

**REPORT OF PROCEEDINGS BEFORE**

**SELECT COMMITTEE ON THE LEASING OF  
ELECTRICITY INFRASTRUCTURE**

**INQUIRY INTO THE LEASING OF  
ELECTRICITY INFRASTRUCTURE**

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**At Sydney on Friday 15 May 2015**

**The Committee met at 9.00 a.m.**

**PRESENT**

Reverend the Hon. F. J. Nile (Chair)

The Hon. R. Borsak  
The Hon. D. J. Clarke  
The Hon. C. E. Cusack  
Dr J. Kaye

The Hon. T. J. Khan  
The Hon. Dr P. Phelps  
The Hon. P. T. Primrose  
The Hon. A. Searle

**CHAIR:** Welcome to the second hearing of the Select Committee inquiring into the leasing of electricity infrastructure. First, I acknowledge the Gadigal people, who are the traditional custodians of this land, and I pay respect to the elders past and present of the Eora nation and extend that respect to other Aboriginals who may be present. This morning the Committee will hear from various representatives of unions including Unions NSW, United Services Union, Electrical Trades Union and Professionals Australia. We will also hear from the director of the Stop the Sell-Off Campaign. The Committee will also take evidence from the Australian Energy Market Commission and the Australian Energy Regulator. Finally, we will hear from economist Mr John Quiggin and executive director of the Australia Institute Mr Richard Denniss. There will also be a hearing on Monday 18 May 2015.

I will make some brief comments about the procedures for today's hearing. I particularly thank witnesses for their attendance today and their cooperation. The hearing is open to the public and is being broadcast live on the Parliament's website. A transcript of today's hearing will be placed on the Committee's website within the next day or two. Updates throughout the inquiry can be found on the Twitter page of the New South Wales upper House. In accordance with broadcasting guidelines, while members of the media may film or record Committee members and witnesses, people in the public gallery should not be the primary focus of any filming or photography. I also remind media representatives that they must take responsibility for what they publish about the Committee's proceedings. It is important to remember that parliamentary privilege does not apply to what witnesses may say outside of their evidence at the hearing. I therefore urge witnesses to be careful about any comments they may make to the media or to others after they complete their evidence because such comments would not be protected by parliamentary privilege if another person decided to take an action for defamation.

The guidelines for the broadcast of the proceedings are available from the secretariat. Media representatives who are not accredited to the Parliamentary Press Gallery should approach the secretariat and sign a copy of the broadcast guidelines. There may be some questions that witnesses could answer only if they had more time or certain documents to hand. In these circumstances, witnesses are advised that they can take a question on notice and provide an answer within three calendar days following receipt of the transcript. Witnesses are advised that any messages should be delivered to Committee members through the committee staff. Please turn off mobile phones or switch them to silent for the duration of the hearing.

I welcome our first witnesses: Mr Steve Butler, Mr Mark Lennon, Mr Scott McNamara, Mr Gordon Brock and Mr Adam Kerslake. Please state your name and position title and swear either an oath or an affirmation.

**SCOTT McNAMARA**, Manager Energy Utilities and Private Sector, United Services Union,

**STEVE BUTLER**, Secretary, Electrical Trades Union, NSW Branch, and

**MARK LENNON**, Secretary Unions NSW, sworn and examined:

**ADAM KERSLAKE**, Director, Stop the Sell-Off Campaign, and

**GORDON BROCK**, Director NSW, Professionals Australia, affirmed and examined:

**CHAIR:** Thank you. Do you wish to make a brief opening statement?

**Mr LENNON:** Yes, I and my colleagues would like to make brief opening remarks. First, it is clear from polling we have done that, despite the outcome of the election, there is still not majority support in the community for the proposal of the privatisation of our electricity network. We have done post-election polling in recent weeks on a number of issues, as you do. That polling showed that, despite the outcome of the election, 60 per cent of the people we polled in the community in seats across the State remain opposed to the privatisation proposal that is on the table from the Government. As to questions of mandates on this issue, the Government cannot claim a mandate; there is no mandate to privatise the poles and wires in the State of New South Wales. Also, we note a similar thing amongst swinging voters—those who determine the outcome—in that 51 per cent of the poll we conducted were opposed to the privatisation of poles and wires.

There is no doubt that the public at large do not like the privatisation of public assets. It is not like they have not had experience of privatisation; it has been going on in this State and across the country for 25 or 30 years. From the experience they have had with privatisation they do not believe that it is in the best interests of the community at large. Again, that is reflected in all the polls that have been conducted both prior to and post the State election, when it comes to the issue of the sale of the poles and wires here in New South Wales.

I would like to make two other key points. Clearly, one of the major concerns about privatisation in the electorate is the impact that it has on the community—I am sure my colleagues will elaborate on this—when it comes to questions of service delivery and, of course, the issue of prices. I am sure we are going to have a robust debate about prices, but let us make it clear: I do not see, from all the evidence that has been presented when we talk about what people are paying in their homes when it comes to electricity prices across the county, that people are in any way better off in a State where the assets are privatised than they are in the State of New South Wales. There is no doubt that concerns about broad impacts on communities are shared across the board, otherwise why is Essential Energy being excluded from the privatisation process? Clearly, there are concerns amongst the Coalition partners of the Government of the day about the impact that electricity privatisation has on local communities.

The other issue is the long-term impact on the budget. We cannot with any certainty guarantee the consequences of privatising poles and wires, and therefore losing the revenue streams that come from those assets, for the budget long term. My other point in my initial statement is that on this issue and concept of asset recycling, on which this whole debate focuses, it is fairly evident from the Productivity Commission report in May last year, I think, that they do not believe that hypothecated money—if you are going to privatise in the first instance—for particular projects is the way to go, because that is not an appropriate way to ensure a proper cost-benefit analysis is done on the projects that the money from the asset sale is supposedly going to support. There are serious concerns about the idea that the two concepts should be considered separately. Do we need to retain assets, like our poles and wires, in public hands? That is the first question, and we say of course we do. The second question is: If there is a need for infrastructure, what is that infrastructure? What are the cost benefits of that infrastructure? How should that be funded? In this we have scrambled the two issues together and that is not going to lead to a very good outcome, in my view, for the State of New South Wales.

**Mr BUTLER:** I am not sure, but I think there are probably a couple of other covering statements that parties want to make so if I can jump in?

**CHAIR:** Yes.

**The Hon. TREVOR KHAN:** I do not wish to prevent anyone from having their say but on Monday, when I was not here, the quite lengthy opening statement of the Premier, as I understand it, was essentially taken

out of the Government's time. Now if each of these gentlemen is going to make an opening statement then it is clearly going to be fairly lengthy and I would suggest it is appropriate that the time should come out of the Opposition's time.

**The Hon. ROBERT BORSAK:** With due respect, Trevor, you were not here.

**The Hon. TREVOR KHAN:** I did say that.

**The Hon. ROBERT BORSAK:** I do not think that happened. The Government elected not to ask questions.

**The Hon. CATHERINE CUSACK:** No, we forfeited our time for the presentation. That was agreed beforehand.

**The Hon. ROBERT BORSAK:** At the start what I heard was that you were not going to ask questions.

**The Hon. CATHERINE CUSACK:** No.

**The Hon. Dr PETER PHELPS:** Only on the basis that the Premier had requested to present a 25 to 30 minute presentation.

**CHAIR:** We will check. There may be no other statements.

**Mr LENNON:** My colleagues would like to make statements but we are certainly not going to—

**The Hon. TREVOR KHAN:** I am not suggesting that they should not be able to make a statement.

**The Hon. Dr PETER PHELPS:** If it is not coming out of the Opposition's time then I am fairly certain the Treasurer will be making a 90 minute opening statement on Monday.

**CHAIR:** Mr Lennon, I assume that you are coordinating the union witnesses?

**Mr LENNON:** Yes.

**CHAIR:** Are all the witnesses going to make an opening statement?

**Mr LENNON:** They are.

**The Hon. Dr PETER PHELPS:** Those opposite indicated that they may not need any questioning in this period.

**The Hon. ADAM SEARLE:** And that may well be the case. Peter, be quiet and let the matter proceed so we can get to the bottom of it.

**CHAIR:** The opening statements should only take a few minutes so that we have time for questions.

**Mr BUTLER:** No problem, mine will take a couple of minutes. My name is Steve Butler and I am the Secretary of the Electrical Trades Union [ETU]. I would like to thank the Chair, the Deputy Chair, the Committee members and the workers for inviting us to have a yarn here and to answer some questions—I am sure that is where we will get to the meat of it. I am an old powerline worker. I have been in the industry for 38 years. My dad was an old powerline worker, and so was my grandfather. We have lived this industry; we have been around it for a long time. Just for some measure, I have been fighting the privatisation of the electricity sector for about half that time—about 17 years. I have been fighting both sides of government, both colours, blue and red, arguing our case in relation to the essential nature of electricity, the importance that it has in the community not only for service delivery but also in regional and rural New South Wales for the presentation of the delivery of good, solid jobs, good careers for young folk, and opportunities for people that they might not get if a privatised company took over the network.

In our campaigns over the past 15, 16 or 17 years we have argued a number of things—fairly basic propositions. One being that there will be significant job losses, and there will. The Australian Energy Regulator [AER] determination gives us the second barrel of a double barrelled blow, along with the proposed privatisation. The second thing we have argued is a loss of job opportunities for young folk. Apprenticeships in other States that were privatised did not just diminish, but disappeared completely. The information that we have from reports in Victoria are that for 10 years after apprenticeship recruitment ceased. The third thing we have always said is that privatisation results in higher power prices, and we don't do that by looking into a crystal ball.

We don't say "This is what we believe is going to happen." We look at the past; we look at what has happened in other States that have been privatised and, without a shadow of a doubt, the comparable prices between privatised networks and publicly owned networks upon privatisation increased. I am sure people will ask me about network charges in Victoria and South Australia—great, love to answer those questions. What we worry about is what the customer, what my next door neighbour and your next door neighbour hands over in hard earned coin when they go to pay their retailer—that is the price, not the network cost, because there is no guarantee in relation to network cost. We have argued this case for a long time and we are going to continue to argue it simply because it is the right thing to do. I would urge this Committee to consider those things when it makes its recommendations and determinations. Thank you.

**Mr McNAMARA:** My name is Scott McNamara, Manager Energy, Utilities for the United Services Union [USU]. Once again I would like to thank the Chair and the parliamentary committee for giving us the opportunity to speak today. I have a brief submission. In the USU submission we have argued strongly against the privatisation of the electricity network. Our submission has a focus on social, community and infrastructure and the employment aspects proposal, pointing out the profound effects that will occur in these areas.

Examination of previous electricity privatisation has shown that the promise never eventuated as the economic basis was flawed to begin with. The sale of public assets cannot be based solely on economic arguments. One of the most significant impacts of privatisation was demonstrated in Victoria where we saw a downsizing of the workforce as a result of electricity overhaul. The Victorian experience was a devastating one for electricity workers. Many found themselves without employment or with employment that was not meaningful; others were placed in positions upon present occupant only with distinct lack of job security and extremely low morale amongst workers who managed to retain jobs.

Job security is a major factor in the USU submission. With the industry already facing job losses and the retail arm of the electricity network already sold off, employees face a bleak future if future privatisation is to occur. The Government has made no attempts to engage with the USU on employment protections for our members, many of whom are females who rely on their incomes to supplement family budgets and, in some cases, are the sole provider. My experience is that my father actually worked for Sydney Electricity, Sydney County Council, many years ago. He took a redundancy in the mid 1990s and that was not a good thing for our family. I see the impacts in relation to job security within this industry firsthand—that is a disturbing thing for me. The USU submission, combined with the economic analysis provided by other submissions, shows that the proposed privatisation is not in the interests of the public and the New South Wales Government. We urge the Committee to take that into consideration. Thank you.

**Mr KERSLAKE:** The Stop the Sell-Off Campaign is funded by the unions that sit at this table today. I have been the spokesperson for that campaign for about 18 months. The Stop the Sell-Off Campaign has campaigned on the idea that we believe a monopoly asset that provides an essential service should be owned, operated and run by the New South Wales Government and not sold off to the highest bidder. The particular areas of concern that we have been raising include the loss of recurrent income to the New South Wales budget, the impact upon employment conditions for people across the industry, and the potential for higher consumer prices.

We make the point that the highest electricity prices today are in South Australia, a fully privatised network. I am sure that will be confirmed when the Committee speaks to the Australian Energy Regulator [AER] later today. Reduced reliability and slower emergency response times are also a result of privatisation. The loss of control of a State-owned asset which is a monopoly is of concern, as is the failure of regulation to be able to deal with that situation. We see a constant stream of attempts by governments to deal with this situation through regulation fail and we are concerned about where we going here—is the Government going to privatise the asset and say, "Don't worry, we'll sort it out through regulation"? That has not worked in a range of other areas.

There has been a loss of control and community benefits. There is no evidence that once a government privatises a monopoly asset we have investment in the infrastructure and the technology that sets us up for the future. We are concerned about the sale of something as important as our electricity network to any company owned by overseas interests or foreign governments, which is what is currently on the table and being considered by the New South Wales Government. Those are the points we currently have been raising in the public arena as a matter for public debate. That includes my opening statement.

**Mr BROCK:** My name is Gordon Brock. I am the Director of Professionals Australia New South Wales. I also thank the Committee for the opportunity to speak before it. Professionals Australia represents about 25,000 professionals across the country, including thousands of professional engineers who build and maintain electricity assets and who carry the responsibility of ensuring reliability and public safety at all times. Professional engineers possess the knowledge and expertise to find and deliver efficiencies, safeguard the economy and serve the public well into the future. They overwhelmingly supported the campaign against the privatisation of this industry. I am not going to repeat the statements of my colleagues but I simply say that we share their concerns.

I also wanted to let the Committee know that this industry has been good in recent times at developing professional engineers and professional technical capacity. It is an industry that currently employs 65 graduate engineers and about 20 cadet engineers across the various businesses. Those people are the future electrical engineering experts for the industry. We share the concerns raised by Mr Butler from the Electrical Trades Union [ETU] in relation to the future of apprentices, graduates and cadet engineers.

**The Hon. Dr PETER PHELPS:** Mr Lennon, who in the Construction, Forestry, Mining and Energy Union [CFMEU] authorised the racist anti-Chinese campaign against the lease of these assets?

**Mr LENNON:** I do not know.

**The Hon. Dr PETER PHELPS:** Is the CFMEU a member of the Unions NSW?

**Mr LENNON:** Several of its branches are.

**The Hon. Dr PETER PHELPS:** Would you undertake to find out who authorised the campaign paid for by the CFMEU?

**Mr LENNON:** I do not see the need to. It was a decision of the CFMEU to run those advertisements.

**The Hon. Dr PETER PHELPS:** Do you agree with the sentiments expressed in that campaign?

**Mr LENNON:** What I agree with is the concern that anyone would have assets or essential services sold to foreign companies that may be state-owned and run by what are indeed authoritarian governments.

**The Hon. Dr PETER PHELPS:** The fact is that only China was mentioned and, for example, Canadian superannuation firms, American superannuation firms or British superannuation firms were not. Was it purely coincidence that China was dragged through the mud in that campaign?

**Mr LENNON:** So you are saying that Canada and America are run by authoritarian governments?

**The Hon. Dr PETER PHELPS:** I am saying that the CFMEU ran a racist campaign of explicit xenophobia designed to tap into the worst instincts of Australians for its own political purposes.

**The Hon. ADAM SEARLE:** Point of order, Mr Chair: I am not clear how this line of questioning relates to the subject matter of the terms of reference.

**The Hon. CATHERINE CUSACK:** The issue of foreign investment is clearly raised in the submissions, both written and verbal.

**The Hon. ADAM SEARLE:** But that is not what Dr Phelps is asking about.

**The Hon. CATHERINE CUSACK:** Dr Phelps is entitled to ask questions about those submissions.

**The Hon. ADAM SEARLE:** Dr Phelps is not asking about them.

**CHAIR:** Order, members will leave out the commentary and just ask direct questions.

**The Hon. Dr PETER PHELPS:** Certainly. Mr Butler, do you agree with member of the Australian Human Rights Commission Dr Tim Soutphommasane where he said:

It's disappointing to see some NSW political adverts using inflammatory language about foreign investment. Let's not licence xenophobia.

Do you agree with him that we should not licence xenophobia?

**Mr LENNON:** I would agree that people should be aware, if our State-owned assets are to be sold, of who may be the purchasers—who may be purchasers from overseas—and the governments that own those particular corporations. Anyone would be very concerned about investment in any asset in this State, and that is evident from before, by any corporation that may be owned by a government that is not open and transparent.

**The Hon. CATHERINE CUSACK:** So, Mr Lennon, do you support the singling out of China in this campaign?

**Mr LENNON:** I support making people aware that the outcome of this proposal may be the purchase of our assets by a corporation that is owned by a government that is not one that is open and transparent.

**The Hon. CATHERINE CUSACK:** China was the country singled out. So, I guess just for the sake of clarity, you are saying that was quite a legitimate point?

**The Hon. ADAM SEARLE:** Point of order: the same question has been asked of this witness a number of times and the witness has given his answer. Chairs of Committees, and indeed in the Chamber generally, have ruled that members can ask whatever questions they like but they cannot dictate the answer given by the witnesses. Witnesses can choose how to answer.

**The Hon. CATHERINE CUSACK:** To the point of order: firstly, Government members listened very patiently to repetitious questioning by Labor members. Secondly, we understand that the Labor Party, and in particular Luke Foley, endorsed this racist and xenophobic campaign—

**The Hon. ADAM SEARLE:** Point of order: Mr Chair, the Hon Catherine Cusack is reflecting on a member of the other Chamber. The standing orders say quite clearly that members cannot do so other than by substantive motion.

**CHAIR:** Order, members cannot make allegations against any member of Parliament unless moving a substantive motion back in the Chamber.

**The Hon. CATHERINE CUSACK:** Mr Chair, with respect, it was endorsed by the Labor Party.

**The Hon. ADAM SEARLE:** There is a clear imputation—

**CHAIR:** Order! The description by the Hon. Catherine Cusack of Mr Foley is not acceptable.

**The Hon. PETER PRIMROSE:** Mr Chair, you have ruled on this and now I think we should move on. Rather than arguing about issues associated with the last election, we should look at our terms of reference here.

**The Hon. CATHERINE CUSACK:** Mr McNamara, in your submission you single out Spark Infrastructure as the foreign company investing in Australian electricity assets that has the worst record of all. Is that correct?

**Mr McNAMARA:** Could the Hon. Catherine Cusack refer to the page number?

**The Hon. CATHERINE CUSACK:** It is on page 8.

**Dr JOHN KAYE:** Are we talking about the United Services Union [USU] submission?

**The Hon. CATHERINE CUSACK:** This is the submission from the Electrical Trades Union [ETU].

**The Hon. ADAM SEARLE:** I think the Hon. Catherine Cusack is referring to another submission entirely.

**Dr JOHN KAYE:** I think we have the ETU and the USU confused. They are different.

**The Hon. ROBERT BORSAK:** Mr McNamara is with the USU.

**The Hon. CATHERINE CUSACK:** Okay, sorry, let me turn to Mr Butler, representing the ETU. Mr Butler, you singled out Spark Infrastructure as having the worst record of foreign companies investing in Australian electricity companies.

**Mr BUTLER:** I think what the member will find is that that reference relates to tax. I am not a tax expert but I will give it a go. As I understand it, the company has been pursued by the Australian Taxation Office for unpaid taxes in Australia and of all the foreign owners of electricity infrastructure in Australia it has the worst record in relation to the Australian Taxation Office pursuit. That is the record to which we refer in our submission. If you go to the page before, page 8, it explains that.

**The Hon. CATHERINE CUSACK:** So where is the criticism of the Chinese Government in your submission?

**Mr BUTLER:** If the Hon. Catherine Cusack cannot find it, it is not there. Our criticism is that the New South Wales Government is seeking investment from offshore companies when it could get investment from the people of New South Wales, if it sought to do that. As we understand it, it is likely to be China or Singapore which invests in infrastructure, particularly electricity infrastructure, in New South Wales. I am not looking into a crystal ball; I am looking at the facts. The facts are that South Australia there is a privatised network and Victoria there is a privatised network. They are owned by China or Singapore.

