

**Submission
No 94**

**INQUIRY INTO THE CONTINUED PUBLIC OWNERSHIP
OF SNOWY HYDRO LIMITED**

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Date Received: 28/06/2006

Theme:

Summary

From: "Doug Nicholas"
To: "Stephen Frappell" <snowyhydro@parliament.nsw.g...
Date: 28/06/2006 11:19 am
Subject: Snowy Inquiry Submission

Dear Stephen,

My submission to the Inquiry follows. It is unsigned but I would be able to have my Secretary add a scanned signature if necessary or send a hard copy instead. Could you advise me please? I have also faxed a copy so perhaps that will be sufficient.

Also, given the numbering system in my preamble is an index, and its extra page, essential?

Regards,
Doug Nicholas
Ski-Jump Runoff Services

Reverend the Hon. Dr. Gordon Moyes
Chairman
Parliament of NSW – Snowy Hydro Inquiry
Parliament House,
SYDNEY NSW 2000

Inquiry into Continued Public Ownership of Snowy Hydro Ltd.

This is a submission to the NSW Legislative Council Select Committee on the Continued Public ownership of Snowy Hydro Ltd by Douglas Ian Nicholas, Consulting Civil Engineer, Member of the Institution of Engineers Australia, Managing Director, Ski-Jump Runoff Services Ltd and Author/Convenor of the Collegiate Letter to the Parliaments of NSW, Victoria and the Commonwealth of Australia by fifty-six prominent Australians, calling for a halt to the sale of Snowy Hydro, delivered to the three parliaments on 1st June 2006.

Douglas Ian Nicholas.RPEng. MIEAust

Dear Hon. Rev. Dr. Moyes and fellow Hon. Members of the Select Committee,

Preamble

With the decision by three governments not to proceed with the privatisation of Snowy Hydro, Australia has been spared the consequences of a deeply flawed proposal, which was opposed by 99% of its citizenry and actively promoted only by those who stood to gain financially or politically from its coming to fruition. That this pitifully narrow interest group was able to prevail upon 494 politicians in three parliaments to act in a manner so inimical to the interests of the mass of society asks profound questions about the strength of the democratic process in at least three of the eight State and Territory administrations that comprise our nation.

Your Committee of Inquiry has a unique opportunity to build upon this unprecedented reversal of a cast-in-stone decision, by Australia's three most powerful Governments, which was prompted by rational public debate, without the disruption of a single street march or the spilling of a single drop of blood.

The major issues, as I perceive them, are:-

1. To discover the reason that we were able to go so far down the path to this sale without proper recognition of the alarm growing in the widening community of people who were able see the danger,

2. To suggest what the appropriate path is for a publicly owned Corporation set up to actively, progressively and profitably manage an entity with such an essential part to play in the nation's water and energy futures and to do so with the public interest paramount,
3. To suggest how such a Corporation, or group of Corporations with different core responsibilities, might be properly facilitated in their tasks by an actively interested and supportive populace and,
4. To reflect upon how this recent chapter in our history might be made the genesis of a new, more healthy and robust relationship between parliament and people, in which the first answer in a crisis is not to cast around for the next thing to sell or for the convenient way to shed some properly collective, societal obligation to those in business whose first, and generally over-riding, objective is short-term profit.

My submission develops each thought in turn and includes recommendations the Inquiry might consider.

1. The Push for Snowy Hydro Privatisation

An objective reading of the principal public document under which Snowy Hydro operates, i.e. its 100 page Snowy Water License issued in 2002 under the Snowy Corporatisation Act of 1997 (NSW), reveals a suite of arrangements that has led inexorably toward a privatisation outcome from its inception. It was prepared by legal consultants, engaged and briefed by the NSW Treasury, in a form that seems designed to facilitate corporate operations with all the freedoms that might normally be expected in a company with obligations indistinguishable from one operating solely for profit in a fully commercial environment. Its author is understood to now hold a senior position with the Corporation.

Exhaustive analysis of the License has not been possible in the period available for submissions but the document has been referred for consideration to the four Queen's Counsel who were signatories to the Letter of 56 referred to above and I ask leave to present any comments they have to the Inquiry during the hearing process in due course. This said, there are observations to be made which suggest the License has too little regard for the conflict between the electricity generation aspect of the operation and its water regulation function, particularly in respect of the derivative trading functions which have become dominant in the corporation's day to day operations and in its business growth model.

