Energy and Country Energy have done a good job in recent years in recruiting and training apprentices. Will this continue with the same dedication under the new owners?

E. What will happen to employees who may have been working with either Integral Energy or Country Energy, and recently switched from one company to the other, giving up certain superannuation benefits. Will they be compensated if the sale proceeds ?

3. Thirdly, the sale price appears to be too low. In early 2008, the Iemma Government when responding to letters of concern at the then proposed sale or lease of power assets had mentioned a need to save "taxpayers up to $15 billion and unlocking funds for investment in roads, trains, hospitals, schools and other essential infrastructure."

Clearly, Victoria got a good price for the sale in the 1990s of some of its power assets. But equally clearly, it seems that the NSW power assets are being disposed of too cheaply.

Up to this year, what were the returns to the NSW Government from its power assets that have now been sold. Was it about $750 million a year ?

It is hoped that the Inquiry can in its report produce a table that will list for each of the entities being sold, the return to the NSW government for each financial year, and the total return.

4. Fourthly, the NSW Treasurer, Mr Roozendaal, in his MEDIA RELEASE dated December 14 2010 $5.3 billion for first tranche of energy reforms in part states “This result puts NSW in a stronger financial position by reducing our future requirement to invest in new power stations, strengthens our balance sheet and improves our capacity to retire debt and fund frontline infrastructure.”

At the end of the day, NSW has a large infrastructure deficit and this will require significant funding to remedy. However, ongoing funding needs will not be solved by selling important public assets. Instead, it is respectfully suggested that more ‘user pays’ and ‘polluter pays’ pricing is required in roads, transport and electricity provision along with taxation reform.

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Appendix A ***Seller's remorse hits as power station buyers jump for joy***

Excerpts of article from the Sydney Morning Herald 18 December 2010 by Ian Verrender

Our beloved Premier … possibly missed the symbolic irony of it all - casting aside the state's power assets even as her own ineffectual government meekly waits to be stripped of power.

If the debate about privatisation, between public ownership and free enterprise, is a choice between inefficiency and greed, then this week's tawdry tale of the offloading of the state's power assets is a combination of the worst aspects of both extremes.

We've sold the retail assets but kept the generators. But we've sold the output - or the trading rights from the generators - for a song and retained all the expenses of maintaining the power stations.

On top of that, we've agreed, even in these days of fearful warnings of global warming, to use a large slab of the money that's been raised to dig a new coalmine so that we, the taxpayers, can supply those generators at a huge discount to market prices.

It gets worse. In addition to taxpayers racking up huge losses on the coal sales, energy consumers have been stripped of much of the pricing protection offered by the Independent Pricing and Regulatory Tribunal.

And therein lies the conflict, or rather the cross-over. Normally, owners and consumers are at opposite ends of the business spectrum. But there's a unique relationship between the two when it comes to publicly owned essential services like power.

Unlike other privatisations such as toll roads or airports, electricity affects us all. It is a utility used by every household and every business in this state.

And for that reason, the debate raging about whether or not taxpayers were dudded by this week's deal has been completely muddle-headed.

The more we would have reaped from the sale, the more those who bought the assets would have needed to charge us to recoup the costs of their investment. What we'd pick up on the sale, we'd lose on the retail roundabout.

At just $5.3 billion, with maybe another $2 billion to come, NSW taxpayers have been royally shafted, ripped off and taken for a ride. At least, that's what the critics would have us believe. And, superficially at least, it's difficult to argue with them.

In 1997, those same assets were in the books at $25 billion. But within two years, the value had plummeted to $16 billion.

Still, that's more than twice the value we've just realised. And what about the Victorians? In the mid-1990s, Jeff Kennett enticed a coterie of global power companies to tip $22 billion into his state's coffers to privatise the Victorian power industry.

Further evidence that we've been given the rough end of the stick was the mass resignation of directors, many of them ALP functionaries, from the boards of two of the power generators. So convinced were they that the deal was a dud and done on the cheap, they jumped ship at the final hurdle to ensure they wouldn't be sued for breaching their duties as directors.

And if there was any lingering uncertainty, that was swept away by the triumph exuded by the Origin boss Grant King and chairman Kevin McCann, the big winners from the state's electricity privatisation.

At a phone hook-up press conference on Wednesday morning, McCann boasted that the $3.2 billion deal his company had signed would be "materially accretive for underlying earnings per share" immediately.

The translation of that goes something like this: "We got it for a song and we're in the black from day one."

So where have we gone wrong? It's worth remembering that in the bleak days of last year, when the state government announced its latest electricity sell-off, most analysts were convinced that, at a pinch, NSW might pull in $6 billion. Most, however, thought $3 billion was closer to the mark. Although we've certainly outstripped those gloomy forecasts, the question is: why have the state's power assets depreciated so much in value?

There are a couple of reasons. To begin with, the fabulous price Kennett achieved for Victoria's power industry was based on, if not an outright lie, then a misconception.
Victoria was the first state to privatise its electricity sector and global power companies clamoured for a slice of the action in the belief that every other state would soon follow. With Australia's biggest and cheapest generators, Victoria would deliver huge profits as the other states followed suit.

Unfortunately, that didn't happen. …The result in Victoria was skyrocketing prices and blackouts. When that happened, the value of electricity assets in other states plummeted; everyone knew the Victorian experience would never be repeated.

The other thing that has changed since the 1990s is awareness of the environment, particularly carbon emissions. Coal-fired power stations, which are faced with paying for emissions, are simply not worth as much as they were.

So would we have been better off keeping the power stations in public hands? Maybe. But there are a couple of reasons why governments should not be in the power business. Energy production has become as much a financial operation as an engineering challenge. Energy is now a tradeable commodity, not just physically, but in the financial world. And that has the potential for financial disaster. You could point the finger at Enron in the US as a glowing example of what can go wrong, but there is a better example much closer to home.

In 1997 the state-owned Pacific Power, then headed by Peter Graham and chaired by the academic Fred Hilmer, lost more than $9 million in a single day on energy trading. In an ensuing court case, it was revealed the group had written uneconomic forward electricity delivery contracts out until 2007. The extent of the losses was never disclosed because the state government broke up the company. But on some estimates, Pacific Power torched close to $1 billion.

There's not a lot to like about this week's sale. We've half sold the industry and kept the liabilities. The side deals - particularly the cheap coal - stink and the energy from the power stations has been sold for a bargain price.

As for competition, we have fewer retailers than before. On the upside, Origin, the new force, believes it has a bargain, so maybe it won't need to gouge customers to make the investment pay.