**The Hon. Dr PETER PHELPS:** Mr Butler, have you made representations to the South Australian and Victorian governments that those electricity industries be bought out or renationalised? After all, you do have Labor governments down there and, presumably, if they accepted your concerns—

**Mr BUTLER:** Do you understand how the principles of State unions work? In New South Wales I am the secretary of the New South Wales branch. I have punch-ups all the time with politicians in New South Wales—

**Dr JOHN KAYE:** You are speaking figuratively there, of course.

**Mr BUTLER:** Figuratively, of course, sorry. My counterpart in South Australia has punch-ups with the South Australian Government, whoever they are, and I know that the South Australian branch of the ETU has had vigorous discussions with whoever is in power in South Australia.

**The Hon. Dr PETER PHELPS:** To renationalise those industries. Is that correct?

**Mr BUTLER:** I do not know if that has been their call.

**The Hon. Dr PETER PHELPS:** If your argument is that only State ownership can provide it, then what is the alternative?

**Mr BUTLER:** You have got me confused just a little bit. Do you want to nationalise the electricity network?

**The Hon. Dr PETER PHELPS:** No. It appears that you want to nationalise it.

**Mr BUTLER:** You have used the words, not me.



**The Hon. ADAM SEARLE:** Point of order: Mr Chair, this is a joke. Dr Phelps is asking questions that are completely outside the scope of this inquiry. The renationalisation of an industry in another State is not within our terms of reference.

**The Hon. Dr PETER PHELPS:** With respect, the witnesses here have said that the only way there can be an effective industry in New South Wales is through government ownership. They have also said, "We look at the historical record". My argument is that if they were serious about it, then their compatriots in other States would be calling for Labor governments to take control of those industries once again. If they have not done so in those States, then it absolutely undermines the credibility of these witnesses that the only way you can have an effective industry is through State ownership.

**The Hon. ADAM SEARLE:** Peter, if that is your proposition put it to the witness.

**CHAIR:** The witnesses here are not responsible for what is happening in the other States. We will confine our questions to the State situation, to New South Wales.

**Dr JOHN KAYE:** To the point of order: I am rather enjoying the answers. I would like this to continue.

**Mr BUTLER:** I am happy to try and answer. You asked me if I believed there should be a nationalisation. We have never said that. All we have said is the State Government should own the electricity infrastructure to provide an essential service for the communities in New South Wales. The ETU in South Australia has done the same thing; the ETU in Victoria has done the same thing; the ETU in Queensland, let us talk about that one—good stuff; the ETU in Western Australia has done the same thing. We are not talking about nationalising, we are not saying that is one Australia—let the Federal Government run electricity in Australia. We are saying in New South Wales the most appropriate body to manage the essential service, to run the essential service of electricity provision, is the government.

**The Hon. Dr PETER PHELPS:** So you are saying that the most left-wing Labor Government in Australia has rejected the arguments used by the ETU in South Australia and refused to buy out Mr Ka-Shing and other overseas investors?

**Mr BUTLER:** I do not know if that is what they have done or not; I am going to answer the question though. I am happy for you to make that assertion. You say that; I do not know. I have argued with the most right-wing Labor government and the most right-wing Liberal governments in New South Wales against privatisation and our position in this State has not changed. We argued against it when Bob Carr sought to do it in 1997; we argued against it when Mike Baird sought to do it in 2015. We will continue to argue against it. If that is not clear, if you do not understand that that is what we will do then I need to make sure I leave this chamber today with absolutely no shadow of a doubt in your mind that in New South Wales the area I have a responsibility for for members of the ETU we will fight you and we will continue to fight you. Does that clarify things?

**The Hon. Dr PETER PHELPS:** Mr Lennon, would it be fair to say that Neville Wran, Barrie Unsworth, Bob Carr, Morris Iemma, Nathan Rees and Kristina Keneally have all supported at some stage some part of electricity privatisation, whether it be the retail, transmission, distribution or generation arms?

**Mr LENNON:** I am not sure on all of those. I cannot give you an honest answer. The list you read out there, I cannot speak for them.

**The Hon. DAVID CLARKE:** Mr Butler, in the submission from your union it says at the top of page three:

In NSW 99 year leases are treated the same as a sale in accounting terms in that all financial responsibility, including improvements and operating costs of the subject fall to the lessee.

Is that a bad thing?

**Mr BUTLER:** I suppose it depends, because this is really where we get to the nub of the problems that come out of this magical leasing proposition. Those costs fall to them, but at the end of the lease, whether it is terminated or terminated by action—somewhere there is an intervention to say "The lease is over. You have not done the right thing; the lease is over"—or at the end of the lease, if they have made those commitments in

payments during the lessee period, does that mean they own them and that any intervention halfway through or part way through or at the end means that the State government has to buy them back?

That is where the problem occurs, and the detail is not sufficient enough to say who owns those assets at the end of the lease, because in 99 years, with all due respect, none of us will be here, none of our kids will be here. The network will have morphed completely; it will have changed. Every substation will have been replaced, every overhead powerline will have been replaced—everything will have changed. If that has been done by the lessee and they have paid that money, then they will say, "We own this. If you want to take the industry back here's what you have got to pay". We will be at their mercy when it comes to getting this back. That is why people can say it is lease but in reality it is not. If after 99 years they own every piece of infrastructure within the network, they own it. To get it back we would have to buy it back and, believe me, it will cost—I guess it is our great-great-grandkids which is probably the generation that will be in the spot—a lot of money to get it back.

**The Hon. DAVID CLARKE:** Later in the same paragraph the submission refers as a negative to the fact that this highlights the intergenerational impact of this proposal. What do you mean by "the intergenerational impact of this proposal"?

**Mr BUTLER:** That is just it: this does not affect just you and me. What we have got here is a proposition from the State Government that says, "Let's sell infrastructure". If I can maybe take just a couple of minutes to answer this question properly. Is that okay?

**The Hon. DAVID CLARKE:** If it is going to take some time you can take it on notice.

**Mr BUTLER:** No, I have got the answer. I talked about my history in the industry and I did not do that just for any sort of theatre. My grandparents and great-grandparents paid for and built the network that we have got now—they started the process. We needed a supply of electricity and that started in around 1900. The demand grew and as the demand grew the infrastructure grew with it. My great-grandparents and grandparents paid for that a lot of the time, because it was a local council, through rates, but also through power bills. They owned it; it is theirs. There is absolutely no shadow of a doubt the people of New South Wales built this infrastructure and it belongs to them. They passed that job onto the next generation, who passed it along to us.

We are in a position whereby the Government has said, "Let's realise the potential cash outcome of this public asset, let's sell it"—sorry—"lease". In doing so, that affects not just us, not just the people who sit around this table now, but the generation after: it affects my kids, my grandkids and their kids. What we see there is that where there was an expectation that there was a reliable source of supply of electricity—an essential service—it is an essential service now and that if it is not delivered in an efficient, safe and effective way then people really arc up; they start to say, "We've lost out in this transaction". So that is where it is intergenerational.

**The Hon. CATHERINE CUSACK:** Vince Graham has given evidence to this committee that a proposed wage freeze to protect job opportunities for graduating apprentices is being put to the unions. Will you support protecting the jobs of these apprentices?

**Mr BUTLER:** You have not quite got that right. What Vince Graham has said is that there are 10,000 to 12,000 people in the industry and the Australian Energy Regulator [AER] determination has come down and said that we have got to strip out a lot of cash. Vince's immediate response is, "Let's sack as many people as we can to make sure we fit within our budget." There are other ways to do it, but leave that aside. What he said is that all those 10,000 people take a wage freeze—not just the apprentices— so that the apprentices may be given an extra year or two years of fixed term employment. That is, in essence, what has been proposed.

I have got no difficulty with having strong negotiations in relation to job security. It is our number one item on our negotiations. It has been and it always will be. But what I find difficult is that they hold these 500 apprentices up as a bargaining tool and say that if you do not take a wages freeze, if you do not do this then they are going to be out of a job. That, to me, is reprehensible—that approach in relation to a negotiation where you say, "Here are 500 young folk. They have done four years training, they have done all this, but if you don't agree to a wage freeze then we're going to sack them."

**The Hon. CATHERINE CUSACK:** Is that a no, you do not support the proposal?

**Mr BUTLER:** I did not say that at all. What I said was—

**The Hon. CATHERINE CUSACK:** Can you tell me if you support the proposal or not?

**Mr BUTLER:** I do not negotiate my members' agreements in the press, in committee or anywhere else but with my delegates and the membership of the ETU. I do not determine what members will accept or will not accept. My delegates would make a recommendation to the broader membership. The broader membership—

**The Hon. CATHERINE CUSACK:** That is fine. If you are not going to answer my question I have more questions.

**Mr BUTLER:** It is a ridiculous question.

**The Hon. PETER PRIMROSE:** He is answering.

**The Hon. CATHERINE CUSACK:** He has indicated why he is not answering the question.

**Mr BUTLER:** It is a ridiculous question.

**The Hon. CATHERINE CUSACK:** That is fine. What is your response to Luke Foley's support for the AER ruling?

**Mr BUTLER:** I said to Luke Foley if he wants to pick a fight in relation to the AER determination I will give him one. Is that clear?

**The Hon. CATHERINE CUSACK:** Yes.

**The Hon. ADAM SEARLE:** The ETU's submission at page 5 highlights impacts on employment in regional areas arising from privatisation. Essential Energy, of course, is being excluded and is not up for privatisation so what do you see being the impacts of privatisation on regional New South Wales?

**Mr BUTLER:** I guess here we talk again about the double barrel approach that is facing workers in this industry. One is the AER determination and the second is the privatisation. Obviously, Essential Energy is not red circled out of the AER determination.

**The Hon. TREVOR KHAN:** It cannot be.

**Mr BUTLER:** I am just stating a fact. I did not say it could be. As a result, if Mr Graham's figures are correct—I think he has overcooked them a bit but we will wait and see—there will be a 30 per cent job reduction in regional New South Wales. I think he said that is about 1,400 jobs. A 30 per cent loss of jobs in a town like Tamworth is likely to cost about 30 jobs, maybe a few more. If 30 jobs come out of Tamworth it is our rough estimate that about \$3 million comes out of the local economy. The knock on effect is that businesses, schools and health provision are impacted as a result of those job losses. That is not to mention the social impacts of job losses like that.

In regional New South Wales there are many various problems that people face. I take my hat off to people living in regional New South Wales. I think they are as tough as teak. But what we find is that sometimes the isolation that may be there leads to a reduction in service. That is not only a reduction in service for electricity as a result of privatisation and the AER determination but other things as well and there a multitude of problems including suicide. What we see when there are major layoffs in any industry is the rate of suicide increases. I have not got studies in front of me but certainly if I look at something like Newcastle and the shutdown of BHP, as a result of that there was an increase in suicides of people who were put out of work or made redundant or took redundancy.

There is a social impact. There is an economic impact. There is an impact that needs to be wrapped up in a bigger ball. The glue of those communities in regional New South Wales is good jobs. Once they disappear out of a town then that town starts to fall apart. Anyone from regional New South Wales knows that to be a fact. To answer your question more directly about what does power privatisation bring, we have already seen it. There are three things we have said: loss of jobs; loss of job opportunities for young folk; and rises in electricity cost.

We have seen the loss of jobs. They have happened in regional New South Wales. Essential Energy has laid people off on voluntary redundancy. As to the second thing, which is apprentices, Essentially Energy has said that they will not put any apprentices on for this year. They said they are going to wait until after the AER determination. The AER determination has carved up their income. They will not put any apprentices on this year, and the apprentices they do have are on a fixed-term contract until June and if the money is not there for those folk then they will be sacked. They are people out of different members' electorates who are going to suffer in a personal way. The town is going to suffer financially and the community is going to suffer. It is going to be wracked similar to the Latrobe Valley—if anyone remembers back when privatisation happened in Victoria. The Latrobe Valley is a social experiment that turned up some of the worst parts of privatisation and job losses.

**The Hon. ADAM SEARLE:** Ausgrid and Endeavour Energy have employees in regional New South Wales as well, do they not?

**Mr BUTLER:** They do.

**The Hon. ADAM SEARLE:** And Transgrid?

**Mr BUTLER:** Absolutely. Transgrid goes right across the State.

**The Hon. ADAM SEARLE:** So it is not just Essential Energy; that is not the only part of the network that operates in country New South Wales?

**Mr BUTLER:** No. Ausgrid goes up as far as Muswellbrook. I call regional New South Wales broader and include Newcastle and Wollongong in regional New South Wales. It certainly goes way up into Muswellbrook and Essential Energy has a strip that runs all the way down the coast into—I think there is another member of the party that has got an electorate down that way that has Endeavour Energy just up before Bega. It also goes out to Lithgow over the mountains. There is a very regional flavour to all three organisations but I am not sure whether the boundaries have been massaged such that the difficulties that might be experienced in Tamworth because of privatisation have been given a bit of a let off, have been let go.

**The Hon. TREVOR KHAN:** The difficulty in Tamworth is the AER determination.

**Mr BUTLER:** No.

**CHAIR:** It is the Opposition's time to ask questions.

**The Hon. ADAM SEARLE:** Mr Butler, your union makes the point in its submission that there has been a much lower rate of investment in Victoria's infrastructure for a number of years and it is now reaching a stage where they need significant investment, whereas the New South Wales assets have already had significant investment in recent years. You say that to that extent comparing the New South Wales network assets with the Victorian network assets is not a case of comparing like with like. Would you or any other witness like to address that?

**Mr BUTLER:** You asked me a question, I will answer it. As far as I can see, the networks in South Australia and Victoria are rusted out old 1964 Holden EHs and the New South Wales network is a 2010 Commodore. I only say that because there is cycle in investment in relation to infrastructure. In New South Wales about seven or eight years ago, and the same in Queensland, there was a recognition that previous governments—and they were Labor governments, I do recall—had underinvested in the network. They were taking out profits, taking out payments and putting them into consolidated revenue. The network suffered as a result so that things started to fall apart.

There was a review done, and that review found that there needed to be major investment into New South Wales. In what I hear politicians call gold-plating, there was about a \$16 billion spend in New South Wales to bring the infrastructure up to speed, but very necessary. What has happened in Victoria and South Australia is that they are on the bottom end of their cycle. New South Wales has invested and the network is very high. Victoria and South Australia have not invested and the network is a third lower than in New South Wales. Very soon they will have to start pouring some coin into the infrastructure in Victoria and South Australia to get it up to the New South Wales level; otherwise, their blackout situation, their reliability, their

capacity to provide an essential service to consumers in those States will suffer. When they do that, their power prices will go up.

**Mr LENNON:** Can I just add to that?

**The Hon. ADAM SEARLE:** Certainly.

**Mr LENNON:** As you note in one of the many reports circulated during debate about this matter, there is one by EY to the NSW Treasury, that I think the Government relied upon, had much for discussion. If you go to page six of that, it talks about the trend in network prices, service and what happened between the States, but it does say in the first column, half-way down:

Various factors can and do contribute to the discrepancy (e.g. the starting position in respect of price levels, the age of the assets and therefore the need for investment, service standards etc.). Not all of these factors are within the businesses' control. For example, over some of this period,—

as you have just heard—

[some] ... networks in NSW and Queensland have invested particularly heavily in their networks.

In contrast, the businesses in Victoria are approaching a stage in their life cycle which may require substantial further investment. South Australia may also have recently entered a similar stage in their investment life cycle as is the case in Victoria.

**The Hon. ADAM SEARLE:** Mr Kerslake, there has been some discussion from supporters of the privatisation proposal that the answer lies in effective regulation.

**Mr KERSLAKE:** Effectively lies in what, sorry?

**The Hon. ADAM SEARLE:** Proper regulation—that you can make up for any dangers of privatisation through effective regulation of the industry. Can you express to the Committee your analysis of how effective regulation of monopoly assets has been in this country and discuss the recent situation with Macquarie Generation, which occurred last year?

**Mr KERSLAKE:** Our concern is that regulation to deal with the sale of a monopoly asset is problematic. If you look at the Sydney Airport, it is a monopoly. The Australian Competition and Consumer Commission [ACCC] produces reports, as it has done every year for the past seven years, saying that the privatisation of Sydney Airport has seen poorer service and higher prices for everyone who uses the airport. It consistently reports on this, yet nothing is done about it. It is the same in most airports around the country that have been privatised. We see monopolies sold off to companies, which then take advantage to make lots of profits.

When we look at the electricity industry and the point that Mr Searle was referring to, the ACCC looked at the sale of Macquarie Generation. The ACCC ruled that the sale of Macquarie Generation would have seen an increase in concentration of ownership and it was not in the public interest to sell Macquarie Generation to AGL. AGL appealed it and was successful, and the ACCC just let it slide. So here we have the independent watchdog for consumers in this country saying it is not a great idea for the Baird Government to proceed with the sale. The company appeals to the courts and the ACCC lets the thing go through.

What has happened is a decision has been made that is against the interests of the people of this country. We say that what happens with regulation is that it is great in theory, but what you are dealing with is massive corporations that have massive resources, huge potential to lobby governments, to influence outcomes, and capacity to use the legal system for their own interests. On the other side we have consumers, the people. How do we actually ever have the opportunity to tackle that sort of corporate power that can work against our interest?

That is why we say a monopoly asset that provides an essential service—I mean, you cannot choose whether you are going to turn your lights on—should be owned and run by the Government because that is the best way to protect. Its regulation over time will just be watered down and we will end up paying the price for that. That is what our experience has been.

**The Hon. PETER PRIMROSE:** I refer to page five of the Electrical Trades Union [ETU] submission. I would appreciate comments from any witnesses. I preface this also by saying that I would like all the witnesses to please take this on notice because they may wish to elaborate. The third-last paragraph states:

Should the Committee resolve to support this transaction, it is evident that a strong employment protection package is required as a condition on the purchaser. It is also necessary that any employment protection package is included in legislation with clear enforcement measures.

Can you elaborate on the type of matters that should be included in there? Again, you may wish to come back to the Committee by taking that on notice so that we have some specific details that we can consider in our deliberations.

**Mr BUTLER:** I take this opportunity to give a brief response. I will also take the opportunity maybe to come back to the Committee in more detail. But if we look at other employment protection packages, it has been a protection in relation to tenure of employment, so how long the package gives people prior to there being a rollout or offers of redundancy to those people, so there is a minimum number of years. In our submission I think we have commented on the Chair's public position in relation to that. But also in relation to conditions of employment including superannuation, there is a complex superannuation question in relation to most of the people in the industry in that they are with a government-controlled fund, the Electricity Industry Superannuation Scheme [EISS], and that a number of those employees are in what is called the defined benefits scheme, which is a requirement to guarantee outcomes. How to those people operate? We need some protections in relation to that.

They are the sort of basic types of things we generally talk about in protections, but I have to always throw in an additional one and that is that we cannot let down the youth of New South Wales. If this is going to go ahead—and I am not an optimist, I am not a pessimist, I am a realist—there needs to be protections in relation to apprentice numbers in these organisations, and they need to be real. They need to be cast in stone. They need to be such that no new owner can wriggle their way out of making sure that the youth of New South Wales get these opportunities as a result of any privatisation. But I will come back. We are happy to come back in more detail.

**Mr LENNON:** I would support that, Mr Primrose. I support Mr Butler's comments. Clearly, as to detail, we need to have discussions among ourselves. But, clearly the broad precedents are out there for this sort of thing. Of course, this is a big if: If privatisation were to take place, we stand by our initial position. But, clearly, we would be happy to provide more detail.

**Mr McNAMARA:** I would like to comment as well, if possible.

**The Hon. PETER PRIMROSE:** Yes.

**Mr McNAMARA:** The United Services Union [USU] looks after predominantly, in the main, a large proportion of the administrative workers and a proportion of outdoor workers. Our members have already seen the face of privatisation in this industry in a large component. Over 1,500 employees were affected through the retail privatisation, which happened in 2011, where they received some employment protections through that privatisation. That was, yes, under a Labor Government and there were negotiations around that privatisation.

The USU opposed that privatisation. We still oppose privatisation of electricity industry, and specifically this proposal of privatisation. There are runs on the board in relation to what should be seen as a minimum and they include a five-year employment protection. We have had issues in relation to the transfer of superannuation entitlements, the transfer of long service leave entitlements, and the transfer of sick leave entitlements—a whole range of benefits—and no forced transfers. When we talk about regional employment, what we see, through privatisation and centralisation, is that regional employment can be dragged out of country towns into a more centralised spot.