Although the core responsibility which the corporation has to the public, on whose behalf the shares are held, is that of maintaining, operating and developing Australia's major consolidated suite of engineering

infrastructure efficiently and equitably for the benefit of those who use its electricity, water supply and environmental products, both the Board and executive structure of the entity appear to lack many of the skills, disciplines and experience sets which one would expect to find in organizations with such technically rigorous obligations. Instead, the Corporation has grown to be predominantly served, in its policy and senior management positions, by those one would normally expect to find in organizations whose central tasks were financial management and derivatives trading. While such disciplines may be necessary in the Snowy Hydro Ltd mix their predominance introduces risks that are rarely permitted elsewhere in the world where the presence of technical competence is much sought after in the upper echelons of such undertakings.

This may have resulted from the License failing to mandate the substantial inclusion of people with specific operational and planning expertise in top management and avenues should therefore be explored by the Inquiry to restore a more appropriate balance by recommending strongly to the shareholders that the Board and executive be recast. It is likely that the focus of the current Board and executive has predisposed the Corporation to actively and aggressively promote privatisation from within. There is anecdotal evidence for this and I have not found evidence of even modest sale advocacy by those concerned with the actual production of electricity or the storage and distribution of water.

Further, on this issue, the quiet way in which preparations for the sale were pursued, where no considered case was offered and no Parliamentary debate ensued, reflect a culture that has come to dominate relationships between government and the corporate sector. Misuse of the expression “commercial in confidence” to disguise aspects of dealings which, it is feared, will be unacceptable to the public is ultimately corrupting to those controls which an open market applies naturally when deals receive proper scrutiny.

The absence of reports and recommendations by a competent, informed, concerned and fearless public service on this most significant of privatisation proposals was, perhaps, the most disturbing aspect of the whole train of events since December 2005. The increasing tendency for Government to diminish the planning and creative arms of the public service, in both numbers and excellence, and its concomitant need to rely upon the advice of Consultants, sometimes self-serving or with divided loyalties, has denied governments the protections once taken for granted and this, too, should be a matter on which your Inquiry makes a finding which would also apply to other recent Government undertakings.

It is suggested that the following recommendation be made to Snowy Hydro Shareholders: -

That the Commonwealth, NSW & Victorian Governments exercise their right, as nominal shareholders in Snowy Hydro Ltd on behalf of the Australian people, to pursue adjustments to the Board & executive management structure of the Company such as to align them more closely with international best practice for organizations managing, operating, maintaining and developing complex engineering infrastructure of critical importance to the provision of the essential services of water storage and distribution and energy generation and distribution while preserving the corporation's trading function and its growing role as a supply guarantor to electricity providers .

2. A Productive Future for Snowy Hydro

The evidence is that Australia is probably in an extended phase of climate uncertainty and that a new equilibrium could emerge which requires that we manage the water we have in ways that could scarcely have been imagined when the Snowy Scheme was built. That we will now be able to manage the change without the added complexity of having the system controlled, in any measure, by an entity whose first allegiance is not to the commonwealth must be seen as fortuitous. This is not to say, however, that we are not in need of a strong, dynamic, innovative entity to spearhead our approach to the new challenges that develop. Snowy Hydro should be seen as the genesis of that entity although there will be a need for it to change into an organization whose goals are suited to one which will remain in public ownership in perpetuity.

The transformed Corporation will continue to operate under its foundation License but, with a Board now looking to the new horizons which can be expected to open to deal with the new rainfall regime, the License can be expected to evolve by mutual agreement, using the mechanisms already embodied. Certain of the development projects planned by the Corporation to accompany privatisation will probably fit into the new objectives. The need for new infrastructure development to enhance our capacity to respond quickly to power outages and demand spikes throughout an increasingly integrated grid will not diminish with the decision not to privatise except, perhaps, as we choose to consume energy more carefully and pricing mechanisms are invoked which reward such care and penalise waste. To have such a Company as Snowy Hydro dynamically in pursuit of such aims, as well as pursuing new operational synergies, new water harvesting approaches, water distribution efficiencies, irrigation practice efficiencies, river restoration projects and a range of other possibilities beyond the scope of this submission, is exactly what might be needed to encourage the Commonwealth & States to rise above the political sniping and parochial defensiveness

which has impeded many honest attempts to begin the mammoth task of coordinating the recovery of the Murray Darling Basin while yet there is time.

If realised, such a dynamic future could increase the vulnerability of the Corporation to predation by some future government and there must be some doubt as to whether passage of an enabling Bill through both Houses would, of itself, be a sufficient deterrent. The recently abandoned sale proposal achieved this through one Parliament with almost no opposition and a new attempted sale in twenty-five years may not be overturned by a diminished aging population who are conscious of the significance of the former Snowy Scheme to the nation.

