REPORT OF PROCEEDINGS BEFORE

GENERAL PURPOSE STANDING COMMITTEE No. 1

INQUIRY INTO THE GENTRADER TRANSACTIONS

UNCORRECTED PROOF

At Sydney on Thursday 10 February 2011

The Committee met at 11.00 a.m.

PRESENT

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

The Hon. G. J. Donnelly
The Hon. L. A. Foley
The Hon. K. F. Griffin
Dr J. Kaye
The Hon. T. Khan
The Hon. G. S. Pearce

ALBERTO FABRINI, Managing Director, Hydro Aluminium Kurri Kurri Pty Ltd, and

TREVOR KENNETH COOMBE, Head of Global Alumina and Smelter Growth, Oceania Region, Hydro Aluminium Kurri Kurri Pty Ltd, sworn and examined:

CHAIR: Welcome to the fourth public hearing of the inquiry into the gentrader transactions. I refer attendees at today's proceedings to the statement I made on Monday 17 January concerning the Committee's proceedings and the prorogation of Parliament. The Clerk expressed the view that the Crown Solicitor's advice was a very restrictive view of the powers of the Legislative Council, however issued a cautionary note that the extent of committee powers during prorogation has yet to be tested before the courts. In summary, the advice to the Government by the Crown Solicitor is that standing committees cannot function during prorogation unless authorised by statute, and that there is a risk that statements made and documents provided to such a committee would not be protected by parliamentary privilege. However, the advice of the Clerk of the Parliaments, supported by an opinion by Bret Walker SC, is that the Crown Solicitor's advice was a very restrictive view of the powers of the Legislative Council and that instead the inquiry is lawful and therefore the proceedings are privileged.

I ask that while giving their evidence witnesses be mindful of this difference of views regarding the status of inquiry proceedings, and be cautious in any matters that may be defamatory or commercially sensitive. A full copy of my statement from 17 January and the advice of the Clerk is available from the table at the back of the room. Today the Committee will hear evidence from Hydro Aluminium Kurri Kurri Pty Ltd about the decision not to proceed with power contracts between the Kurri Kurri smelter and Delta Electricity. The Committee also has invited Professor Bob Walker, Dr Betty Con Walker and Professor Hugh Outhred to discuss the impact on Macquarie Generation and half of Delta Electricity now that the Government has announced that those organisations will not be privatised.

Before we commence, I will make some comments about procedural matters. The Committee has previously resolved to authorise the media to broadcast sound and video excerpts of its public proceedings. In accordance with these guidelines, members of the Committee and witnesses may be filmed or recorded, but people in the public gallery should not be the primary focus of any filming or photographs. In reporting these proceedings, the media must take responsibility for what it publishes or what interpretation is placed on anything that is said before this Committee. Witnesses, members and their staff are advised that any messages should be delivered through the Committee clerks. I ask everyone to turn off any mobile telephones during the proceedings as they may interfere with some of the Hansard recordings. I am pleased to welcome our witnesses for today from Hydro Aluminium Kurri Kurri**.** Thank you for attending and at short notice. We appreciate that you are very busy. Do either of you wish to make an opening statement?

Mr FABRINI: Yes. Thank you for inviting us. We think it is a good opportunity. Hydro Aluminium has been a good corporate citizen of New South Wales and has worked well with the Government's various energy-related agencies and entities over many years. However, recent actions taken by the New South Wales Government and the energy reform group steering committee potentially have serious and far-reaching consequences on Kurri Kurri smelter, its work force and the regional economy. We provided a submission to the Committee to describe these actions and their potential implications.

The Hon. GREG PEARCE: Could you outline for the Committee your concerns regarding your dealings with Delta and the Government's electricity reform team?

Mr FABRINI: Yes. Our major concern is that the way we operate our business, we need a long-term view for our investments and for our future. A key point for that is our power contract. Normally our capital investment for modernisation and even for major maintenance has a horizon of 20 to 30 years. This is what we expect in terms of return of capital for what we invest. Kurri Kurri is a 40-year-old plant and we are competing in a very competitive market—not only externally but also internally with our smelters in Europe, Brazil and some other countries. So, it is important that we have this competitive edge in front of us. Then we can continue to modernise and we can continue to invest and we can assure a future for our company, for the region, for our employees and for the community where we operate. This is overall for that.