The example I would give you is through the Essential Energy experience and through retail privatisation. We have seen the shifting of jobs from Queanbeyan to Port Macquarie. Whilst the shift was to another regional area, without the guarantees in relation to those regionally based jobs staying where they are, you see a shifting into a different regional location and, therefore, affecting those regional areas. They need to be protected. The United Services Union, which has a large predominantly female base membership, needs to make sure that those marginalised employees have protections.

**The Hon. ADAM SEARLE:** Have your organisations or members received any assurances about employment protections to this point in connection with possible privatisation?

**Mr BUTLER:** The proposition that was alluded to by the Hon. Catherine Cusack previously through Vince Graham said that they wanted to introduce forced redundancies into the organisation. At present there is a provision there that there are no forced redundancies.

**Dr JOHN KAYE:** That is a provision in the Enterprise Agreement?

**Mr BUTLER:** In the Enterprise Agreement. What we see is the companies, I suppose, encouraged by government to remove those employee protections. But what I have got to say is a lot of people in that industry have a similar history to mine—we have been around and in the industry for a long time. For forced redundancies to take place for those people is, in essence, throwing them on the scrap heap. They have put in 30 or 40 years into an organisation. They have done hard yards all the way through and the proposition about forced redundancy becomes very emotional and people end up, in what I call in their prime, you know, my age, being thrown out on the scrap heap and essentially considered to be of no use to anyone any more.

We believe those things are paramount. If your government were prepared to support that proposition of no forced redundancy then your proposition about a wages freeze may be considered by other organisations but we do not get that. What we get is one-way traffic in relation to what should be provided. There is a very clear fix in relation to this, that is, negotiation around the Enterprise Agreement that helps these people and wages protections as we move into any sale process. People have said they will get \$20 billion out of the sale—sorry, lease—of the electricity industry. We are asking for job protections in there for people who have put in a lot of time and service. If there will be \$20 billion come out, if that is the right number, cut a bit out and say that bit needs to go here to look after these people who have done the right thing within these organisations. In my view that is the moral and possible thing to do. It does not take huge chunks out of a proposed infrastructure spend to do that.

**Dr JOHN KAYE:** Mr Kerslake, you have been accused by the Premier, the current Treasurer, the former Treasurer and a number of other right wing commentators of running a campaign of lies in regard the sell-off. Could you very briefly explain—

**The Hon. TREVOR KHAN:** Point of order: The Hon. Peter Primrose made a valid point that we are supposed to be looking at the privatisation issue, not back at the election campaign. This is clearly an invitation to go backwards.

**Dr JOHN KAYE:** To the point of order: It is a little bit surprising that the Hon. Trevor Khan takes that point of order before I have completed the question. He could have no way of knowing what my question as going to be.

**The Hon. ADAM SEARLE:** You are so predictable, John.

**CHAIR:** Will you finish the question?

**Dr JOHN KAYE:** Could you explain why what you were saying were not lies and was not a fear campaign? How did they resonate with the people of New South Wales? Why should we take the issues you raised seriously in writing this report?

**The Hon. TREVOR KHAN:** I take my point of order again. It is an invitation to look backwards, not forwards. I think we should stick to the terms of reference of this inquiry.

**The Hon. ADAM SEARLE:** To the point of order: He is clearly asking a witness to identify the validity of those matters while they may have been raised during the campaign they nevertheless will either come to fruition or not should the privatisation proceed.

**The Hon. TREVOR KHAN:** I am not going to argue any more. I have made my point. I do not want to cut into any more of your time.

**CHAIR:** We will proceed with the question. It is what is relevant now in your campaign considering potential privatisation.

**Mr KERSLAKE:** I just think this is a matter of really significant public policy. There needs to be strong voices articulating concerns that people have. The polls that Mr Lennon has referred to about people having concerns about privatisation are not new. They have been there ever since this issue was first raised. People are really worried about the sale of the electricity network, what it will mean for them, for their lives, for electricity prices, for the certainty and the future of the sector. What we have been doing is being strong advocates for workers and for the community and we think it is entirely appropriate to raise legitimate concerns. The fact is that this campaign has been run along political lines and a lot of stuff has been said that, I think, exaggerates the situation.

We have tried to stick to the facts. The electricity in this State has provided the people of New South Wales with a good reliable service. Just a few weeks ago we had emergency situations arise. It was not the SES that was first on the scene, it was people from the electricity industry securing the situation before the SES could arrive and get households back into power. That has been built up by generations of people to provide us with a really good network. It provides the Government with revenue. I accept that the decision of the AER is going to set up some challenging times ahead but the fact is we have got a lot of revenue as government and benefits for the taxpayers of New South Wales as a result of public ownership of the electricity network.

On the issue of prices, we have argued consistently that the highest prices in this country are in South Australia. That is where this Government wants to take us to a fully privatised network like what they have in South Australia. How is it the case that that is in the interests of the people of New South Wales to privatise our electricity network and to go where the South Australians have gone? That to me requires a strong degree of public advocacy and that is what we have been about the whole time.

**Dr JOHN KAYE:** Mr Butler identified himself as having worked as a linesman for a number of years—a relatively longer number of years than some others—and that you have a lot of experience operating electricity. I want to take Mr Butler to the fourth paragraph on page five of his report where he identifies a matter that has been reported in the media where a Victorian privately owned distributor, I think, brought in private contractors illegally from the Philippines and employed them on contracts that were illegal, abused their rights quite significantly and effectively blackmailed them into performing work. Mr Butler then makes the point that this type of behaviour can be expected in New South Wales should the transaction proceed.

I will not ask you about the substance of that case but about the consequences if that were to happen in New South Wales. I want you to address three issues. The first is safety and equality of work that is being done—safety for other workers who would come afterwards and whether contractors who would not be properly qualified and who may be operating under stress brought in would leave a risk for future contractors. The second is: if that becomes a regular occurrence what impact will that have on the knowledge base that I believe is so critical to security and safety? Mr Brock you might want to comment as well. My third question is on the forward knowledge accumulation, the development of the skills in the industry. Could you comment on those three aspects?

**Mr BUTLER:** That is a great question. I guess it leads to those other impacts rather than just the financial impacts. You first talk about someone who may be under pressure or stress working on the network and whether their skills are at the appropriate level, and even if they are whether being under threat of being back home if they did not do something that their employer asked. Well that puts all sorts of things at risk, there is absolutely no doubt.

I am an old lineworker and like I said, if I am up a pole and my employer says, "If you don't get that job done and if you don't get it done within this particular time frame, and you don't do it in this way"—so that you might be working on your own on viable electricity—"then your employment is at risk". If my employment is at risk, then also my residency in Australia might be at risk. They are pretty big motivators. I am going to do what that boss says. The reality is that a lot of people die working in this industry. It is a hazardous area of occupation and I have a number of friends, past friends, who have been electrocuted. They have died as a result of working on the network. But it is clear that the pressure that could be applied by an unscrupulous employer—and they are in the minority, but they are there—is so great that it would lead to—and could lead to—significant safety breaches.

The second part of the question I think went to a knowledge gap. What we have got now is a situation where the network operators are not putting on apprentices and our experience is with overseas private equity that buy into these networks, they maximise profits and cut costs. One of the costs that is fairly significant is



training, particularly apprentices, so that the training of these tradesmen—they are four-year trades now—iron-worker, cable joint and electrical fitter-mechanic—four-year trades. They cost a bit for people to go through, it is an investment in people. They will not train and have not in our experience. It is not a crystal ball, we look into the past. In Victoria they were not put on for 10 years. What you then have, at some time in the future, is employers and businesses running around saying, "We have a skills gap. How do we fix this skills gap?" when the fix was in the continuing engagement of apprentices anyway. The skills gap is usually fixed by saying, "Let's invite people from somewhere else to come in and work". So we have that problem. I tried to hold all three parts of your question in my head but I have lost the last one.

**CHAIR:** We will move on to Mr Borsak.

**Dr JOHN KAYE:** I will put the rest on notice.

**The Hon. ROBERT BORSAK:** Mr Lennon, do you have any views relating to the trade sale preference that the Government seems to demonstrate in this process? In other words, should it occur?

**Mr LENNON:** Our view is that privatisation should not occur so we are not in a position, nor would we want to go to a situation where we would be discussing what sort of sale it should be, Mr Borsak.

**Dr JOHN KAYE:** Mr Brock, if you can briefly recall the question I asked. The practice of bringing in contractors from overseas which would be more likely to occur under private ownership, in terms of the skills base that your organisation represents—and I should declare that I was once part of that skills base—what impacts would that have?

**Mr BROCK:** For us, we have not seen a lot of impact from bringing in foreign-educated contractors but what we have found in other States particularly, is that there is not the investment in the next generation of skills in our areas. And I mentioned briefly in my opening address that currently the four organisations combined employ 65 graduate engineers. There would not be 65 graduate engineers in the other network businesses in the other States, I can say that confidently.

That number is dropping, in line with what Mr Butler indicated in respect to apprentices, but it is a critical source of professionals for this industry into the future and we take the view that engineers are effectively professional problem-solvers—that is what they do. They support the efforts of the other classifications in the businesses and they try to find efficiencies in ways of working. The golden rule has always been that you put safety first; reliability second; and revenue is the third consideration. That is how these professionals conduct their business. The concern our members have is that, if there were to be a change in the nature of the ownership of the industry, that that rule may be played around with a little bit. We can say that we view, as an indicator of that, the growth of the next generation of professionals is a testament to that.

**Dr JOHN KAYE:** Mr Lennon, your organisation or the organisations your organisation represents, have been accused—including today—of xenophobia. Can you briefly respond to that accusation?

**Mr LENNON:** The fact is that, during the election campaign—if we are going back to the election campaign—the question that has to be asked is: If this privatisation were to take place, what are the likely consequences, including who may potentially be the owner of this essential service? There is no doubt that there are a number of potential foreign investors, one of which would possibly be State Grid Corporation of China. I think you might be aware of the consequences of where those foreign investors are coming from, the nature of their ownership structure, and the consequences thereof. There is no doubt that some corporations are state-owned by governments that are not open, transparent and democratic governments and it is a cause for concern.

**The Hon. CATHERINE CUSACK:** So you make no apology for that disgusting campaign?

**CHAIR:** Order! Dr Kaye is asking the questions.

**Dr JOHN KAYE:** So your point, Mr Lennon, goes not to the fact that they are foreign in any way, speak a different language or come from a different culture, I take it that your point goes to the fact that they are owned by a government or by corporations whose track records are not congruent with Australia's standards of corporate behaviour?

**Mr LENNON:** That is right, absolutely. If you look at some countries around the world, they do not have the system of the rule of law and what we believe are property rights and other rights that you would expect, that would make you comfortable with them owning an essential service such as our poles and wires.

**Dr JOHN KAYE:** To pick that point up with Mr Butler, and Mr McNamara might want to comment on this as well, you make the observation, on page 8 of your submission about the tax payments, about the failure of a number of multinational corporations and owners of the Victorian networks.

**The Hon. CATHERINE CUSACK:** Not from China.

**Dr JOHN KAYE:** A number of multinational corporations own the networks in Victoria and their failure to pay tax, their fairly substantial tax avoidance behaviour. Does this matter go beyond just tax avoidance? For example, one of the observations that has been made in the media is that one of the senior executives of the State Grid Corporation of China, Mr Shu Yinbiao, is the subject of a massive audit in China. It has been reported in the *South China Morning Post*, a massive audit for irregular behaviours and potential corruption of his company's management. Are you concerned that where companies come from environments of substantial—

**The Hon. CATHERINE CUSACK:** Goodness John, that is disgraceful.

**Dr JOHN KAYE:** —environments of substantial corruption, that there would be a risk that—

**The Hon. CATHERINE CUSACK:** What an outrageous statement.

**Dr JOHN KAYE:** —a risk that that would be imported into Australia?

**CHAIR:** Order! The member will cease interrupting the question.

**Mr BUTLER:** What we would see is that Australia, and in particular New South Wales, has what we believe is a structure of governance requirements that rate very highly.

**Dr JOHN KAYE:** Under public ownership?

**Mr BUTLER:** Under public ownership and that what we would be concerned about is that that corporate governance regime would start to slip and if there are standards that are measured and met by companies in New South Wales and Australia, then it has to be the expectation that that would continue. Our experience, in relation to tax and others, does not quite mirror that requirement. So, the obligations are clear and what we find with these corporations is that they have a lot of money, they have a lot of very smart people and we can make up all the rules we want but what they do is, they get those smart people to work a way around those rules.

**CHAIR:** Mr Lennon, you mentioned the polling in the research that you conducted. Is it possible to table that research for the benefit of the Committee or is it confidential?

**Mr LENNON:** No. I am happy to provide that to the Committee.

**CHAIR:** There has been reference, and we just had another one, that the regulations may not work if it was privatised and where governments seem to have trouble controlling them. Can you give me an example of where regulations have failed in South Australia or Victoria?

**The Hon. TREVOR KHAN:** Surely that has to be limited to the electricity industry under the current regime.

**CHAIR:** Yes, I am talking about the electricity industry.

**The Hon. TREVOR KHAN:** Under the current regime.

**CHAIR:** You have said that regulations have failed. Are there any examples?

**Mr KERSLAKE:** If we look at what was reported in the press this week—the report in the *Age* newspaper—about workers who have come over from the Philippines, and what has been circulating on social media suggests that they were asked to sign contracts that said that they were not allowed to engage in trade union activity. Here we have outsourced the maintenance of electricity network to the lowest common bidder. That bidder has sought labour that has come through 457 visas and those workers were, as part of their contract, bound not to become members of trade unions. This has been exposed, but here we have a race to the bottom for the maintenance of the electricity network. That is happening in Victoria. That is not happening in New South Wales because New South Wales has a system that is set up to provide quality services and look after the rights of workers at the same time.

**The Hon. Dr PETER PHELPS:** A closed shop for white folks is what you really mean.

**Dr JOHN KAYE:** Shame.

**Mr KERSLAKE:** Call it what you like. It is actually treating people with respect to respect their legal rights. If you deregulate the whole thing you throw it out to the market, which is where you want to take it. You see people getting exploited. The people who get exploited are not the rich people driving big cars. It is the poor people who have trouble paying their bills. They are the workers of the industry. That is the point here. If we have a regulated system that is owned by the Government—and that is what we are advocating—I can tell you my conscience is clear. Those of you who want to sell it off to the lowest common denominator and have workers and consumers exploited, I think that is a disgrace.

**Mr BUTLER:** On page 6 of the Electrical Trades Union [ETU] report, we point out that there was a coronial inquiry following the disastrous bushfires a number of years ago in Victoria. As I understand it, and I do not have the coronial report in front of me, but the coroner attributed more than half of those fires to the lack of maintenance on the electricity network, which was privatised under Mr Kennett some years ago. There was severe criticism as a result of that coronial inquiry. As I understand it, there is still an ongoing class action for people who lost property and for families who lost loved ones as a result of what we would very clearly say is a fundamental failure of regulation to control private equity, running these organisations where they put profit ahead of safety.

This is an absolute classic example. I know people may take it out of context and I ask you not to, but I would hate to see the same set of circumstances come about in New South Wales in the Blue Mountains, or any other area that is prone to bushfires, that as a result of a lack of maintenance of the networks we see a series of events that start these disastrous events. Very clearly in my mind, Reverend Nile, the lack of compliance with regulation led to substantial loss of property and the absolute worst outcome of substantial loss of life. That was a failure of regulation.

**CHAIR:** The Australian Energy Regulator [AER] has made new decisions and there is an estimate of how many jobs would be lost if leasing went ahead. Do you have your own figure of how many jobs would be lost?

**Mr LENNON:** Could I go back to your previous question, Chair? On the question of failure of regulation, I am happy to provide the Committee with an article that was written in the *Herald* prior to the election by one of the business reporters who made the point that companies in Victoria have gamed the system to the extent that it cost the Victorian consumers \$3 billion. The point is that there may be a regulator in place, but it is the role of private companies to work in the best interests of their shareholders; it is what they have got to do. The point is that whatever the regulations are that are in place, they will do their utmost to maximise the return for their shareholders within the framework of that regulation, and that is what was evident in Victoria.

**Mr McNAMARA:** I wish to comment on that specific question as well. Regarding regulation, specifically in relation to the intention of providing employment protection for employees post-privatisation—I think it was in 1996 in Victoria when employment protections were provided—they were in the form of no forced redundancy clauses within the employees' enterprise agreements. They were contained as a proposal with the Government and the unions and employees in relation to protecting employees and they regulated through those provisions. What we then saw was that the organisations—I will not mention those organisations because there is criticism in relation to picking on certain Governments—sought to circumvent those employment protections through creatively using employment regulations to introduce individual contracts that deteriorated those employment protections.

In any decision about privatisation or leasing, and hopefully at the end of this process we realise this is not the best thing for the State, but if it is, we need to ensure those employment protections are secured in a consistent manner. Governments come and go, legislation comes and goes, but regulations change. We need to ensure that the people in this industry are protected.

**The Hon. CATHERINE CUSACK:** Mr Butler, turning the focus back to consumers, do you support the AER's recommendation for essential energy customers that we transition to lower prices over time?

**Mr BUTLER:** Not at the expense of service. What happens is that the AER make a determination, and we believe the AER make a determination in a vacuum. All they do is punch some numbers into a cypher and there is an outcome. When you look at what that outcome delivers, people may get lower prices. There is no legislation or there is no requirement for the retailers to pass that lower price on, so they could profit gouge—there is no doubt. They may get lower prices. What they will get and what the AER has also said in its determination is that customers and consumers must be prepared to sacrifice service and endure wait times for connections and reconnections. There is a balance here. I believe that the AER has got the balance wrong. Where we see the biggest impact is if a storm event goes through a town. Again, let us use Tamworth because it has storms. A storm hits and there are 100 people ready to leap to the assistance of the town and get the power back on. If the 30 per cent come out, then what will happen is that those response times and those reconnections will take much longer because that is the way the network works.

**The Hon. CATHERINE CUSACK:** Is there no hope for lower prices for country consumers?

**Mr BUTLER:** I am trying to get to it. When we connect people to the network—and I have done it myself—they say, "Thank God you are here. Thanks for putting our power back on. We could not have stood being off another day." My view is that if a customer is going to save \$100 a year but they will be off for an extra couple of days, they would prefer to pay the extra \$100 a year.

**The Hon. Dr PETER PHELPS:** Except as an exceptional customer, I have gone from 23¢ to over 33¢ a kilowatt an hour. That is a 30 per cent rise in less than three years.

**The Hon. ADAM SEARLE:** Mr Butler, in answer to an earlier question—

**The Hon. ROBERT BORSAK:** Gold-plating.

**The Hon. Dr PETER PHELPS:** Feather-bedding.

**The Hon. ADAM SEARLE:** —you said that the AER determination sets the income for the State-owned electricity companies, but the Networks NSW chief strategy to meet that determination has been to cut jobs. In the past your union has been a constructive partner with Networks NSW in reducing expenses in those businesses by something like \$3 billion.

**Mr BUTLER:** Yes.

**The Hon. ADAM SEARLE:** I understand that you put to Networks NSW other strategies other than job losses to meet the AER determination strictures. Is Networks NSW proving to be open to your constructive proposals or is it focusing on job losses as the first port of call?

**Mr BUTLER:** It is focusing on job losses. We have yet to meet and go through the AER's full impact. But in previous discussions we made suggestions and recommendations for productivity improvements that would number in 30s or 40s. On every occasion, the chief executive officer of Networks NSW has said he is not interested in productivity improvements and he does not want to know about it. It is all about costs and how we get to the lowest costs for the business.

I will provide an example. The organisations were in an area that they call "contestable work". That is work that is open to the full market. Instead of, for example, Ausgrid having a monopoly, contractors can bid on the work so that the customer gets the best price. Ausgrid withdrew completely from the contestable market. It has all the trucks, people and gear; it is ready to go. However, it withdrew from the contestable market and left it to private contractors. What we have seen happen in places such as Muswellbrook—and this is relevant—is that Ausgrid withdrew from the contestable market and people in that area could only get contractors to do the work. The contractors then gamed it. Ausgrid employees told us that their price on, for example, a pole/transformer

job, would be \$20,000 and the cheapest the customer would be able to get it from local contractors was \$30,000. They took a competitor out of the market. We said that the organisation should re-enter that contestable market. It is an area in which it can make money and as a result keep more jobs.