It is suggested that two recommendations be made on the future of Snowy Hydro Ltd.

That, subject to its continued public ownership in perpetuity, Snowy Hydro Ltd be actively encouraged to continue its measured growth as a provider and manager of water storage and distribution infrastructure, electricity generation and distribution infrastructure and of associated services authorised under its operating License as amended from time to time by the Water Administration Ministerial Corporation.

That all physical works and lands under administration by Snowy Hydro Ltd and not otherwise protected by statute be given permanent protection as part of the national estate in a manner equivalent to the protection given to items nominated and approved for World Heritage Listing.

3. A Proposal for Ongoing Capital Injection

A consequence of the decision not to float Snowy Hydro Ltd is that NSW & Victoria will not receive the income expected from the sale of their shares that had been notionally allocated for the construction of schools, hospitals and similar public works. A second consequence is that Snowy Hydro Ltd will itself be deprived of capital inflow associated with the float and of the future ability to extend its capital base by the issue of further shares from time to time. If the Corporation is to grow in a measured way to increase its spread of services and its profitability it will require regular capital inputs from other sources.

One source, already identified by the Corporation CEO, may be found through retained dividends. This would impact on the shareholders whose reluctance to support the capital demands of Snowy Hydro Ltd is suggested as the reason the sale was proposed. An alternative capital raising option is therefore desirable.

One option that has long been used by Governments seeking capital for infrastructure is that of a Bond issue through which the public subscribes to a loan to a capital guaranteed loan to Government that attracts a rate of interest below commercial rates in recognition of its virtually total capital security. Such a facility allows Governments to borrow advantageously and to maintain a healthy bond market which is a useful mechanism for movement of funds between cash, equity, property and other investment markets and provides guidance to the comparative values perceived by investors as market risks & rewards fluctuate.

If the Commonwealth issued Snowy Bonds with interest set a little above the Reserve Bank Cash rate target a National Capital Fund could be created which would allow Snowy Hydro, or to other such nationally orientated entities to be offered development loans on the best possible terms. If Snowy Hydro is as sound as the Prospectus was no doubt preparing to say, regular interest remission to Treasury and a return of principal in ten to fifteen years could be expected. Bonds could be offered for fixed terms of 5, 10 or 20 years and their maturity would see either a return of capital to investors or Bond renewal to fund new projects of national importance. Prudent project selection would result in capital works or acquisitions funded in this way building the real value of the asset under management, the income stream and, hence, the public purse. Although it is not certain that the level of dynamic management achievable by a Corporation managed under a Charter to act in the public interest in its dealings could match that of the current corporation it should be possible within the corporate structure to offer highly stimulating employment and commensurate rewards. It is probably true that the excessive remuneration packages now available in some sectors of business would not be sustainable but it can be argued that the present market for executive labour is also unsustainable and is likely to be more so in the longer term. An attempt to have the Corporation follow a more temperate middle road could be a timely one for the calibre of executive who would be drawn by the challenges and opportunities discussed under the previous heading.

The likely success of a Bond issue can be gauged from the almost universal support for retention of Snowy Hydro in public ownership and by the reported response of 200,000 to the call for registration of interest in the Prospectus for the proposed float the company although my own enquiries suggest that this was driven as much by a desire to protect the asset from predation as it was by a need to invest.

Consider three scenarios based upon that investor response in the last two weeks of June :

- If 100,000 investors took up Commonwealth Snowy Bonds, at the \$5000 minimum level usual, a Capital Reserve of \$500 million would accrue, just the amount CEO Terry Charlton says is the capital shortfall the collapse of the float has created for him.
- If 200,000 investors took up an average \$16,000 each, \$3.2 billion would be raised, enough for the Commonwealth to buy out the NSW and Victorian Governments so they could immediately proceed with all those planned hospitals and schools with \$600 million going to the Capital Reserve Fund.
- If 200,000 investors took up an average of \$20,000 each the Capital Reserve would accrue nearly \$1.5 billion after expenses and we could begin some more of the daunting tasks in the burgeoning water crisis that we can now hardly muster the energy to even talk about.

These scenarios should not be taken to imply an endorsement of Snowy Hydro's \$500 million wish-list. This should be subject to a public interest test and, although some projects seem likely ones others may not be.

It is suggested that the following recommendation be made on capital raising:-

That the Commonwealth Government offer Snowy Bonds to investors as a means of creating a National Capital Reserve for the purpose of offering loans to Public Corporations to allow the development and ongoing management of infrastructure projects critical to Australia's Water and Energy Futures.