The Hon. GREG PEARCE: What was your understanding of what happened in the negotiations you were undertaking with Delta for your long-term contract?

Mr FABRINI: Mr Coombe will answer that.

Mr COOMBE: We negotiated with Delta Electricity over a period of somewhere between 18 months and two years. In July last year we came to a heads of agreement, which we all signed in Oslo. From that we then worked towards the contract. This is a contract that goes from 1 July 2017 to 30 June 2027. We came to a conclusion on those and finally both boards—the board of Delta and the board of Hydro—agreed to those contracts. The contracts are quite a complex exercise and we had worked with Delta to make sure that in any chance of the gentrader exercise coming up—at that stage that had not been developed fully—our contracts had to reflect the potential for this to happen. There was always interaction between, obviously, Delta and the Government to make sure that the contracts were congenial. This is where the time was spent. Finally, we were advised in early November that the energy reform committee had rejected the opportunity for Delta to sign those contracts. We do not know what statutory authority the energy reform committee has to actually tell a government company not to do those kind of things. As far as Delta was concerned, it was a commercial contract; they were happy with it, we were happy with it. We still to this day do not know why it was turned down.

The Hon. GREG PEARCE: Would it be fair to speculate that the gentrader contracts might have increased in value if your contract was not signed? Would that be something that might have been an influence?

Mr COOMBE: I have a personal view on that and I do not believe that is the case. As to that particular question, I think you would have to ask the Government as to whether there was a loss or gain in value.

The Hon. GREG PEARCE: You have written to the Premier and other people expressing concerns about what happened?

Mr COOMBE: Yes.

The Hon. GREG PEARCE: Who have you actually contacted in the Government?

Mr COOMBE: We have contacted Treasury. We have contacted and we have sent letters to the Treasurer requesting meetings. We have sent letters to the Premier, and in fact in our submission there is a copy of a letter that we sent to the Premier requesting meetings. We have had no response at all.

The Hon. GREG PEARCE: You said you wrote to Treasury?

Mr COOMBE: Yes. I am pretty certain that we did write to the Treasurer actually requesting a meeting.

The Hon. GREG PEARCE: Would you have expected that the Treasury secretary would have known of your concerns?

Mr COOMBE: I do not know how the paperwork goes on in Treasury, but certainly we wrote a letter. Whether they passed it on, I do not know.

The Hon. TREVOR KHAN: Are you able to indicate when, for instance, you wrote to the Premier?

Mr COOMBE: I think it is 26 November. There is a letter actually signed by Alberto as well as our chairman of the board of our company to the Premier on 26 November, and that copy is in our submission.

The Hon. TREVOR KHAN: You have received no reply to that letter of 26 November?

Mr COOMBE: No reply whatsoever.

The Hon. TREVOR KHAN: With regards to the size, am I right in saying that Kurri Kurri aluminium smelter has something in the order of 500 employees?

Mr FABRINI: Yes.

Mr COOMBE: There are at least 600 employees, but on any one day there would be at least 800 people at the smelter.

The Hon. TREVOR KHAN: Does that make it one of the larger employers in the Hunter Valley area?

Mr COOMBE: Excluding Tomago and maybe the University of Newcastle, we would be certainly in the regional sense by far the largest employer. But in the whole Hunter Valley it is a little different because you have coalmines as well, which have different things. But certainly for the Kurri-Cessnock region we are by far the largest employer.

The Hon. TREVOR KHAN: You have mentioned Tomago; am I right in saying that at the time you were negotiating your long-term electricity supply contract you were aware that Tomago also was in the process of negotiation with Macquarie Generation?

Mr COOMBE: That is public record. There was an article in the paper that Tomago put in because the negotiations had stalled. That was about the same time. We actually had come to virtually a conclusion with our contract with Delta.

The Hon. TREVOR KHAN: Before Tomago concluded its negotiations?

Mr COOMBE: Yes, correct.

The Hon. TREVOR KHAN: Am I correct in saying also as a matter of public record that whilst the Tomago smelter negotiations may have stalled, it was successful in eventually signing a contract?

Mr COOMBE: We were advised on 5 November that the contract was not going to be honoured. The very next day Tomago's contract was honoured.

Dr JOHN KAYE: Can you make that clear—you were advised on 5 or 6 November?