**The Hon. Dr PETER PHELPS:** So you support competition.

**Mr BUTLER:** Competition was forced upon us.

**Dr JOHN KAYE:** I refer to the employee guarantee. This is a without prejudice question. It is clear that you and everyone else at the table are totally opposed to privatisation of the grid.

**The Hon. Dr PETER PHELPS:** Of anything, anytime for any reason.

**Mr BUTLER:** I would not mind privatising Parliament.

**Dr JOHN KAYE:** Do not fall for his stupid antics.

**Mr LENNON:** I would like to make a point about the statement that there has been no privatisation in this State over the past 15 or 20 years. That is entirely wrong.

**The Hon. Dr PETER PHELPS:** And the unions have opposed every damn one of them.

**CHAIR:** We are not debating the issue.

**Dr JOHN KAYE:** I would prefer it if members did not yell at witnesses during my time for asking questions.

**The Hon. Dr PETER PHELPS:** Coalmines, the State Bank, the fish markets—

**CHAIR:** The Hon. Dr Peter Phelps should not be making a speech.

**The Hon. ADAM SEARLE:** The honourable member is simply a sore winner.

**The Hon. Dr PETER PHELPS:** They were all State businesses.

**The Hon. ADAM SEARLE:** He cannot help himself. He is an utter joke.

**Dr JOHN KAYE:** I have a serious and important question.

**CHAIR:** I apologise for the antagonism that the Hon. Dr Peter Phelps is trying to create. Please do not take the bait.

**Mr LENNON:** That is okay. I have never experienced it before from Dr Phelps.

**Dr JOHN KAYE:** Let the Hansard record reflect the fact that that last comment from Mr Lennon was ironic. Mr Butler and Mr McNamara, I refer to your jobs guarantee. If this were to be sold, what would you see as the bottom line to maintain a level of apprentices?

**Mr BUTLER:** Over the past five to six years, the organisations have engaged between 250 and 300 first-year apprentices each year. That is not a huge number across the State. Without being able to analyse the exact numbers previously engaged, we would say that that number should be maintained so that the skills gap that could eventuate down the track does not.

**Dr JOHN KAYE:** You would want there to be an analysis of the skills needs of the industry going forward. I see Mr Brock is nodding his head. I imagine that that would also relate to traineeships for engineers. You would be looking for an analysis of the jobs needs of the industry, including in rural and regional New South Wales, and some commitment to ensuring that that gap would be filled by apprentices.

**Mr BUTLER:** I think that is a logical, smart and necessary move to make for New South Wales. I look at youth unemployment in regional New South Wales, Western Sydney, Tamworth and all around the traps.

There must be an obligation on someone to ensure that our young folk are not left high and dry. I will fight for that.

**CHAIR:** Any other questions should be placed on notice. Thank you for attending this hearing and providing a great deal of valuable information. The Committee appreciates that. Members know how strongly you feel about this issue.

**Mr LENNON:** Thank you. I take this opportunity to place on the record our thanks to the hardworking Hansard reporters. Given the argy-bargy, they must find it very difficult. They do a remarkable job.

**(The witnesses withdrew)**

**(Short adjournment)**

**MICHELLE GROVES**, Chief Executive Officer, Australian Energy Regulator, and

**SEBASTIAN ROBERTS**, General Manager Networks, Australian Energy Regulator, affirmed and examined:

**RICHARD OWENS**, Senior Director Transmission and Distribution Networks Australian Energy Market Commission, and

**JOHN PIERCE**, Chairman, Australian Energy Market Commission, sworn and examined:

**CHAIR:** I welcome from the Australian Energy Market Commission Mr Richard Owens and Mr John Pierce and from the Australian Energy Regulator Ms Michelle Groves and Mr Sebastian Roberts. Please state your name and position title and swear either an oath or an affirmation. Mr Pierce, do you wish to make an opening statement?

**Mr PIERCE** Yes, thank you. I will be brief and then hand over to my colleague from the Australian Energy Regulator, Michelle Groves. As Committee members are probably aware, the Australian Energy Market Commission is a national institution that reports to the Council of Australian Governments Energy Council. We essentially have two roles. The first is to advise the council and its member jurisdictions on market development, and that is usually in response to terms of reference issued to us by the council via public consultative reviews we undertake. These serve as input to the council's policy considerations. Our second role is a statutory one in that we make the rules that govern the natural gas and electricity markets in response to rule change proposals.

Most relevant to this inquiry, that covers the way in which network businesses are regulated. It is open to anyone to put rule changes to us, and when they do we are required to deal with them on their merits, irrespective of where they come from. In fact, the only person or entity that cannot initiate a rule change process is the commission itself. In practice, what tends to happen is that if the council has a question about an issue or a problem and they are not sure of the answer then they ask us to do a review. If the council, consumer groups, industry participants or anybody else thinks there is an issue or an improvement to be made to the rules and they think they know how that should be done, that is when they tend to go straight into the rule change process.

In performing both these roles in relation to the electricity sector, we are obliged to have regard to what is known as the National Electricity Objective that is set down in the National Electricity Law and that has been adopted by each of the participating jurisdictions. That objective is to promote efficient investment in, and efficient operation and use of, electricity services in the long-term interests of consumers of electricity, importantly, with respect to: price, quality, safety, reliability and security of supply of electricity; and the reliability, safety and security of the national electricity system. We are one of a trinity of market institutions, the others being our colleagues at the Australian Energy Regulator [AER] and the Australian Energy Market Operator [AEMO].

The relationship between us and the council may generally be understood to what conforms to principles of subsidiarity in that the council is responsible for policy that is expressed through the national legislation, the AEMO gives effect to this by administering the detailed rules, the AER is responsible for enforcing and monitoring compliance with the rules, which includes the economic regulation of networks, and AEMO is responsible for operating the power system and wholesale spot market in accordance with the rules. Of course, what consumers actually experience is determined by a raft of things that happen outside that structure. States, usually via energy Ministers, determine the network reliability standards, and governments have various policies and portfolios other than energy that impact on the sector through, for instance, land-use planning regulations and site-specific and more systemic environmental regulations. I suppose the Renewable Energy Target and regulations around emissions are prime examples.

With respect to price and reliability outcomes that consumers experience, this is really a function of three things: what is happening in the competitive generation and retail sectors; what is happening in the regulated network sector; and those policy positions of government that emerge from portfolios other than the energy ones. Importantly for the purposes of this inquiry, the structures, rules and regulatory processes that the commission is part of is agnostic with respect to ownership—they apply equally irrespective of whether a participant is publically or privately owned. The question of public versus private, or some combination of the two, is squarely a policy question for governments. From a rules perspective, this agnosticism with respect to

ownership and the primacy of the national electricity objective applies equally to the competitive generation and retail sectors as it does to the regulated network sector.

This applies not only to how network revenues are determined but also to other issues of importance to consumers such as the way the network prices faced by the individual consumer are structured, which is an issue the commission addressed in some rule changes in 2014; the way consumers engage with the market and, where relevant, its regulatory processes; the obligations on distributors with respect to connecting distributed and embedded generation; through to issues that are particularly important at the moment, given the nature of the technological change that is impacting on the sector, as to where we draw the line between what is regulated and what is competitive.

For instance, at the moment we are dealing with a rule change that redraws that line so that the services provided by meters will be moved from the regulated sector into the competitive part of the industry. My final point—and I suspect the AER will expand on this—is that it is important to appreciate that the economic regulation of networks is a class of regulation referred to as incentive-based regulation, which is unlike what is referred to as cost of service regulation which applies predominantly in North America. In effect, the important part of that distinction is that under incentive regulation the revenues set for business are not a function of their actual costs, rather it is a function of what is assessed as being required by a prudent and efficient operator so they can earn a return that is commensurate with the risks in that business—that framework was reinforced in the 2012 rule changes proposed to us by the Australian Energy Regulator and a group of large users.

During a regulatory period if the business operates more efficiently than assessed by the regulator the business gets to keep those gains for a period, and then in subsequent regulatory periods they are able to be passed on to consumers; if they operate with a cost structure that is higher than what a prudent and efficient operator would be assessed to have, then they earn lower returns. That provides the incentive for the business to improve productivity. I am happy to take questions during today's proceedings. Michelle Groves, chief executive officer of the Australian Energy Regulator, may also want to expand on some of those points.

**CHAIR:** Ms Groves, would you like to make a brief opening statement? Please bear in mind that we do not wish to spend too much time on introductory remarks.

**Ms GROVES:** I would like to make some comments. What I will be focusing on is the work that we have been doing in regards to the electricity distribution and transmission networks because that is the part of our work that is most relevant to the Committee's inquiry. As set out, we are the national energy market regulator and we are an independent decision-making body, and one of our roles is about determining the amount of revenue that network businesses can recover from their customers for providing the poles and wires that transport electricity. As set out by Mr Pierce, this is done under a regulatory framework set out under the national electricity law, the national electricity rules and in pursuance of a very clear objective—that is, to deliver for the long-term interests of consumers.

**The Hon. TREVOR KHAN:** Does that mean lower prices?

**CHAIR:** Ms Groves, please finish your comments and then we will proceed to questions.

**Ms GROVES:** I will proceed with my comments and then perhaps we will come back to your question. As pointed out by Mr Pierce, the regulatory framework is applied consistently to electricity network businesses in the national electricity market to both private and government-owned businesses. Whilst there have been questions from time to time about whether the regulatory framework should be different for firms with different types of ownership, this idea has been consistently rejected by policy makers, rule makers and, indeed, by the AER. It is very clear that the same set of rules apply to both privately-owned and government-owned firms and that the outcomes from the applications of those rules will be the same for a particular firm irrespective of their ownership.

Using the regulatory jargon, the framework is an ex ante incentive-focused building block regime—the Committee has probably heard those terms coming through—and Mr Pierce has already set out what that means. In essence, the job of the AER is to set business revenues for a future period—normally four or five years, although in the case of the current round of resets in New South Wales it is four years for the distributors and three years for TransGrid, the transmission business—based on forecasts and estimates of what would be appropriate revenues for the next period of time. As set out by Mr Pierce, this incentivises businesses to improve and innovate because any savings a business can make they can keep for a defined period of time, with the



benefits to consumers flowing through in future periods from those lower costs rather than being the starting point for the next regulatory period.

Under the framework we regulate a business' revenues; we do not regulate its costs. A business must decide how to best use this revenue in providing network services and meeting its obligations. This provides incentives for businesses to operate their business efficiently and, in the long run, at least cost to consumers. It provides incentives for businesses to innovate and to invest in response to changes in consumer needs and productive opportunities. The rules relating to the network determination process were significantly amended in 2012 following a very extensive review process undertaken by the Australian Energy Market Commission [AEMC]. These changes strengthened the framework, increased the opportunities for consumer engagement and allowed for greater use of regulatory tools such as benchmarking.

A key way in which the framework was strengthened was in respect of the approach to setting rates of return. The rate of return provides a business with revenue to service the interest on its loans and to give a return on equity to its shareholders. The allowed rate of return is a key determinant of allowed revenues. The rate of return must be commensurate with the efficient financing costs of a benchmark efficient entity with a similar degree of risk that applies to the business. It is not related to the business' actual cost of financing.

Clearly, operating expenditure is also a very important component of the total revenue required by these network businesses. Under a regulatory framework the Australian Energy Regulator [AER] must be satisfied that the level of a business' operating expenditure reasonably reflects the costs that a prudent operator with efficient costs using a realistic expectation of demand and cost of inputs would require. As pointed out by Mr Pierce, this means that it is not the business' actual costs that are the central consideration but rather the costs it would incur if it were a prudent operator with efficient costs.

The framework was strengthened to provide the AER with additional tools, in particular to give the AER very clear authority to benchmark network business practices and costs and to use the results of that benchmarking to inform its decisions on the efficient levels of cost going forward. Our assessment of capital expenditure by the business is also a very important component of the total revenues and the framework has been strengthened to ensure that, going forward, only the efficient capital expenditure will be included in the regulatory asset bases of network businesses.

Following the rule change process the AER put out a series of guidelines that set out in great detail our approach to the new rules. We developed these guidelines through extensive consultation over 12 months with the sector and with a very wide range of stakeholders. These guidelines were finished in 2013 as part of our better regulation reform package. So we consider that the new rules and the better regulation reforms provide a framework which ensures that proposals from network businesses are subject to a significant amount of scrutiny to ensure that customers are paying no more than necessary for a safe and reliable electricity supply.

The AER has just completed applying this framework to the network businesses in New South Wales: TransGrid, Ausgrid, Endeavour Energy and Essential Energy. Our final decisions in respect of these businesses provide them with revenue that will allow them to meet their obligations in respect of quality, reliability, security and safety. They will apply to the businesses for the next four years—or, in the case of TransGrid, for the next three years—irrespective of the ownership of these businesses.

We have considered what revenues are necessary for the businesses to meet their safety and reliability requirements, including, for example, to meet efficient levels of vegetation management costs. We recognise that safety is an obligation for businesses, as is reliability levels. All of the businesses meet their legislative obligations, and at times exceed the minimum standards. The issue for the AER was whether these businesses were meeting these obligations and standards efficiently, like their counterparts in Victoria and South Australia, or whether they were incurring inefficient costs. We consider that consumers should only be funding efficient and prudent costs.

We have not made decisions requiring particular staffing levels for these businesses. We have approved total revenues for the businesses to recover from their customers. Questions about how the businesses operate to deliver the services required by their customers are for the businesses to determine. Any expenditure above the efficient levels we have approved will need to be funded by the businesses and their shareholder. This will be a decision for them. Our decision allows TransGrid to recover \$2.19 billion from its customers over the 2015-18 regulatory period. This is approximately 25 per cent less than TransGrid's proposal to us, principally driven by our decisions in regards to the rate of return that TransGrid will be allowed to recover.

For Ausgrid we allowed total revenues of \$6.58 billion, which is approximately 38 per cent less than what they proposed. The two most significant drivers of this difference were, once again, the rate of return and, additionally for Ausgrid, differing approaches to setting the operational expenditure. Those two drivers—rate of return and operating expenditure—were also the major contributors to the differences between the proposed and allowed revenues for Endeavour Energy and Essential Energy. For Endeavour Energy we allowed \$3.2 billion, or 28 per cent less than what they proposed. For Essential Energy we approved \$3.8 billion in total revenues.

Based on these lower charges being passed through to customers, we would expect average electricity bills to reduce for residential customers by between \$130 and \$337 per year and for small business customers by between \$190 and \$564 in the first year depending on distribution area. We are confident that we have allowed sufficient revenues for each of these businesses to operate safely and reliably, to meet their obligations and to provide the services required by their customers. We are satisfied that customers will pay no more than necessary for a safe and reliable electricity network service.

**CHAIR:** Thank you for that very detailed introduction. I acknowledge the presence in the public gallery today of the Hon. Michael Egan, a former Treasurer. I welcome him.

**The Hon. ADAM SEARLE:** Ms Groves, you have said that the regulatory framework you operate is designed to make sure that customers pay no more than is necessary for the service. You have outlined some of the cost reductions that you think the determination will create. What guarantees are there that those prices will flow through to customers in terms of the prices charged by the retailers?

**Ms GROVES:** As set out by Mr Pierce, retail prices are made up of a range of factors and the framework does not direct how those prices will flow through to consumers. Our role is to determine efficient revenues that will then go on to derive the network tariff. The expectation would be that in a competitive market competition will ensure that those savings are passed through to customers.

**The Hon. ADAM SEARLE:** Nevertheless, it is possible that one or more of the retailers could trouser some or all of those savings in the network costs?

**Mr PIERCE:** If I may offer a comment, part of what the commission does at the request of the council is to conduct reviews each year of the nature of retail competition in various jurisdictions. We have not had any experience in the past of anything other than the changes in the regulated part of the costs being passed through to consumers. If a retailer attempted to, as you say, keep part of that cost reduction for itself, given the very high levels of switching between retailers that occurs in this sector—which is much higher than in any other comparable sector such as telecommunications, banking or insurance; and we publish those comparisons—

**The Hon. ADAM SEARLE:** So this is the invisible hand of the market theory.

**Mr PIERCE:** It is more than just a theory; it is actually what we have observed in practice, measured and presented in our report.

**The Hon. Dr PETER PHELPS:** Facts as opposed to socialist theory.

**The Hon. ADAM SEARLE:** I am happy for anyone to answer this. The fact is that the prices charged of customers at the point of sale or point of use in Victoria are comparable to those here in New South Wales, and in South Australia they are significantly higher than customers here in New South Wales. Those are the facts, are they not, Mr Pierce?

**Mr PIERCE:** When I started in this sector in January 1979 it was the case that retail prices in South Australia were higher than in New South Wales and that the prices in Victoria were comparable to New South Wales. I am not sure that anything has changed since.

**The Hon. ADAM SEARLE:** My question was directed to the actual prices that customers are paying.

**Mr PIERCE:** I think that is exactly what I am referring to. The relativities between the jurisdictions that we observe now are comparable to how they have been for many decades and, in the main, that is a reflection of differences in fuel sources, geography, the nature of the networks in those jurisdictions. So it is not

particularly surprising that you would observe, particularly, South Australian prices being higher than New South Wales. I think it has always been thus.

**The Hon. ADAM SEARLE:** But the fact is that both South Australia and Victoria have smaller network sizes than New South Wales and customers do not pay a network bill and a retail bill; they just pay their electricity bill. The fact is that South Australian customers are paying a total electricity bill that is higher than the average customer here in New South Wales. That is the fact, is it not, Mr Pierce?

**Mr PIERCE:** It is and it has always been thus.

**The Hon. ADAM SEARLE:** So privatisation of the South Australian industry has not led to prices in that State being the same as, or lower than, the publicly owned customer service here in New South Wales.

**Mr PIERCE:** I think we have both made clear that it is not our role to attribute outcomes to particular types of ownership, that both the rules that we administer and the way these networks are regulated are done in the same way irrespective of whether they are publicly or privately owned.

**The Hon. ADAM SEARLE:** Just on that, you say that the regulation does not discriminate or is not adjusted between public or private ownership. These determinations that have just been finalised by the AER, Ms Groves, they apply to the specific companies, do they not?

**Ms GROVES:** They do.

**The Hon. ADAM SEARLE:** So there is one for Endeavour Energy, one for Essential, one for TransGrid and so on.

**Ms GROVES:** Yes, that is correct.

**The Hon. ADAM SEARLE:** And it only binds those companies?

**Ms GROVES:** That is correct.

**The Hon. ADAM SEARLE:** What happens here in New South Wales if next year the transmission system is not operated by the legal entity known as TransGrid? What if it is operated—not owned but operated by a completely new corporate entity that does not today exist? How does your regulatory determination legally, as a matter of law, then flow through and apply to any new business operator?

**Ms GROVES:** My expectation would be that the change of ownership documentation legislation would ensure that the rights and responsibilities currently undertaken under the name of TransGrid to that extent would continue for whatever the new corporate entity was. That is not unusual. There have been changes of ownership mid-regulatory determinations. Electricity networks do not get sold often but they have been sold between private players, between government and part way through regulatory determinations and it has not been something that we have experienced as a problem under the framework.

**The Hon. ADAM SEARLE:** But that would be a question of how the switch is made, would it not?

**Ms GROVES:** There are a range of obligations that sit within the National Electricity Law and National Electricity Rules that apply to network businesses. So for someone to operate a network business—say, for example, a transmission business—there are State-specific obligations around licensing that they need to meet, but there is also a range of obligations about being a registered market participant, and it is those obligations, it is that framework that gives the outcome of the determination its regulatory force.

**Mr OWENS:** But the electricity rules are clear that no-one can operate a distribution or transmission business unless they are registered under the National Electricity Rules and unless they have a determination from the AER. So if there was, for some reason, a different business setting up they would need to apply for registration, they would need to get an AER determination, if they were not just taking over the existing licence and registration of one of the existing businesses.