4. The Role of the Public Service in the Sale Proposal

It is my belief that many of the poor results achieved in recent years by public undertakings, conceived in good faith for legitimate purposes and for the public good, are the inevitable result of a decline in the ethic and the reality of public service. This decline has largely been brought about quite directly by governments seeking to reduce costs by reducing public service numbers and by shedding those responsibilities which we have traditionally regarded as the role of society as a whole rather than of individuals. A comprehensive discussion of these issues is outside the scope of this submission but the events leading up to what was very nearly an Australian tragedy, the loss of the Snowy Scheme, are a case that illustrates the consequence of the decline I perceive. It would therefore be legitimate for the Inquiry to bring in recommendations relating to the poor response of the public service to the event and to those steps that might be taken to restore the service's ability to react more appropriately in the future. I would appreciate the opportunity to address the Committee on this issue in due course and present here only a few observations drawn from my five months of personal enquiry leading up to my letter of 56 to three parliaments.

□ Although I have enjoyed strong ties with people in public service arising from my training in the Water Conservation and Irrigation Commission in the 1960's I was able to learn nothing concerning this sale by enquiry. A cone of silence, or possibly ignorance, surrounded the subject saving only the 'mantra-like' utterance I heard, time and time again from both public servants and Minister's Aids. "Don't waste your time. This is a done deal. It cannot be stopped." It was so consistent it seemed to have been scripted and it persisted right through to the day I presented the letter in Canberra.

□ As far as I could determine, and the odd friend did speak to me, the advocacy for the sale came only from within the Corporation and initial support came only from the NSW Treasury and from the bevy of bankers, lawyers, accountants, brokers and minders contracted to be the de-facto public service that had actual carriage of the project. None of these people would comment in any way on the sale. Everything it seems is 'commercial in confidence' and the only real source of information is the web where only the material which people want to release can be reliably found. There is gossip & speculation a-plenty of course but its objective value is indeterminate. How different this was to my time in Public service when I spent time on telephones and counters helping people solve problems and unravel the mysteries of government actions because I believed my employer expected it of me.

□ One reason that carriage of the sale fell to hirelings appears to be that the skill and experience sets required to assess the merit of the proposal and move on to its execution are no longer cultivated in public service and are therefore not found there. One can no longer easily find people who actually know how to plan things or do things. Departments that we think of as 'doers' are instead peopled by project managers who may never have conceived, planned or done anything but have, rather, acquired the generalist skills of one who knows a range of people in the private sector who might know how to get things done or can act as an agent for those who do. Please believe that this ridiculous scenario is not uncommon and could certainly be found, in analogue, in the operational train of the Snowy sale.

□ The most insidious thing in this is that, far from reducing public service numbers, government downsizing through redundancy, depressed recruitment, abandonment of training and preference for generalists has seen a huge growth in overall personnel and in cost by sleight of hand. Those dependent on the public purse are now more likely to be employed by the consultancies, industries, charities, churches, contractors, bankers, lobbyists, agents, infrastructure moguls etc. who draw income from us for the provision of public services. Government even has to contract out the task of regulating and supervising those providing the services in some cases. The big difficulty is that the first loyalty of the vast

majority of the contracted out-workers, from CEOs to toilet cleaners is not to public service. It is vanishingly rare for fearless advice on the non-viability of a dud projects to come from those who expect to make real money out of it. The best one can ever hope for is some carefully crafted constructive criticism designed to knock off the rough edges and impress the proposer with the integrity of the potential provider or set up a supplementary study (at supplementary cost) to ensure that the best decision is being made. That's the way things work now.

It is recommended that the Inquiry note the failure of the NSW Public Service to report comprehensively on the merits, alternatives and implications to the Government & the State of the decision to sell Snowy Hydro.

It is further recommended that, in view of this failure, replicated as it has been in a number of public projects & programs in recent years an Inquiry be established to assess the capacity of current Public Service arrangements to adequately and forthrightly advise government and to effectively manage and adequately supervise the full range of public services upon which the people of NSW rely.

Thank you for the opportunity of placing my thoughts on the aborted Snowy sale and its desirable aftermath before your Committee. There are issues raised by this event which have considerable bearing on the process of government in our State and Nation which I am sure you will take the opportunity to address in the conclusions and recommendations you reach after considering all the evidence that is put before you. I would be grateful for the opportunity to appear before you to clarify any issue raised here and to generally expand upon my concerns for government processes that allow such things as the Snowy Sale to happen.

Yours Sincerely,

Douglas I Nicholas