**The Hon. ADAM SEARLE:** Just to go back to what Ms Groves said, you talked about the sale documents. We are being told that the transaction being contemplated in New South Wales is not a sale; the

Government is saying they are going to lease things only. In terms of the revenue envelope set in your determinations, how can there be a guarantee through your regulation that the new legal entities operating the business will be bound by those revenue envelopes?

**Ms GROVES:** Because the entity, to be able to recover revenues from customers for the sale of transmission services through the current TransGrid network, would need to ensure that it meets the law and rule obligations in order to do so and then that would give force to our determination. They cannot operate a business and recover money from customers without complying and without having a corporate structure and set of obligations on them that would enable them to be a registered market participant in the way set out by the law and rules.

**Mr PIERCE:** It would be independent of whatever the transaction documents say.

**The Hon. ADAM SEARLE:** I can understand the need to comply with all the rules and regulations that apply to the operators but I am still not seeing exactly how you have that same legal connection with the revenues that they are able to charge. Are you saying they cannot operate at all without having a determination made by your organisation?

**Mr OWENS:** The only right that transmission or distribution networks have to recover revenue now they do not bill customers and users directly, they bill retailers—as you have said they then bill customers—the only right the transmission or distribution networks have to recover any revenue from retailers is under the rules: they must be registered under the rules and their revenue must be within the maximum revenue allowance set for that business by the Australian Energy Regulator. If a new business came along in any form it would need to be registered, it would need to have a determination and then the only way it could charge retailers would be in accordance with the terms of that determination.

**The Hon. ADAM SEARLE:** So it is possible that a new determination applicable to the new legal entity might have to be made before that entity can start to operate in New South Wales?

**Ms GROVES:** That would be unusual.

**The Hon. ADAM SEARLE:** If we are talking about a different legal entity.

**Ms GROVES:** I am not in a position to comment on the New South Wales situation of how it might transfer ownership, in what form, or how they meet their obligations under the law and rules. All we can say is that in order for them to be able to recover revenues from customers they will need to ensure that happens.

**The Hon. ADAM SEARLE:** I am happy to get some further feedback on notice. Has the New South Wales Government shared with you any of the details about how it proposes to effect or structure the transactions to lease the New South Wales poles and wires?

**Ms GROVES:** No.

**The Hon. ADAM SEARLE:** But the detail of how it does that would be important to your effective regulatory oversight, would it not?

**Ms GROVES:** All we would need to be assured of is that they complied with their law and rule obligations.

**The Hon. ADAM SEARLE:** What are the total savings that will be made for electricity users over the next regulatory period for each of the businesses subject to your determination? If you do not have the answer I am happy for you to take it on notice.

**Ms GROVES:** There are a number of caveats around this. What we are talking about here is the concept of an average customer who will consume in a certain pattern within various areas. There are also things that affect the revenues of the business through the period; they may receive more or less revenues, depending on other processes, through pass throughs, et cetera. The best indicator I can give you, for example, is if we start with AusGrid. We are anticipating from 1 July 2015—so from this year—a reduction for the average residential consumer of about 8 per cent, which would be \$165 if that was flowed through completely. Then what we would expect to see is significantly smaller, pretty close to flat prices. We would be anticipating something

perhaps more like a \$20 reduction in the year after and then single-digit reductions after that. So there would be something like 8 per cent and then closer to 1 per cent and then maybe half a per cent reductions over the period. As I said, as you get further into the period those estimates do become a little more speculative

**The Hon. TREVOR KHAN:** But they are real reductions in prices, not adjusted for CPI?

**Ms GROVES:** Yes. These are nominal numbers.

**The Hon. Dr PETER PHELPS:** So the real reductions will be even greater?

**Ms GROVES:** They could be, yes. Did you want me to go through the rest of them?

**The Hon. ADAM SEARLE:** If you have more information I am happy for you to provide it on notice.

**Ms GROVES:** I think they are set out in our determinations. We can draw your attention to them.

**Dr JOHN KAYE:** Those numbers are based on your assumption of how the revenue will translate through to distribution use of system [DUOS] charges, which are set by the Independent Pricing and Regulatory Tribunal [IPART] in New South Wales on the basis of those revenues. Is that correct?

**Ms GROVES:** No, that is not correct.

**Dr JOHN KAYE:** Who sets DUOS?

**Ms GROVES:** Mr Pierce can talk about the changes that are just about to be made, but for these processes we determine a total amount of revenue. The businesses then apply their tariff policies. They have a whole series of different types of tariffs for different types of customers and they determine what they should be for the next year going forward, taking into account their allowed revenues. They provide those to us. We go through a process of checking that those will allow them to recover those allowed revenues and no more.

**Dr JOHN KAYE:** You authorise their proposal for distribution and transmission use of system charges?

**Ms GROVES:** We do. We go through a process of checking that they accord with the rules.

**Dr JOHN KAYE:** In relation to the efficient allowable revenues that you set, I think you made the suggestion that you should only really allow efficient and prudent costs to be recovered.

**Ms GROVES:** Yes.

**Dr JOHN KAYE:** Does that include, for example, the cost of employing apprentices and reproducing and enhancing the knowledge base of the workforce?

**Ms GROVES:** The expectation is those would be the sorts of costs that would be included as an efficient cost of the business, yes.

**Dr JOHN KAYE:** How do you know they are part of the efficient cost of the business? I note in your determination that you rely heavily on comparisons, for example, with the Victorian networks.

**Mr ROBERTS:** This goes to how we compare performance across the different businesses. There are a few elements to that. Basically we have used data and compared it across all of the different distributors in the national electricity market. All we are doing is we are asking the question: what have the other businesses been able to achieve taking into account the different circumstances that they face?

**Dr JOHN KAYE:** In that critical achievements statement do you include, for example, making sure that there are sufficient numbers of skilled workers coming through the system?

**Mr ROBERTS:** Yes, that is implicit in the comparison points with the other businesses.

**Dr JOHN KAYE:** How implicit?

**Ms GROVES:** What we are doing is setting revenues based on efficient costs for these businesses to deliver—for example, in regards to the distributors, distribution network services. How they deliver those is up to each of the businesses. Each of the businesses will have different internal drivers that they will make decisions on accordingly. What we are doing is measuring the cost of their inputs for the delivery of a particular output.

**Mr PIERCE:** One of the principles of this regulatory framework is that the business and the management is responsible for managing the business and that we have a framework which discourages heavily the idea that the regulator is able to second guess how the organisation should be managed. To that end, the way in which or the means by which different businesses achieve their cost structures and their outputs and their reliability—whatever measure you would like to pick—is a matter for them.

**Dr JOHN KAYE:** I understand what Ms Groves and Mr Pierce have said to us but it has not answered my question. In your determination how do you make sure that there are sufficient funds available to reproduce the knowledge base? I am using that as a shorthand to mean sufficient numbers of apprentices, trainee engineers and professional development. If you are comparing it against Victorian utilities, which are notoriously bad at doing that—

**The Hon. TREVOR KHAN:** We are now moving from a question into a commentary. I ask that the witnesses be given the opportunity to answer the question that has been put without the commentary.

**Dr JOHN KAYE:** I have not put the question yet.

**CHAIR:** Dr Kaye, summarise your question.

**Dr JOHN KAYE:** My question is where in your determination of efficient costs is there specific allowance for apprentices, trainee engineers and professional development?

**Ms GROVES:** Our determination looks at the total efficient costs of these businesses. We do not direct how they derive an efficient business. You rely on their management and their ownership structures to work out at that business what they consider are appropriate internal practices, procedures—

**Dr JOHN KAYE:** You are talking about how they spend the money. I am asking how will you determine the X billion dollars that Ausgrid can spend? When you say it is the efficient number, you are deriving that largely from looking at Victoria, which does not employ apprentices, as we heard earlier today, and does not employ trainee engineers.

**The Hon. TREVOR KHAN:** That is not the evidence. They employ less.

**Dr JOHN KAYE:** Mr Khan, you have your opportunity and I have my opportunity. I am going to continue. Ms Groves, how do you make sure that there is sufficient allowance for those expenditures; not that it is spent that way, which you do not do and I appreciate that is how you regulate, but how do you make sure there is sufficient capital to do that?

**Ms GROVES:** That is the way we regulate, so that is actually a very important component of my answer. That is actually the regulatory framework. What we do is measure efficient levels of total input to derive the efficient level of outputs. How those outputs are delivered and what decisions are made internally within a business to ensure that they deliver those outputs most efficiently is a question for management. We rely on an incentive framework. We rely on the fact that there are a range of regulatory obligations around safety and reliability that all of these businesses must meet. We rely on a whole range of frameworks and factors to ensure that these businesses do deliver what they are required in a way that is efficient. But what we measure are the total outputs, not how those individual outputs may be made up on a business by business case.

**Dr JOHN KAYE:** You do that by comparison with other States. Is that correct?

**Mr ROBERTS:** Can I add one point? We need to be clear here that we have used benchmarking to adjust revenues for two of the businesses, Ausgrid and Essential. We have not used benchmarking to benchmark down Endeavour or Transgrid. All we are asking of these two businesses is to replicate what Endeavour has done within this State. That is all we are asking them to do, including on the issues that you are referring to.

**Mr PIERCE:** Like everything else, it also depends on the objective that is being set. The objective that we operate under is set in legislation and it has to do with providing a service to consumers. If government, as a public policy matter, wishes these businesses to do something else then it is always open to government to fund that activity directly. In some cases in some jurisdictions that is what they have done.

**CHAIR:** I wish to clarify one matter that is in my mind. You are making recommendations. What powers do you have to enforce those? Can you fine companies that do not follow through and implement your regulations?

**Ms GROVES:** Yes, our determinations have force on the companies. They are actually not entitled to recover any revenues above that those that we allow. We go through an annual adjustment process to ensure that the revenues they have collected within the past year are no more than those that are allowed under the determination, and those are enforceable.

**CHAIR:** How do you enforce them?

**Ms GROVES:** I would have to take that one on notice. We have never had a company not comply with the regulatory determinations. They are prohibited from collecting those unless they are in accordance with the regulatory framework.

**Mr OWENS:** The Australian Energy Regulator [AER] ultimately sets the prices. Every year the business must propose. By next Thursday, the businesses will need to propose how much money they will recover; how will they set their actual prices for every customer the next year. If the AER believes that those prices will recover more than the allowed amount, the AER will reject them and can substitute its own prices. The AER has the final and binding say on what the prices will be. If, for any reason, the total revenue recovered next year is higher for some reason—say, demand has gone up higher than expected—when approving next year's prices, the AER will make an adjustment so that the businesses prices are lower. Every year the AER is checking and setting the prices or approving the businesses' prices to make sure they recover not a cent more than that maximum revenue allowance for each year.

**Mr PIERCE:** I would imagine that if there was something else going on within the business, which was not in accordance with the determination and hence not in accordance with the rules, then the AER, through its compliance activity, would be in a position to take them off to the Federal Court.

**The Hon. TREVOR KHAN:** Because it is a breach of the licence condition.

**Mr PIERCE:** That is right.

**Mr OWENS:** Yes.

**CHAIR:** I am seeking an indication of what might happen in New South Wales with foreign companies. Say an American company, being a private company, objects to what is seen to be all this red tape, and objects to all these regulations, or would not want to cooperate with all the regulations?

**Mr PIERCE:** I suggest, Reverend Nile, depending on which part of the United States they came from that, relative to what they were used to, they would find that the regulatory arrangements in Australia are less arbitrary and clearer, and that they are better able to anticipate the nature of regulatory outcomes, and that it is far less intrusive on the internal workings of a business.

**CHAIR:** Are you saying that there are regulations in the United States controlling the pricing in the same way in which you do it in Australia?

**Mr PIERCE:** We must always be careful about generalising because the United States regulatory arrangements are by no means homogeneous, but it is certainly the case that, firstly, the way in which both Federal and State regulation impacts on a business is far more complicated than it is in Australia. Secondly, in quite a few jurisdictions a business must go through a regulatory approval process, not just to determine overall revenue, or rates as they would refer to it, but the approval of individual investments and individual projects. That effectively means that the regulatory process is continuous. An individual business will be continually before the regulatory bodies and have a much bigger staff to deal with it because of that. They are not just

determining rates. The regulator has to approve individual bits of line being built and substations. Essentially, the regulator is standing in the shoes of the management and pretending it can make decisions as the management would.

**The Hon. TREVOR KHAN:** You talk in terms of the process by which this final determination was made. Do I take it that what occurred was that there was a draft determination that was first issued?

**Ms GROVES:** That is correct—in November 2014.

**The Hon. TREVOR KHAN:** And there was an opportunity for response from each of the licence holders to that draft determination. Is that right?

**Ms GROVES:** In fact, there is a prescribed process under the rules where the businesses actually put in a revised proposal in response to the draft decision of the regulator. They put in an original proposal. We examine that over a course of some months, take submissions on it, meet with the businesses and engage consultants.

**The Hon. ADAM SEARLE:** It is in the market commission's submission, Trevor.

**Ms GROVES:** We put out a draft in November and then they put out a revised proposal. They then also have an opportunity to put in submissions that address both their revised proposal and our draft determination in the same way as other stakeholders can as well.

**The Hon. TREVOR KHAN:** That is what I am getting to, really. The bottom line is that each of the licence holders in their submissions indicated to you the impact of the application of that draft determination on their business in terms of job losses and the like. Is that not right?

**Ms GROVES:** They certainly raised issues around those things, yes.

**The Hon. TREVOR KHAN:** What we are now looking at in terms of all this various talk about job losses is really a consequence of the Federal application of a determination—that the costs are too high at the moment. That is, irrespective of whether ownership is changed, there will be job losses in this market.

**Ms GROVES:** The nature of the employment arrangements for the businesses will be up to them to determine, but the total revenue for these businesses will stay the same, irrespective of ownership.

**The Hon. TREVOR KHAN:** And those businesses have made plain, have they not, that the impact of the application of the determination will be significant job losses across the market.

**Ms GROVES:** That is how they have expressed what they see as the outcomes.

**The Hon. ADAM SEARLE:** But spending the revenue is a matter for them. You do not dictate how many people they should employ in each business.

**Ms GROVES:** No. I mean, it is up to them to determine what the total expenditure within their business is. What we have set is revenue they are allowed to recover from their customers.

**The Hon. TREVOR KHAN:** Sure. But the bottom line is that you are proposing reductions—and I am not being critical.

**Ms GROVES:** Yes, thank you.

**The Hon. TREVOR KHAN:** You are proposing reductions in revenue of 28 per cent and the like—very significant reductions in the total amount of revenue.

**Ms GROVES:** That is correct, from what the businesses have proposed.

**The Hon. TREVOR KHAN:** Yes, sure. And one of the major costs that those businesses have is labour.



**The Hon. Dr PETER PHELPS:** Seventy per cent is labour.

**The Hon. TREVOR KHAN:** Seventy per cent is labour.

**Mr PIERCE:** Of operating costs.

**Ms GROVES:** Of operating costs.

**The Hon. ADAM SEARLE:** Operating costs are only about 30 per cent of total costs.

**The Hon. TREVOR KHAN:** The bottom line is that it is logical, is it not, that the impact of your determination—you can I get away from the fact that the impact is a loss of employment.

**Mr PIERCE:** If I may, one of the things about this general discussion which I have found a bit curious is that there are three variables: There is revenue; there is the productivity of the business, jobs if you like; and returns to the business. This process sets revenue. It is not for us but just as a matter of framework, it is really not possible for us to comment on what the effect is of any one of those other two without also referring to the third. We set the revenues and there are then, depending upon the productivity of the business, an effect on return. The particular combination of productivity or lack of efficiency within the business and return is a matter not for the regulatory framework but a matter for the management and the owners.

**The Hon. TREVOR KHAN:** Sure. Am I right in saying that the current regulatory regime is really one that dates from some date in 2013, or thereabouts?

**Ms GROVES:** The new rule framework, the rules themselves, came into effect at the end of 2012 with the rule change. Throughout 2013 there were a range of guidelines and schemes that were developed that have been applied, so to the extent that you see that as a total package I think, yes, that is an accurate date.

**Mr PIERCE:** I think it actually goes back further than that. The 2012 changes were a further development—a refinement, if you like—of what was an existing set of rules. Those rules were in effect and effectively go back to 2006, and the 2006 rules were essentially derived from what was previously undertaken within individual State jurisdictions, broadly speaking, before coming into the national framework.

**The Hon. TREVOR KHAN:** Which were applied to a greater or lesser extent, depending upon each State, I take it?

**Ms GROVES:** Yes.

**Mr PIERCE:** That is right. This particular framework is a development of something that has had a very long history, not just within Australia but also in places such as Great Britain and New Zealand.

**The Hon. Dr PETER PHELPS:** There has been some implication that a reduction in transmission distribution costs will not flow through to retail bills. In your experience is there any evidence, either by a market dominance or collusive behaviour, that retailers are making super normal profits?

**Ms GROVES:** I will ask Mr Pierce to answer that. The AEMC looks more closely at retail prices.

**Mr PIERCE:** I will start with the answer. The short answer is no.

**The Hon. Dr PETER PHELPS:** Thank you. That is all I need.

**Mr PIERCE:** We publish quite detailed assessments of that very question each year, not just from the viewpoint as, if you like an economist would look at it but we actually go to the trouble of surveying real customers and holding forums with real customers so that we can be aware of what they actually experience in terms of service.

**The Hon. Dr PETER PHELPS:** Approximately how many retailers are operating in the New South Wales market?

**Mr OWENS:** Between 12 and 14, I am not sure. It depends on which area you are in.

**Mr PIERCE:** In terms of the nature of different contracts and offers you could pick up it is in excess of 30, I think it is 35 or 36.

**The Hon. Dr PETER PHELPS:** Earlier Mr Butler from the ETU seemed to express some doubts about the efficacy of the figures in relation to efficiency scores. I presume he was referring to your April 2015 paper in which you stated:

The historic opex of ActewAGL, Ausgrid, Endeavour Energy and Energex Ergon Energy and Essential Energy have low efficiency scores ...

And later:

With the assistance of our consultants ... we investigated the likely drivers of these benchmarking results. This analysis corroborated our benchmarking findings, and indicated that there was scope for Queensland, NSW and ACT service providers to achieve efficiency improvements.

How rigorous is your analysis of X efficiency? Do you believe that it has statistical validity? The way Mr Butler put it was "You throw some numbers in. You have an algorithm, and some bogus numbers come in at the end.

**The Hon. ADAM SEARLE:** That is not what Mr Butler said at all.

**The Hon. Dr PETER PHELPS:** That is certainly what he implied.

**The Hon. ADAM SEARLE:** That is not what Mr Butler said. If you want them to respond to Mr Butler's evidence they will have to take it on notice.

**Ms GROVES:** I will get Mr Roberts to provide a little more detail.

**CHAIR:** Please avoid quoting previous witnesses.

**The Hon. ADAM SEARLE:** Or do so accurately.

**Ms GROVES:** Our benchmarking work has been developed over a number of years. We have relied on international experts to assist us in its development. The information that we use in that is derived from the businesses themselves through audited numbers. We have engaged extensively with the broad marketplace in the development of the techniques and consulting on those. I think the Committee heard on Monday from the ESAA who was one of the industry associations that represent these network businesses that, in fact, the AER's benchmarking work is extremely good. In fact, it was the best that had been seen to date. I will ask Mr Roberts briefly to add to that.

**Mr ROBERTS:** I think the main additional points is that we have been through a two-year process in developing this approach; we are using relatively well established and standard benchmarking techniques that have been used by overseas regulators. They have been used by Ofgem in the United Kingdom. We have used the world's leading expert in this area so we think we have been through a very rigorous process. In terms of the data, yes, we have worked with the businesses. It is their data, it is not our data.

**The Hon. DAVID CLARKE:** Do you agree that another factor working to support consumer protections is the announcement by the Government that the price commissioner must sign off that each transaction will not put upward pressure on prices in the short- medium- or long-term? And if those guarantees are not met then a transition will not proceed?

**Mr PIERCE:** In our formal roles, Mr Clarke, I suggest it is not really within our responsibility to express a view one way or another on that but I can understand how that role may be seen by some people as providing the additional assurance to which you refer.

**Ms GROVES:** I have nothing further to add. I concur with that.

**The Hon. CATHERINE CUSACK:** Part of your role is to regulate safety standards, for example, for customers who are on life-support machines in their own home so that they get proper notice if they are going to be turned off for maintenance, for example. I do notice that recently you have issued infringement notices to a

number of companies, including Essential Energy and Ausgrid. Will you explain how the process of issuing infringement notices works? Is it possible for the Committee to get details of how many infringement notices have been issued to the State-owned businesses in New South Wales in recent years? Is that different to the privately owned companies that regulate?

**Ms GROVES:** I certainly can provide that. In fact, all that information is on our website. We can certainly distil that and send that through to you. In total I think the AER has probably issued about 20 infringement notices across a whole range of our functions, so not just the retail ones. There is not a large number so we will certainly provide those to you. The obligations you are referring to come under the National Energy Retail laws. There are obligations on businesses that when they are doing planned interruptions which are sometimes necessary for them to be able to work on their networks, that they provide notice to customers. There are very specific provisions about the type of notice they need to be able to provide to customers who are registered as being life-support customers.

If the businesses consider that they may have breached they are required to notify that to us. So these businesses have all notified that they have engaged in activity where insufficient notice may have been provided or inadequate notice. We then investigate further and if we consider that they have not complied with their regulatory obligations we look at what would be an appropriate enforcement action. An infringement notice is one of the tools we use so that is one that we have recently employed in respect of a specific instances that were raised for those businesses.

**The Hon. CATHERINE CUSACK:** I have further really important questions because there is a suggestion that the private sector is less likely to comply with the rules.

**Dr JOHN KAYE:** Your time has expired.

**The Hon. ADAM SEARLE:** If you go over time I have extra questions too.

**Dr JOHN KAYE:** I have an extra question too.

**The Hon. ADAM SEARLE:** I am happy for Catherine to ask her extra question or pursue those matters.

**CHAIR:** Will you put further questions on notice to the witnesses.

**Mr PIERCE:** With your indulgence I would like to table a brief document as a supplement to our submission that outlines the processes we are going through to allow this sector's development to be further driven by the choices that consumers make.

**CHAIR:** Do you attach that to your submission?

**Mr PIERCE:** If I can table it today to go with our submission. I did not table it when we submitted it.

**Document tabled.**

**(The witnesses withdrew)**

**(Short adjournment)**

**JOHN QUIGGIN**, Professor Economics, University of Queensland, before the Committee via teleconference, affirmed and examined:

**CHAIR:** Professor Quiggin, would you like to make a brief statement?

**Prof. QUIGGIN:** Yes. The primary purpose of this submission is to argue that the proposal to sell assets and to nominally use the proceeds of those assets to finance new non-income-generating infrastructure investment is unsound, as all previous proposals of this kind have been. Proposals for new infrastructure investment should be assessed on their merits and independently of any asset sales. In addition, the structure of this particular asset sale procedure—with a 99-year lease and a partial sale of essentially a small majority interest in some assets—that those two features are likely to reduce the return to the State from a privatisation compared to an outright sale with no conditions, without generating any corresponding benefits, in terms of protection to the public.

**CHAIR:** Thank you.

**The Hon. Dr PETER PHELPS:** Prof. Quiggin, have you ever supported a privatisation?

**Prof. QUIGGIN:** Yes, I have. If you look at the Queensland asset sales undertaken by the Labor Government, there were a range of proposals there of which I supported the privatisation of the State interests in Queensland Forests and I took a neutral view on the privatisation of the Port of Brisbane.

**The Hon. Dr PETER PHELPS:** What is your view of the Australian Competition and Consumer Commission [ACCC] chairman, Mr Rod Sims' view that:

NSW electricity prices would now be significantly lower had the NSW electricity network assets been privatised.

**Prof. QUIGGIN:** I addressed that question in my submission. Looking at the performance of the electricity industry Australia-wide, what we see is that the reform process which has been strongly supported by the ACCC, has in fact delivered very substantial price increases across the whole of Australia and those prices are just as high in the states that have experienced privatisation with standard retail prices in Victoria and New South Wales, as they are in states that have not, New South Wales and Queensland.

**The Hon. Dr PETER PHELPS:** So is it fair to say that you do not think prices will increase as a direct result of the lease proposed?

**Prof. QUIGGIN:** That is correct. I do not believe the lease proposal will have a substantial impact on prices either way. The large increases in prices we have seen have been associated with the process of reform. Of course, the claim that privatisation is necessary to complete reform has been one of the main arguments presented in justification. I do not believe that stacks up.

**The Hon. Dr PETER PHELPS:** So, on the basis of that, would you say that it is also fair to say that you would reject the Electrical Trades Union's [ETU] campaign premise that a lease would axiomatically lead to higher prices for the consumer?

**Prof. QUIGGIN:** Yes, I have made that clear. I do not believe a lease would automatically lead to higher prices. It is part of a broader reform process that certainly has generated higher prices but the primary failures have been in the structure of the electricity market.

**The Hon. Dr PETER PHELPS:** Do you believe that privately-owned transmission networks are more efficient in terms of their operational expenditure than State-owned transmission networks?

**Prof. QUIGGIN:** There is no good evidence on that either way. I think it is fair to say that in these highly capital-intensive industries we have not seen the benefits of privatisation that have been claimed, and there are significant costs in terms of patterns of strategic investment that we have seen in privatisation. For example, Telstra's failure to invest in broadband, reflecting its monopoly position. I think there are effects going both ways but there is no general reason to expect that privately-operated firms will produce more efficient outcomes.

**The Hon. Dr PETER PHELPS:** Do you reject the Australian Energy Regulator's [AER] benchmarking report of April 2015 which showed that ActewAGL, Ausgrid, Endeavour Energy and Essential Energy all had significantly lower efficiency scores in terms of their operating expenditure?

**Prof. QUIGGIN:** I would make the point that this does not take account, as I have said, of the distorting effects on capital investment, which I believe have been significant in any situation where we privatise a regulated monopoly. This problem of investment distortion I think has been well established in the economic literature.

**The Hon. Dr PETER PHELPS:** Is your argument that state-owned firms are more efficient at capital expenditure?

**Prof. QUIGGIN:** Efficient in the sense that they do not have the incentive to use capital expenditure in a strategic fashion. For example, to hold up expenditure in order to obtain more favourable regulatory treatment. There is a further point, that the potential risk imposed on the public is smaller, in the sense that what they gain on the roundabouts, what they are going to lose in terms of higher prices paid in returns if the judgement is wrong, is returned to them as owners. I think there is a general economic case for public ownership in the case of regulated monopoly assets like this.

**The Hon. Dr PETER PHELPS:** If that was true then you would also reject the argument that there was a significant amount of gold-plating in New South Wales capital expenditure over the past ten years, wouldn't you?

**Prof. QUIGGIN:** I would. I think that the claims about gold-plating, it is important to remember that these claims were made, similar claims were made in the early nineties, before privatisation and before deregulation. I speak more directly to Queensland experience, having been a member of the Queensland Competition Authority during this period. We saw in Queensland, in the year after the introduction of the national electricity market, a significant run-down in capital expenditure. That was reflecting a widespread belief that gold-plating was in place. That was followed by network breakdowns to do with extreme weather events and the necessity to invest heavily in these new assets, driven by the culmination of increased demand for the security and by the rise of more peak electricity demand associated with weather conditions.

In my view, the general claim of gold-plating is incorrect. It is probably true that the high prices have led now to unforeseen decreases in demand but, in general, in my view the investment reflected an actual increase in peak demand, particularly associated with air conditioning combined with, as I pointed out in more detailed reports, the poor design of the national electricity market. It is important to remember that this has been a global Australia-wide failure that has driven these very large increases in prices and obviously, that has been overseen by the ACCC and the Australian Industry Regulator.

**The Hon. Dr PETER PHELPS:** Does that mean you also reject the Productivity Commission's report looking at transmission costs which found that there was a material incentive for publicly-owned or government-owned transmission networks to over-invest on the basis that they could obtain capital more cheaply?

**Prof. QUIGGIN:** Obviously obtaining capital more cheaply is a major advantage of publicly-owned assets and therefore the economically justified level of investment is, in fact, higher because there is a real saving in costs there that has to be offset, if it can be, by operating efficiencies. Certainly, in my view, the analysis of the Productivity Commission, again looking at this issue over the past 25 years, has been seriously wrong on a number of occasions.

**The Hon. Dr PETER PHELPS:** You have been quoted as saying that, "There isn't really very much difference between corporatisation and privatisation". What do you mean by that?

**Prof. QUIGGIN:** It is important to say there are significant differences, of course, unlike the fiscal impact, obviously, but if we are looking at the sources of the large increase in prices that we have seen in the electricity market, and I think this is the context in which that remark was made—

**The Hon. Dr PETER PHELPS:** It was.

**Prof. QUIGGIN:** —the primary sources are not the ownership of the assets in question but the general failure of the whole system of the national electricity market that was introduced in the 1990s. Of course, much of the case of privatisation that is needed to complete this process—my point is that the process as a whole has been a failure.

**The Hon. Dr PETER PHELPS:** You disagree with the creation of an Australian energy market?

**Prof. QUIGGIN:** I disagree with the way in which the Australian energy market has been constructed, certainly. I think there were major flaws in the way in which that was done and that reflected a significant overestimation of the benefits of competition and private ownership.

**The Hon. Dr PETER PHELPS:** Would your view be that it would be economically efficient now to buy out private generators, retailers, transmission and distribution networks and return them entirely to State control?

**Prof. QUIGGIN:** Certainly in my view we would have done better with a single national grid. So far as transmission goes, that is my view. I think there is also a substantial case for returning distributors to public ownership. That obviously follows from that fact that I am critical of the proposal to privatise.

**The Hon. Dr PETER PHELPS:** And generators as well?

**Prof. QUIGGIN:** There is more room for competition in generation. With a correct design, we could have had significant competition in generation. That is more of a secondary issue, in my view.

**The Hon. TREVOR KHAN:** You previously raised concerns regarding the loss of dividends to the State of some \$1.7 billion. How do you reconcile the \$1.7 billion with the dividends of \$1.2 billion in 2015 and the forecast reduction in dividends of \$400 million in 2015-16 and \$152 million to 2017-18?

**Prof. QUIGGIN:** I am sorry I will have to check my numbers on that.

**Dr JOHN KAYE:** They are incorrect.

**The Hon. Dr PETER PHELPS:** Those are the Treasury projections in the out years.

**Prof. QUIGGIN:** I am aware of those Treasury projections.

**Dr JOHN KAYE:** If I may, they are not dividends, they are tax equivalent payments.

**Prof. QUIGGIN:** I am just looking at where I have used that \$1.7 billion number.

**CHAIR:** He is asking the question did he use the \$1.7 billion.

**The Hon. TREVOR KHAN:** Let me put it to you this way: it seems plain that as a result of the Australian Energy Regulator's actions there is to be significant reductions in—to meet Dr Kaye's point—returns. Does that change your view at all?

**Prof. QUIGGIN:** No. I addressed that question in my submission. Obviously that is public information and that is going to be reflected in the price that will be realised for the assets. I made the point that that issue was, at the time of my submission, still unresolved. I am not aware if there is a final determination yet. I made the point that, say, over the time of regulatory uncertainty it is likely to yield a poor outcome. If privatisation were to proceed, I would suggest waiting until this regulatory uncertainty has been resolved or selling the asset outright without the various hedges and conditions that have been imposed upon it.

**The Hon. Dr PETER PHELPS:** Professor Quiggin, what are your defining elements for an industry that you believe can be privatised? What do you look for to say that, as far as you are concerned, a privatisation is necessary?

**Prof. QUIGGIN:** There are a number of factors which are relevant. The first is the presence of substantial competition. In a highly competitive industry, public ownership has rarely been successful, particularly obviously in industries that naturally operate on a small scale. Capital intensiveness is another

factor. As I have mentioned, the big disadvantages of private ownership come with capital intensive regulated monopolies. The final issue is the extent to which the management enterprise depends on the rapid responsiveness to changing consumer demand, these kinds of factors. The more you have a competitive industry focused on changing consumer demands and largely on the management of labour, the stronger the case for private ownership. The more you have the opposite factors, capital intensive monopoly, which basically delivers a basic service, the stronger the case for public ownership, and obviously the electricity distribution is very much at the public end of that spectrum. It is reflected in the fact that it has so wildly around the world been the subject of public ownership.

**The Hon. Dr PETER PHELPS:** So on two of those three criteria Qantas should not have been privatised?

**The Hon. ADAM SEARLE:** Professor Quiggin, the value of an asset is a multiple of the revenue streams that are able to be extracted from a business. Would you agree with that basic proposition?

**Prof. QUIGGIN:** Yes. It depends on the revenue that flows from it, that is correct.

**The Hon. ADAM SEARLE:** If the return to a shareholder or an owner takes a significant hit of, say, 30 per cent, in this case potentially as a result of the energy regulator's determination, you would expect a similar negative impact on the price of the asset in total?

**Prof. QUIGGIN:** That is correct.

**The Hon. ADAM SEARLE:** Professor, you also did a review of the Victorian privatisation experience 20 years on. Is that correct?

**Prof. QUIGGIN:** That is correct, yes.

**The Hon. ADAM SEARLE:** That review found that the promised benefits of that privatisation had, in many respects, not been delivered under the privately operated system. Is that correct?

**Prof. QUIGGIN:** Yes, that is correct. Obviously, first, of course, the reforms in general were supposed to substantially reduce consumer prices. In the short run we saw price reductions around 40 per cent. Those, of course, have not been sustained and broadened. We have seen Victorian prices rise similar to the rest of the country. Similarly, when you look in retrospect at the fiscal impacts, they are broadly neutral.

**The Hon. ADAM SEARLE:** In relation to the Victorian experience, you said prices went down and back up again. Are you able to say what the drivers were of those increased prices in Victoria?

**Prof. QUIGGIN:** Do you want me to talk about the initial reduction in prices or—

**The Hon. ADAM SEARLE:** No, what drove them back up. We have been told by the regulator—

**Prof. QUIGGIN:** The initial reductions reflect the situation of overcapacity and the fact that only a limited number of market participants had access to these competitive prices. The claim was, of course, that when we went to full retail competition, everybody would get them. In fact, the prices only fell because the discounts were available to a limited group. Looking more broadly, what we have seen, of course, is with the need for new investment, partly driven by poor retail pricing—we do not have the right kind of retail pricing in the natural electricity markets—combined with the high rate of return, which private and regulated Government monopolies receive under the national electricity market, that is really what has driven prices substantially higher. In Victoria, the increase in distribution charges has not been so great, but we have also seen a substantial increase in retail margins, of which I do not have a full analysis.

**The Hon. ADAM SEARLE:** To put it bluntly, the retailers have trousered a fair bit of any of the network savings that might have been yielded?

**Prof. QUIGGIN:** Certainly it does seem that if there were any network savings they have been reflected in higher retail costs. Of course, the structure is somewhat different, and there are a bunch of risks and things which can be partitioned between retailers and distributors, so it is unclear entirely what the cause is.

Certainly any reduction, any small increase in distribution charges has been fully offset by increases in retail margins.

**The Hon. ADAM SEARLE:** We have received evidence in written form that suggests that the Victorian network assets have not had the same degree of investment and upgrading in recent years and Victoria and South Australia are now at the point where they might well need significant investment. Does that accord with your understanding and what impacts would that have on prices?

**Prof. QUIGGIN:** It certainly seems as if there has been less investment. As I say, if you look at the drivers of investment in Queensland and New South Wales, one has been vulnerability to extreme weather, which has certainly been a major factor in Queensland. The second has been the impact of peak and demand associated with the spread of air-conditioning. However, the other feature of the dynamic has been that the owners have an incentive to put to the regulator a justified level of investment and then to hold their actual investment below that level because the allowed level of return depends on the assessed sufficient level of investment and not on the actual level. We have seen this dynamic play out, certainly in Queensland, where there was under-investment in the assets in the late 1990s. That leads to network breakdowns that were then followed by an increase in investment. That kind of pattern could well be playing out in Victoria.

**The Hon. ADAM SEARLE:** We have seen some material suggesting that privatisation of electricity assets in this State could lead to a net negative impact on the State budget. As an economist, what steps do you think need to be taken into consideration to ensure there is no net impact on the State budget?

**Prof. QUIGGIN:** The crucial step in terms of changing the package is that all of the proceeds of privatisation should be allocated to reducing public debt. Any attempt to package a privatisation proposal with attractive but otherwise unjustified investments, which we have seen in the great majority of Australian privatisations, always leads to an adverse impact on the State budget. If we keep separate investment proposals separate, it is then possible to make a correct economic assessment of whether savings from selling assets and using the proceeds to pay down debt exceed the forgone dividends. As has been the case with this proposal, and with many previous proposals, if we do not do that we invariably get an adverse impact the State budget.

**The Hon. ADAM SEARLE:** As an economist, would you say that a reasonable and prudent first step would be to have a rigorous and independent analysis of the earnings that may be forgone through privatisation?

**Prof. QUIGGIN:** Indeed. That is obviously a sensible step and one that typically has not been taken. When I have undertaken retrospective evaluations of these proposals very frequently privatisations have failed this test.

**The Hon. ADAM SEARLE:** One of the Coalition members talked about decreased projected returns from the state-owned electricity companies. However, as I understand it in New South Wales, leaving aside the tax equivalent payments, the actual dividend paid by these businesses to the Government is essentially directed by the Treasurer. Therefore, Treasury projections about earnings may be influenced by the views of the Government of the day.

**The Hon. Dr PETER PHELPS:** That is an outrageous assertion against the Treasury bureaucrats.

**The Hon. ADAM SEARLE:** How it works is in the Treasurer's circular. That being the case, how can we take steps to ensure that any analysis of earnings forgone is rigorous and the truth?

**Prof. QUIGGIN:** If the analysis is undertaken on a consistent basis, we should see similar effects on the predicted sales price as on the predicted earnings forgone. A correct analysis takes account of both of those factors. I direct members' attention to the section of my submission in which I look at the question of what the fiscal impacts would have been if the privatisation proposals in the late 1990s had gone ahead. We had an estimated sale price and then the actual experience of the dividends and tax equivalent payments. We can assess those two things together, and it shows that if that proposal had proceeded at that time it would have substantially reduced the public sector net worth relative to a privatisation now.

**The Hon. ADAM SEARLE:** You say that the decision not to privatise in the late 1990s left the New South Wales public sector better off by about \$15 billion.

**Prof. QUIGGIN:** That is correct.



**The Hon. ADAM SEARLE:** That does not take into account, does it, any Treasury Corporation guarantee payments that the state-owned corporations have been paying to the corporation each year?

**Prof. QUIGGIN:** I did not include Treasury Corporation guarantee payments. There are arguments both ways as to whether they should be included. That would certainly increase the benefits for the public.

**The Hon. ADAM SEARLE:** Did you include only shareholder dividends and tax equivalent payments in that analysis?

**Prof. QUIGGIN:** Yes; that is correct.

**The Hon. ADAM SEARLE:** If you included the Treasury Corporation guarantee payments, that \$15 billion would be significantly higher, probably by \$5 billion or \$6 billion. Is that about right?

**Prof. QUIGGIN:** That is right.

**The Hon. ADAM SEARLE:** Is that a correct ballpark figure? Is it correct that that number would be higher by about \$5 billion or \$6 billion?

**Prof. QUIGGIN:** I do not have the number to hand, but it is a significant margin. Of course, that offsets the claim that these earnings are an illusory benefit. The guarantee to the enterprise is fully captured in those payments. Of course, those guarantees in the Australian public sector have never been called on; major public enterprises do not often require that. We can certainly argue about that and it suggests that the \$15 billion that I propose is a low amount.

**The Hon. ADAM SEARLE:** The networks in Victoria and South Australia experience a greater number of scheduled outages or load shedding on particularly hot days. Is it your understanding that outages and load shedding are greater in those two States than they are in New South Wales, and that they have increased since privatisation has occurred in both of those States?

**Prof. QUIGGIN:** Unfortunately, I do not have detailed numbers.

**Dr JOHN KAYE:** Thank you for providing evidence today. As other members have observed, the Baird Government claims that the impact of the AER determination on the distributions to the States takes the dividends from \$1.1 billion in 2012-13 to \$109 million in 2017-18. The Baird Government is also claiming, roughly speaking, a \$13 billion sales price. Can you comment on the consistency between a \$13 billion sales price and dividends of \$109 million a year?

**Prof. QUIGGIN:** Obviously those two are entirely inconsistent. There is no expectation that somehow or other the operating efficiency of the assets can be drastically improved under this privatisation proposal. As I point out in my submission, that claim is undermined by the structure of the proposal, which is not a sale but a lease. That is a secondary issue. It is also only a partial privatisation, which removes many of the potential gains in operating efficiencies. Clearly, the high sale price cannot be squared with the suggested level of earnings.

**Dr JOHN KAYE:** As a ballpark figure, what sort of rate of return on investment do you think a modern multinational private utility corporation would be looking for?

**Prof. QUIGGIN:** Obviously there would be a substantial amount of gearing of debt, and typically it should all be debt. So we would be looking at debt for part. However, for equity return on an investment like this they would be looking for something like an 8 per cent real rate of return.

**Dr JOHN KAYE:** There is obviously a lot of uncertainty about the future revenues that the electricity undertakings will bring in. This is subject to regulatory uncertainty, technological uncertainty and probably to some extent wage uncertainty. In an environment of uncertainty, who does better, the buyer or the seller?

**Prof. QUIGGIN:** Uncertainty is costly to both parties. This is part of my submission. Obviously it would be desirable to resolve any uncertainty rather than to sell in such an environment. What we are seeing is worse-case projections for the viability of the enterprises coming from the Government. Of course, that same information is available to potential buyers, many of whom will not necessarily have any particular expertise in

assessing the likely future direction of regulatory policy. I mean the desirable buyers again should mostly be overseas enterprises. Then there is domestic regulatory risk which, reasonably enough, foreign buyers tend to be worried about. So general uncertainty imposes a cost on both parties, although once it is resolved one party will have come out better and the other party will have come out worse.

**Dr JOHN KAYE:** But it would be reasonable to assume, would it not, that somebody who is going to stump up about \$13 billion would invest in fairly good quality advice and would know as much about the future evolution of the regulatory environment, technological changes and so on that would affect potential earnings from their purchase. They would invest with the knowledge that would probably put them on a par with the New South Wales Government, so there would be some sort of equality of expertise.

**Prof. QUIGGIN:** I would say broadly speaking that is the case. If it is correct, the best estimate of the enterprise's future earnings is the one published. If the New South Wales Government has published its best and most accurate estimates of future earnings, that is likely to be very close to the level—bearing in mind the fact that earnings in this enterprise are very much determined by the capital side of business and by the efficient capital allowance of the regulator, and those two estimates are going to be fairly close together.

**CHAIR:** We will move on to questions from Mr Borsak.

**Dr JOHN KAYE:** No, that was the end of Labor's questions. I am going to pass back to Labor because I took some of Labor's time.

**The Hon. ADAM SEARLE:** I have an extra question.

**CHAIR:** Your time has expired, so we will move on to questions from Mr Borsak.

**The Hon. ROBERT BORSAK:** The National Electricity Market restructure has to date not resulted in lower prices as expected—I think you put that rather well in your submission. With a higher level of private ownership in the future electricity mix, would you expect electricity prices to move downwards of their own accord?

**Prof. QUIGGIN:** I do not see that there is any likely benefit from an increase in private ownership. We have seen a range of measures which have taken the industry more in the direction of private ownership and that has been accompanied by these very large price increases. More generally, although there is a bunch of offsetting factors, there is no general evidence to support the view that regulated private monopolies level lower prices than does public ownership.

**The Hon. ROBERT BORSAK:** So what you are really saying is that the Australian Energy Market Commission and the other regulator are the only ones that are really forcing prices down and that there is no true competition.

**Prof. QUIGGIN:** There is no competition and the regulatory framework has failed to deliver what was hoped for when the National Electricity Market was created.

**The Hon. ROBERT BORSAK:** Do you want to speculate on further adjustments to the national market in relation to how we might turn it into a real competitive market?

**Prof. QUIGGIN:** Inherently in distribution and transmission there is no serious prospect of competition; the nature of the enterprise makes it a natural monopoly and unsuited to the kind of structure we built with the National Electricity Market with a very naïve faith in competition. There are problems unscrambling the egg, but a far better model would be a so-called "gentailer" model, where generators and retailers are in general vertically integrated. We did not move that way for historical reasons at the start and it is somewhat difficult to get back to that with our current structure.

In terms of distribution as well as generation, charges need more of a price-a-day system of pricing and a maximum use-type of pricing. Part of the problem that has driven the so-called gold-plating is that you pay the same for electricity whenever you use it, but the costs not only of generation but also of distribution are determined by the peak load on the network, which has been increased greatly by air conditioning. Those kinds of reforms would make things better. A further problem with privatisation is that you then have private asset

owners with rights not to have the rules changed on them. That has made appropriate reform of our infrastructure assets more difficult. That is true in electricity and in telecommunications.

**The Hon. ROBERT BORSAK:** Then we are probably removing competition at the national market level by privatising.

**Prof. QUIGGIN:** We are removing significant elements of regulatory flexibility in essentially an illusory quest for competition, in my view.

**The Hon. ROBERT BORSAK:** Going to your assertion that the process of financing is a magic pudding from a governance and Treasury point of view, do you want to explain what you mean by that?

**Prof. QUIGGIN:** What I mean is that we have for the public a very large program of infrastructure investment we would like combined with, in the case of state governments, very limited sources of revenue from which to finance this program. So we have seen more or less continuously over the past 30 years an attempt to find a way to get something for nothing, either by getting a private sector firm to build the asset in a way that seems to provide it at no cost to the public or by finding sources of financing that seem to not impose any burden on the public. That essentially cannot be done.

Eventually, one way or another, if we want infrastructure we have to pay for it and so notions like "we cannot raise charges so we will sell some assets" or "we will have a public-private partnership and we will not have to pay" are essentially spurious ways of attempting to deliver the asset without a burden on the public. The term "magic pudding" comes from the statement by the then-secretaries of the New South Wales and Victorian Treasuries in which they referred to a pot of money that could seemingly be generated by public-private partnerships. That is illusory and the same is true for asset sales. The only legitimate use of the proceeds of the asset sales would be to pay down an equal amount of government debt.

**CHAIR:** In your submission you are very critical of the proposed privatisation in Queensland. You say it was characterised by waste and pork-barrelling and that expenditure proposals were targeted at particular electorates and made conditional on the return of a Liberal-Nationals member. Has that situation coloured your views of the New South Wales privatisation proposal which has none of those factors?

**Prof. QUIGGIN:** Although that is an extreme case, as obviously a guide of making proposals conditional on electoral outcomes was seriously improper, we have nonetheless seen over the past 25 years in which I have studied this topic a strong tendency for the case where proposals supposedly financed by asset sales are assessed far less critically and are far more motivated by political pork-barrelling than is the case when proposals go through the normal process of benefit-cost evaluation. There are New South Wales instances in the supposed process of asset recycling where you can see that there is a significant lack of fiscal discipline that arises whenever public expenditure proposals are supposedly financed by asset sales.

**CHAIR:** In your submission there are four areas where you are critical of the New South Wales proposal. The first is that it is a partial sale. Would you be happier with a total sale?

**Prof. QUIGGIN:** In my view, yes. If we are going to sell an asset, the only way to get an adequate sale for the public is an unconditional and 100 per cent sale. Partial sales are always the worst case.

**CHAIR:** You are also critical of the lease proposal rather than an outright sale. Would you prefer an outright sale?

**Prof. QUIGGIN:** Again, yes. The impact on the sale price is probably modest, but it is certainly negative and there is no offsetting benefit whatsoever. By the time of the sale and when the lease term is up, the assets will have been completely depreciated to nothing. There is no possible benefit from a lease other than the cosmetics of not calling it a sale.

**CHAIR:** You criticise proceeds notionally allocated to new expenditure programs. Do you see any public benefit from what the Government is proposing to do with proceeds of the leasing for major infrastructure projects in New South Wales that are desperately needed?

**Prof. QUIGGIN:** My view is that these should be assessed completely separately. There is no improvement in the State's capacity to undertake infrastructure expenditure, so if the Government thinks infrastructure is desirable that should be the case regardless of whether these assets are sold.

**CHAIR:** Where would the Government get the \$20 billion?

**Prof. QUIGGIN:** There is no net gain in funds from the sale because they are forgoing the income from the asset. In essence they can finance the new investments either by user charges or by borrowing and then repaying the debt out of general revenue. There is no alternative way of financing new infrastructure investments regardless of what transactions like asset sales are notionally paired with.

**CHAIR:** So you do not analyse the actual benefits to the public as a major factor?

**Prof. QUIGGIN:** No. My view simply is that the infrastructure proposals should be evaluated separately on their own merits and they need to be financed by additional revenue, either general revenue or user charges, regardless of whether these asset sales go ahead. These are separate transactions and linking the two can only lead to bad choices on the infrastructure front, as I have argued the Queensland example shows, but it is also shown if you look at the kind of proposals that have been promoted by the so-called asset recycling program in New South Wales.

**CHAIR:** You are also critical of the sale at a time of high regulatory uncertainty. I thought we had a lot of regulatory certainty.

**Prof. QUIGGIN:** Here I am referring specifically to the point that has come up on a number of occasions about the electricity regulator's determination, which is seen as drastically reducing the earning capacity of the enterprise but which, as I understand it, remains to be resolved. That is the specific area of regulatory uncertainty to which I am referring.

**The Hon. ADAM SEARLE:** I have one quick question, which I am happy for you to take on notice if you cannot answer it now. In financial and accounting terms what is the practical difference between a 99-year lease and a sale?

**Prof. QUIGGIN:** There is no practical difference between a 99-year lease and a sale, the only point is that because the ultimate owner retains some kind of interest the buyer has slightly less security than they would in the event of an outright sale and that will potentially affect the sale price.

**The Hon. Dr PETER PHELPS:** And the owner has greater control.

**Prof. QUIGGIN:** That control though, in my view, is of no use to the public. It cannot be used in ways that would advance public policy; it simply undermines the security of the buyer without delivering any corresponding benefit.

**CHAIR:** Thank you for making yourself available today. The Committee appreciates the information you have provided.

**(The witness withdrew)**

**RICHARD DENNISS**, Executive Director, The Australia Institute, affirmed and examined:

**CHAIR:** Do you wish to make a brief opening statement?

**Mr DENNISS:** Yes. I was at the back listening to Professor Quiggin just then and I would echo many of the sentiments that he expressed. As an economist I think the economic arguments advanced for privatisation are largely erroneous or illusory. Most of the benefits that come from privatisation are projected as if they are, as Professor Quiggin has said, some sort of magic pudding, some form of windfall gain, when really all they are is a transfer of asset ownership. Allow me to start with an analogy. If I owned a parcel of shares and those shares were returning eight per cent per annum and I had a mortgage on which I was paying five per cent per annum interest, my financial adviser would never tell me to sell my shares to repay my mortgage. Why would you sell an asset that is returning returns that are significantly above the interest you are paying on the debt you owe? This is bad economics, bad finances. In Australia in the last couple of decades this notion that somehow it makes more economic or financial sense for governments to fund infrastructure by selling highly profitable assets rather than accessing cheap debt is a view that is just not found in the private sector. Allow me to give the Committee an example.

During the mining boom companies like BHP and Rio Tinto were running what we would call large deficits, they were borrowing very heavily—borrowing—in the middle of the mining boom because they were investing very heavily in the middle of the mining boom. They were borrowing money at low interest rates and they were investing it to earn high rates of profit. Their debt was going up—this is all fully available in their annual reports—yet there was no stock market analysts saying, "BHP is being recklessly irresponsible. Have you seen how its debt is growing?" If the debt is linked to high yielding assets this is a good idea. The idea that selling a high yielding asset to pay some low interest debt makes economic sense has no foundation in the economics that I was taught, or indeed the economics I have taught to 20 years. It may make political sense, I will leave that to you, but it certainly makes no economic or financial sense. If it does not make financial sense, why do it?

Some people seem to think that public ownership is in and of itself evidence of inefficiency. As Professor Quiggin made clear, the empirical evidence on this does not back that up—we have privatised assets and seen prices increase. If one accepts the idea that governments owning assets is in and of itself a sign of inefficiency, why would we sell to a foreign government? If public ownership is ipso facto a problem then why would we even countenance selling to another government? If the advantage is private ownership then why would one government sell to another government? We have got a great example in New South Wales right now of the very real risks of privatisation—that is, Glencore. Glencore, a small, struggling mining company with no market power—that was ironic, apologies—is saying it is being exploited by the privatised Newcastle Port. If an enormous multinational mining company feels that it does not have the market power to push back against the price rises that come with privatisation, what market power would mums and dads in New South Wales have? If Glencore are already running to the Australian Competition and Consumer Commission [ACCC] a year after the privatisation, how on earth do we expect individual customers in New South Wales to look after themselves?

To wrap up—and I suppose this goes to the point that came up again with Professor Quiggin—the only reason that someone is willing to buy these assets is because they expect the flow of dividends to them to be much greater than the flow of interest they will have to pay. Whoever buys this asset is making a choice: Do I borrow money to buy this asset or do I not? The flow of dividends to whoever buys these assets has to be greater than the cost of interest to them. Frankly, almost no-one in the world can borrow more cheaply than the New South Wales Government. The cost of debt is lower to the New South Wales Government than to any private sector buyer. Now what this means is, if someone is willing to pay a high price for these assets—this is exactly what happened with the port privatisation price-earnings ratio, the price that the New South Wales Government got seemed very high. At that time everyone was clapping and saying it was a great outcome—

**Dr JOHN KAYE:** Not everyone.

**Mr DENNISS:** The people who were pro-privatisation said, "This is a great idea." It is not an accident that they were willing to pay a lot more than we thought because they jacked the price up a lot more than we thought. To some extent if you want to know what the future value of the dividends of this enterprise are, then the market's estimate of that is the price they are willing to pay. If they are willing to pay a lot for it they think the future dividends are worth a lot. If they are not willing to pay a lot then they do not think that the future dividends are worth a lot. But keep in mind, the New South Wales Government can borrow more cheaply than

the people you are selling to. So if it is profitable for them to buy at their interest rate then by definition I would suggest the New South Wales Government is losing money by selling.

**The Hon. CATHERINE CUSACK:** Do you accept that many of the pension funds are cashed up and looking at the allocation of the money they have got rather than borrowing? Many are looking to balance their portfolios—

**Mr DENNISS:** I think what you mean is that the superannuation funds in Australia have money that they would love to put into a safe, high-yielding asset. Yes, they would love to do that.

**The Hon. CATHERINE CUSACK:** As would those from Canada and other nations.

**Mr DENNISS:** Absolutely. But, again, the reason they want to buy is probably a reason that we should not sell.

**The Hon. CATHERINE CUSACK:** Do you accept that debt ultimately needs to be repaid?

**Mr DENNISS:** That is an interesting question. BHP has been around for more than 100 years and its debt continues to grow. The shareholders of BHP seem entirely unconcerned that it has no plans to repay its debt—no plans whatsoever. The objective of BHP is to deliver benefits to its shareholders over time. Whenever it borrows money, which is regularly, to invest in assets, it is only asking itself the question, "Will the profits be greater than the rate of interest?"

Individuals typically seek to repay debt and see being debt free as advantageous because we pretty much know that we are not going to be around after we are 100 years old—although some of us might be more ambitious than that. Most Australians themselves would like to repay their debts, so to speak, before their income collapses when they retire. Unless the New South Wales Government plans to retire at a particular point in time there is no need to repay debt by a particular point in time.

**The Hon. CATHERINE CUSACK:** I am asking about taking on additional debt. I guess the second aspect is what if that additional debt impacts on your credit rating, resulting in the entire cost of the debt going up by literally hundreds of millions of dollars, which is the situation that we are in.

**Mr DENNISS:** Selling assets that are yielding way above the interest rate in order to repay debt could not in any way improve the financial situation of a state.

**The Hon. CATHERINE CUSACK:** Mr Dennis, we are looking at a lease. I suppose, going back to your original analysis about a house and a mortgage on a house and having a parcel of shares, what if everybody in the house was stranded there and could not leave and they needed to buy a car? They would need to access money in order to enhance the size of the assets they have.

**Mr DENNISS:** I am not quite clear on this example of being stranded in a house and needing a car.

**The Hon. CATHERINE CUSACK:** You gave the example of an individual who owns a house and who has a parcel of shares. They have income from the shares and outgoings for the mortgage on the house. I am asking about what happens if they need a new asset—like a car in order to go to work and do all the things they need to pay back the debt owed on the house. What is wrong with utilising that parcel of shares to fund a new asset—that being the motor car that you need in order to get on with your daily life—which is pretty what we talking about doing.

**Mr DENNISS:** It would be a bad idea. Let me say that I had a \$20,000 parcel of shares, and I was earning 8 per cent on those; I had a \$200,000 mortgage, and I was paying 5 per cent on that—

**The Hon. ROBERT BORSACK:** Interest rates are more like 4.75 per cent at the moment.

**Mr DENNISS:** Yes, I was being conservative. It is probably even 4.39 per cent if customers shop around. Let us say that I want to buy a \$20,000 car. If I sell \$20,000 of shares to buy my \$20,000 car—

**The Hon. CATHERINE CUSACK:** Sorry, Mr Dennis, let me stop you there. We are not talking about a sale; we are talking about a lease. If I forfeit income from those shares or reduce the amount of income

I am getting from those shares, which would be more accurate, over a period of time would that not make good economic sense for that family?

**Mr DENNISS:** No. If you need to obtain finance for an asset, economic theory and finance theory would suggest that you should obtain it at the lowest rate you can. If the rate of interest you are paying on a mortgage is lower than the rate of return you are receiving on your shares then to sell the shares or lease the shares to somebody else, to use your analogy, would be to voluntarily be paying in my example an extra 3 per cent.

**The Hon. CATHERINE CUSACK:** We are not trying to maximise our income here; we are trying to maximise our asset base.

**Mr DENNISS:** Well, you would be failing to do that; you would be selling an asset.

**The Hon. CATHERINE CUSACK:** We are talking about the utilisation of assets in order to increase the asset base. That is essentially what this proposal is all about.

**Mr DENNISS:** No, I think it is quite simple. If someone is earning 10 per cent on \$20,000 worth of shares then that is earning them \$2,000 per year. Let us assume that they are paying 5 per cent interest on their mortgage. If they increase their mortgage by \$20,000 then they will pay \$1,000 per year in interest. If they sell \$20,000 worth of shares then they will forego \$2,000 per year in dividends. So they would be \$1,000 per year worse off if they funded a car purchase by selling high-returning shares rather than increasing low-interest debt.

**The Hon. CATHERINE CUSACK:** But the problem is that by increasing your debt on your house by that amount you become a higher risk borrower and the entire interest rate on that debt goes up. This is the issue of the AAA rating, and all sides of politics are committed to retailing the AAA rating.

**Mr DENNISS:** I think there is a misunderstanding here. The net asset position is no different. If you sell \$20,000 worth of shares, you reduce your net asset position by \$20,000. If you borrow \$20,000, you reduce your net asset position by \$20,000. But if you do it in a way that sacrifices a high-returning asset, while your net asset position is entirely unchanged, you are \$1,000 a year worse off in this example.

**The Hon. CATHERINE CUSACK:** But we are doing this for the public. So the public will still have poles and wires delivering services to their homes and in addition we will have increased the public asset base in terms of the Rebuilding NSW program that has been outlined. The idea that this process is going to result in less for the public rather than more is quite ludicrous.

**Mr DENNISS:** One of us is completely wrong.

**The Hon. Dr PETER PHELPS:** We heard Professor Quiggin express his doubts about whether the New South Wales network was gold-plated over the past 10 years or so. What is the view of The Australia Institute in that regard?

**Mr DENNISS:** That is not my area of expertise. What we have seen in not just New South Wales but the Australian electricity system generally is that our regulatory structure has not found a way to ensure that appropriate investments in capacity are being made. The Australian Energy Market Operator [AEMO] forecast and other forecasts that were used to forecast electricity demand and, in turn, decide how much to invest in poles and wires were spectacular wrong for five years in a row. That drove the electricity price up quite significantly. That happened in both states where there was privatisation and states where there was not privatisation. So I think there is no doubt that we have made some very bad investments in electricity poles and wires infrastructure, and that makes me nervous about the capacity of a regulator to contain that in the future.

**The Hon. Dr PETER PHELPS:** What is your view on the most recent Australian Energy Regulator [AER] determination?

**Mr DENNISS:** I think it has finally turned the corner on realising that we invested excessively in the past. I think that the price reductions it has proposed are well overdue, and the kind of pushback coming from the people who own the assets suggests how hard it is going to be over the next 99 years.

**The Hon. Dr PETER PHELPS:** Does your view also include the fact that the likely result of the AER's determination will be job reductions within the three distribution companies in New South Wales?

**Mr DENNISS:** I must admit that I did chuckle to myself when I read that low electricity prices were going to cost jobs, because only a year or two ago we had a massive political debate about how high electricity prices would cost jobs. I think low electricity prices, all other things being equal, is a good thing that is likely to increase jobs not reduce them.

**The Hon. Dr PETER PHELPS:** What is your view of the AER's finding that Victorian distributors demonstrate the best capital expenditure efficiency in the Australian market?

**Mr DENNISS:** My view is that it is interesting that Victoria does not seem to have significantly lower electricity prices even though people find improved capital performance, and that is exactly what you would expect with these sorts of regulated monopoly industries. Economic theory—the kind that we talk about and the kind that is used to rationalise privatisation—makes it clear that it is competition that pushes prices down not private ownership. When we sell an asset it becomes a private monopoly. Even when they obtain the kind of efficiencies that they are described, strangely enough those efficiencies are pocketed by the people who own them. There is no competitive pressure to pass it on to consumers.

**The Hon. Dr PETER PHELPS:** What is your view of the AER's finding that privately owned networks are more efficient than those in government ownership?

**Mr DENNISS:** I think it is contestable. But, again, the point is that to the extent that efficiencies have been apparent in some markets at some time, they have not been passed on to consumers.

**The Hon. Dr PETER PHELPS:** Is that a failing of the transmission and distribution pricing structure or a failure of retail?

**Mr DENNISS:** I think it is a failure of the model of deregulation that we implemented from the mid-nineties. I agree with what Professor Quiggin said previously. I think the "economic rationale" for breaking the industry up in the way it did with generation distribution and retail, the entire rationale for that has been proven to be flawed. I remember the debate well; I was a participant in it and I was told at the time that lots of competition at those three levels would deliver benefits to customers. Now I am told that they actually need to buy each other up and aggregate in order to deliver benefits to customers. So the question you have asked me is very difficult to answer. But, in a nutshell, I think the ideology that drove the break-up of electricity, even though it was demonstrably flawed, the same people are now the ones advising this kind of privatisation.

**The Hon. ADAM SEARLE:** What is the practical and accounting difference between a 99-year lease and a sale?

**Mr DENNISS:** I am not a lawyer but I think the answer is more legal than economic. In economic terms there is no difference, but in financial terms I think that a lease is a riskier proposition for both sides.

**The Hon. ADAM SEARLE:** A less valuable commodity?

**Mr DENNISS:** Yes, but on both sides of the transaction I think it diminishes the price we will get for selling it, but, to some extent, when we get it back in 99 years' time it becomes our problem again. So we are giving it away when it is massively cashflow positive and we are accepting it back when who knows what it needs in 99 years' time. It might be a remediation mess that we have to solve.

**The Hon. ADAM SEARLE:** Just on that: As infrastructure ages it needs to be upgraded and replaced. What guarantees do we have, based on what we know, that the new or updated infrastructure will be owned by the community rather than by the new lessee?

**Mr DENNISS:** Again, it is a very risky transaction. I am from the Hunter Valley; there were big floods up there recently and it took a week to get a lot of people back connected to their electricity supply. How we build our distribution network, how we maintain it and how we repair it when something catastrophic occurs, those decisions fundamentally determine how much it is going to cost over the next 99 years. Usually in a market when it is competition, if I think the service at a cafe is bad I do not go back; if I think the service on an



airline is bad I do not use it. But for a monopoly asset like the poles and wires, if it takes a month to reconnect me after a flood rather than a week, what do I do?

**The Hon. ADAM SEARLE:** Go off grid.

**Mr DENNISS:** Maybe. Maybe I can maybe I cannot. I might be renting; I might not have that capacity. My point is that I am an economist and the reason economists like markets is because consumers are empowered in markets. The consumer is not empowered.

**The Hon. ADAM SEARLE:** There is no market.

**Mr DENNISS:** There is a market. I have to pay for something but I have no choice. So if it takes you a month to restore me, after you restore me I have got nowhere to go but back to you. It is going to be profitable for them to push risk onto me, but as they push risk onto me I have got nowhere to go.

**The Hon. ADAM SEARLE:** I want to explore the net impact on the budget from the lease, if any—whether it is positive or negative. We have heard evidence that suggests that these companies have returned over \$20 billion to the State Government over the last 20 or so years. We are told the State Government expects to yield a net \$13 billion from the sale, notwithstanding the AER determination, but we also are told by the Premier in his presentation that the returns from these assets are going to diminish radically to the point of a small fraction.

**Mr DENNISS:** Don't tell the buyers that.

**The Hon. ADAM SEARLE:** I was going to say, how do we as a committee in evaluating whether this proposal stacks up financially for the community—what would be a prudent step? Do we need to get an independent valuation of the profitability of these businesses?

**Mr DENNISS:** It would not hurt. I think more transparency is good when it comes to such enormous and long-lasting transactions. But the economics of it are really quite simple. The price that someone is willing to pay tells you what they think the future dividends are worth. This is not complicated. Whoever buys this—do not take this the wrong way—they do not care about New South Wales and they do not care about poles and wires. It is their job to invest in the assets that generate the highest returns for whoever they are accountable to. If I have got \$10 billion to spend I could put it in the bank and earn 3 per cent—this is an option. I could buy some New South Wales electricity assets with it. I could invest it in some share market index. It is my job to think of all the things I could buy; which one will I buy? I am not going to buy the New South Wales poles and wires for 99 years; I am going to buy the revenue from those assets for 99 years unless the rate of return from that is significantly greater than the rate of return I can get for sticking in the bank.

**The Hon. ADAM SEARLE:** Particularly if the revenue is capped.

**Mr DENNISS:** That is right.

**The Hon. Dr PETER PHELPS:** Does anyone buy bullion? What is the guaranteed rate of return on bullion?

**CHAIR:** Mr Searle is asking questions.

**Mr DENNISS:** I am happy to answer. It is up to you guys.

**CHAIR:** Mr Searle?

**The Hon. ADAM SEARLE:** Please answer.

**Mr DENNISS:** The buyer, for two reasons, they think that bullion is a safe hedge. They expect capital gain and the expected rate of return on bullion is positive, risk-adjusted. It is absolutely no different.

**The Hon. Dr PETER PHELPS:** But it is not guaranteed.

**Mr DENNISS:** Nothing is guaranteed. They are all risk-adjusted. The reason I talked about putting the money in the bank is that is the lowest risk thing that most people can think of doing.

**The Hon. Dr PETER PHELPS:** That is a monopoly interest.

**CHAIR:** Dr Phelps, this is not a discussion group. Mr Searle is asking questions.

**The Hon. ADAM SEARLE:** What do you think, as an economist, of the notion of selling an income-producing asset and buying or building assets that do not provide a net return to the owner but, in fact, cost money on an ongoing basis? Is that a financially sensible transaction for an owner?

**Mr DENNISS:** I hate to say it but it seems that non-economists find this a lot harder to get their head around than economists: they are just separate transactions. If you want to sell an income-producing asset because you would rather have a stock of cash than a flow of income, you should do that. If you want to go and build a hospital or build a road or give people tax cuts—

**The Hon. Dr PETER PHELPS:** Or a rail network.

**Mr DENNISS:** We could have a long list; it is a simple analogy I am making. If they are good investments you should make them. But this idea that you can only invest in rail, which I encourage you to do, that we can only invest in rail if we sell an income-producing asset, it has just got nothing to do with economics or finance. If the income-producing asset is giving you an 8 per cent flow of income and you can borrow money at 2 per cent, if you want to build a \$10 billion rail project you should, but you should finance it by the cheapest way you can find. Giving up an 8 per cent return rather than borrowing at 2 per cent is costing you 6 per cent of \$10 billion—it is hugely expensive.

**The Hon. Dr PETER PHELPS:** What if you are not getting 8 per cent?

**Dr JOHN KAYE:** Point of order: Mr Chair, can we not have this continual stealing of question time?

**The Hon. ADAM SEARLE:** Mr President, perhaps you could adopt the approach taken by the President of our Chamber and stop the clock when there is disorderly conduct. Mr Denniss, in financial terms, should the proceeds of privatisation, whether it is by sale or lease, be more sensibly used to retire debt absolutely rather than to build new infrastructure?

**Mr DENNISS:** It depends on your expected return of infrastructure.

**The Hon. ADAM SEARLE:** Even with the projected diminution these companies are still projected to pay for themselves and produce a return under current ownership. If they are to be sold for a net \$13 billion is it more financially sensible for the State Government to retire debt rather than build new infrastructure that will cost money to maintain and service?

**Mr DENNISS:** Since the Sydney Olympics Australia's population has grown by more than the population of Sydney at that time. If we want to double our population we will need to spend a fortune on infrastructure. If you have got four million people a decade moving to Australia we are going to need a lot of infrastructure. The idea that the only way to fund it is to keep selling profitable assets is very short-term thinking.

**The Hon. ADAM SEARLE:** If you keep selling profit-making assets you will run out of your ability to finance your own operations.

**Mr DENNISS:** This is the point. And population is going to continue to grow long after you have run out of assets to sell.

**The Hon. ADAM SEARLE:** That would apply not just to new infrastructure but also to recurrent services such as health and education that may be in part funded by these profitable assets. That is the case, is it not?

**Mr DENNISS:** Absolutely. Again, if you are selling an asset that is making you 8 per cent to retire debt that is costing you 2 per cent you are losing 6 per cent.

**The Hon. ROBERT BORSAK:** You could characterise it by saying that it is economically irrational.

**Mr DENNISS:** It is absolutely economically irrational.

**Dr JOHN KAYE:** Some people think that the networks were gold plated by decisions that were made around 2008 and 2009. Other people think they were not. Either way, what I want you to talk about is whether it would make any difference if those assets were publicly owned or privately owned. I think I am correct in saying that the forecast came from the Australian Energy Market Operator [AEMO] and they were available to all participants and the decision was made by the Australian Energy Regulator [AER] just to allow that capital expenditure, or not to enter the rate base as it were. The AER has just told us that they are agnostic about ownership; they are ownership blind. Would gold plating have been different in New South Wales if the wires and poles, distributors and the transition company Transgrid had been in private hands?

**Mr DENNISS:** No, I fear it might have been worse. We have changed the way we run our electricity system in so many ways in the past decades, but once upon a time all of these things were fully owned and run by governments. In those days when the old Elcom or any of those statutory bodies came to Treasury and said, "I want a billion dollars for poles and wires", Treasury scrutinised that decision very hard and said, "Actually, I would rather not spend a billion if I can avoid it, I would rather spend it on hospitals or schools or something else." Once upon a time it was very hard to get your gold plating up because you were just another bureaucracy asking for cash.

Now we have created this kind of regulatory model where for every extra billion dollars I get into the asset base I get 13 per cent return on it. I am lobbying harder than anybody in the world to get that gold-plating up. The AEMO might be blind to who owns it but once someone gets a very high rate of return on the asset base their primary task is to inflate the size of the asset base.

**Dr JOHN KAYE:** You are saying that the capital investment performance of a private leaseholder would not be better from a parsimony point of view—from a point of view of not overinvesting in the network—than a public owner of that asset?

**Mr DENNISS:** No, I fear it would be worse. I fear they would be even more goal oriented.

**Dr JOHN KAYE:** To get the profit?

**Mr DENNISS:** The get the asset into the asset base because the minute you can convince people that the asset needs to be built you have got 13 per cent return on that and you have borrowed at 3 or maybe 5 per cent.

**Dr JOHN KAYE:** My second set of questions goes to the value of the lease itself. I think you have said this but I to want get it absolutely clear. If it is true that the asset dividend is genuinely falling by a factor of 10 under public ownership between 2012-13 and 2017-18, what is going to be different under private ownership? What can a private owner do that would make that different?

**Mr DENNISS:** Well, what we have just seen in the Newcastle ports is increase the price.

**Dr JOHN KAYE:** They cannot do that under the Australian energy market rules because they are largely regulated on price.

**Mr DENNISS:** Sorry, I interpreted the question more generally. They are going to lobby harder to get more into the asset base or they are going to have to lower the quality of the service, pushing risk onto customers.

**Dr JOHN KAYE:** Which in the electricity sector means what? What would be the consequences for consumers?

**Mr DENNISS:** I think the most likely ones are increased risk of blackout and longer durations of blackouts.

**The Hon. ROBERT BORSAK:** Mr Denniss, you gave a lot of good examples of the economic irrationality of trading off a cash flow positive asset and investing in necessary infrastructure which may not be cash flow negative but is certainly not self-financing. On Monday the Premier threw around the spectre of losing the triple-A credit rating. That seems to be the boggy word every time someone talks about on State balance sheet or off State balance sheet financing. Do you think that particular scare is valid for New South Wales?

**Mr DENNISS:** I think it is massively exaggerated. That said, I do think that the ratings companies have an interest in creating a bit of volatility in their ratings. If the ratings never changed no-one would pay for the product.

**The Hon. ROBERT BORSAK:** No-one would pay fees.

**Mr DENNISS:** Exactly. Take the household analogy if you want to. If I have got \$100,000 in the bank and I have got a \$100,000 mortgage, my net asset position is zero. If I take the \$100,000 out of the bank and I repay my debt with it, my net asset position is zero. It is just a financial transaction. Whether I am holding lots of debt and lots of assets or I get rid of some debt and some assets; the net asset position does not magically change. The idea that the ratings companies are so naive that they would say that New South Wales debt just went down, they must be safer and better now—

**The Hon. ROBERT BORSAK:** The reality is New South Wales debt will not go down with the sale of these assets.

**Mr DENNISS:** I guess you could argue that it would be down lower than it would otherwise be because, again, with rapidly growing population we are going to spend a fortune on infrastructure.

**The Hon. ROBERT BORSAK:** But there other mechanisms through which you could finance infrastructure off State balance sheet if you really wanted to.

**Mr DENNISS:** I just think that if you want to invest in a good idea, whether it is public infrastructure or a commercial investment, you should finance the good idea at the lowest rate of finance you can get. If someone is offering you low debt or that you could sell a high-returning asset my advice, and the advice that you would get from any financial adviser, is to take the cheap debt.

**The Hon. ROBERT BORSAK:** Just as you outlined with those examples of BHP and others, when an economy is growing that is when you borrow and gear.

**Mr DENNISS:** Yes.

**The Hon. ROBERT BORSAK:** If the economy is not growing that is when you acquit assets.

**Mr DENNISS:** Where the household example really folds over is most households anticipate retirement and actually New South Wales is anticipating massive growth.

**The Hon. ROBERT BORSAK:** It would be reasonable to expect that New South Wales, as its economy grows, that its net debt position would grow as well.

**Mr DENNISS:** Look, whether it grows slightly, whether it declines slightly, or whether it stays the same, it has very low levels of debt by international standards.

**The Hon. ROBERT BORSAK:** There are alternative to not borrowing. Where I come from in the business world, it is usually prudent to match long-term debts to long-term assets. We do not seem to be doing that with this transaction.

**Mr DENNISS:** No.

**The Hon. ROBERT BORSAK:** Do you agree with that?

**Mr DENNISS:** I hate to say it, but if I had to explain why economists do not seem to get as excited about privatisation as politicians is that is, really, what privatisation allows you to do is take 99 years of future revenue—

**The Hon. ROBERT BORSAK:** Future cash flow.

**Mr DENNISS:** —future cash flow and turn it into something.

**The Hon. ROBERT BORSAK:** Turn it into buying the next election.

**Mr DENNISS:** Well, you get to spend in a term of office. Obviously, that has political benefits.

**CHAIR:** Thank you very much for coming in and giving us the benefit of your knowledge. Have you done the comparisons of the actual prices consumers are paying for electricity in New South Wales with Victoria and South Australia?

**Mr DENNISS:** We have not conducted any of our own analysis. I am familiar with other people's, including Professor Quiggin's and the regulator's.

**CHAIR:** What do you learn from that?

**Mr DENNISS:** What we find is that prices are remarkably stable across States, even though their structures are quite different. This comes to the point before that in Victoria, where there is a greater degree of privatisation, there does seem to be some evidence that it is more efficient—that is, cheaper to produce—but the prices to consumers are not significantly lower, which again in a monopoly is pretty much what you would expect.

**The Hon. ROBERT BORSAK:** That is what you would expect.

**Mr DENNISS:** Yes, they have an incentive to push down costs, but they have no incentive to push down price. Two cafés next to each other have an incentive; they are competing with each other. But if I am the only supplier of distribution infrastructure in Victoria, and if I can do it cheaper, I do not need to pass it on to you.

**CHAIR:** Is it a fact, though, that prices in New South Wales are the highest for the whole of Australia?

**Mr DENNISS:** The last time I looked, they were, but whether they still are I am not sure. But I do not think that ownership is going to change that. In fact, I fear the opposite.

**The Hon. ADAM SEARLE:** By that you mean network prices.

**Mr DENNISS:** Yes. I assume that is what we are talking about.

**CHAIR:** The other question applies to the dividends. Some of the conversation gives the impression that there is a very high dividend coming to the State Government from the poles and wires, and that has dramatically decreased.

**Mr DENNISS:** Yes.

**CHAIR:** And will decrease further in the future.

**Mr DENNISS:** I am sceptical about that and, again, the fact that someone would be willing to pay a large price for it suggests that they, too, would be sceptical that dividends will continue to fall. The lost dividends are what are being sold. Again, you are not really selling poles and wires; you are selling a flow of future income. The fact that someone is willing to pay a lot for it is proof that they expect that those future dividends will be very high. The idea that we in a public hearing could be sitting here saying, "All these dividends are going to fall and stay down low, but don't tell people who are going to come and buy them", beggars belief.

**The Hon. ADAM SEARLE:** The two are in lock step.

**CHAIR:** But the fact is that the dividends are falling dramatically.

**Mr DENNISS:** Yes, but there is incredible discretion from an accounting point of view in how these transactions, especially distributions to the Government, operate. Fortescue Metals has been paying out dividends to shareholders as the iron ore price has been falling because the people that run that company have decided that, even though the profits falling, they should keep their dividends up. Other companies, when profits are rising, say, "We actually want to hang onto all of the money and invest in future growth." The profitability of an entity and the current distribution of dividends are really unrelated. In the long run they have to be related. In the short term, they have nothing to do with each other.

**CHAIR:** Are you suggesting that the Government could be pushing the dividends down—

**Mr DENNISS:** Absolutely.

**CHAIR:** —through Treasury involvement?

**Mr DENNISS:** Absolutely. I cannot see any other real explanation; or, similarly, if the industry was this volatile and getting far less profitable, then I would suggest on behalf of the owners of the asset, "Please don't sell now. You'll get the worst price that ever. Hang onto it for five or 10 years and sell it then." But, hopefully, we are not having a fire sale of one of our State's biggest assets; yet this idea that dividends are plummeting and are going to get worse very much suggests a fire sale. There is no need to rush

**CHAIR:** The banks handling the sale will have to convince the purchaser that the dividends will keep increasing.

**Mr DENNISS:** Exactly. I think anyone buying this suspects that is exactly what is going to happen.

**CHAIR:** Thank you very much for assisting us in our inquiry.

**Mr DENNISS:** Thank you for inviting me.

**CHAIR:** We get a different view when we have two economists.

**Dr JOHN KAYE:** Actually we get three different views from two economists, do we not?

**CHAIR:** No. We got the same view from two economists, but a different view from many other people.

**The Hon. ADAM SEARLE:** That is unusual.

**The Hon. ROBERT BORSAK:** That is right.

**Dr JOHN KAYE:** We do think differently. Thank you very much.

**(The witness withdrew)**

**(Committee adjourned at 1.15 p.m.)**