Mr COOMBE: I think it was 5 November. Yes, on 5 November we were informed that the energy reform group steering committee had declined permission to Delta Electricity to proceed with our extension contracts.

The Hon. GREG PEARCE: Do I take it from your earlier comments that your current supply agreement runs to 2017?

Mr COOMBE: It is 30 June 2017.

The Hon. GREG PEARCE: In the absence of a new supply agreement after that, when would you have to stop operations or commence closing down the plant?

Mr FABRINI: Again, this is a matter of long term and if we do not have a supply. We are not going to wait until the last day to stop because what happens normally with this operation is that we will slow down the investments—not only the modernisation investments, but also the maintenance investments, of which we are talking millions of dollars per year. That is the major concern. That is why we like to have this contract signed with a certain time so we can keep up with our regular maintenance. That is our main concern and that is why we needed this contract in renegotiating. We started negotiating two years ago. So we are being proactive on that. That is very important for us to keep our operation in good standard, otherwise if we start deferring maintenance we can get to a point of no return. In two, three years time we can get to a point of no return in such a way that you have to put so much money to have the plant in a good position that it might not be viable when we compare with other smelters with which we are competing.

The Hon. GREG PEARCE: So if this is not resolved within a couple of years you could be at the point of no return—

Mr FABRINI: We could be at a point of no return, certainly.

The Hon. GREG PEARCE: And that would mean that even prior to that in the short term you may be deferring maintenance, so maintenance jobs will be gone very quickly?

Mr FABRINI: I can tell you that right now we are deferring modernisation projects—we started. We have projects in the pipeline that is very much needed for us. We have plans to creep our production and these projects have been deferred right now as we speak because there is no certainty. That is the start. Of course, if this continues we can have other effects, like I said, even in our regular maintenance. Of course, we will preserve the safety, we will preserve the environment, our values, but to keep up in the rhythm that we are now is going to be very difficult in two years time certainly.

CHAIR: You just mentioned about the plans you had for potential investment which you have now suspended. Roughly what would that amount be?

Mr FABRINI: We normally spend in the order of magnitude of $50 million a year. Our budget this year is around $64 million. As I said, we are still keeping up in our sustainable projects. We have all the intention to continue. We believe Kurri Kurri is a very important facility for hydro aluminium. We supply 70 per cent of our products to Australia so I think we are also very important in that portfolio, otherwise you may have to import material. So there are a series of benefits of having Kurri Kurri besides all that I already mentioned. We have plans to creep our production, as I said, gradually—we always do that—and it is very important to have available power for us to do that.

The Hon. TREVOR KHAN: Could I go back to July 2010 when the heads of agreement were signed? I think the evidence is that those heads of agreement were signed in Oslo, is that correct?

Mr COOMBE: That is correct.

The Hon. TREVOR KHAN: Was that a signing in a darkened room of only your own people or was it done in some formal sense?

Mr COOMBE: It was quite a formal exercise. We went to the head office in Oslo and the head of the aluminium section signed as well as the chairman of our company—he signed—as well as the CEO and chairman of Delta Electricity. Whilst it was July, the sun was shining in Oslo.

The Hon. LUKE FOLEY: The midnight sun.

Mr COOMBE: Yes, it was shining most of the time. There was certainly no darkness.

The Hon. TREVOR KHAN: In terms of the level of investment that your company makes in relation to, for instance, its ongoing annual maintenance and the like, have those figures been made aware to the New South Wales Government customer?

Mr COOMBE: I think in a letter to the Premier that is actually highlighted as well. Yes, in fact it is in the last paragraph of the first page.

CHAIR: It is $80 million per year?

Mr COOMBE: That is in wages alone and then $50 million in capital works that we do, and most of that capital works is actually spent in the regional area. We do not import stuff; most of it is done with local people doing the work.

The Hon. TREVOR KHAN: So apart from the 500- or 800-odd employees that are at the plant each day are you able to indicate, in a sense, the knock-on of other workers that are dependent upon Kurri Kurri for employment?

Mr COOMBE: Depending on what multiplier you use—we use—as a rough number it is about 2,500. When I first went to the plant 15 years ago the list of contractors, which is people we use to come onto the plant every now and then, was up to 5,000 people. So there are a lot of people. Not all of them work there all the time, obviously, but we have a contact with a lot of people who are in some way reliant on our operation.

The Hon. TREVOR KHAN: You would have read in the *Newcastle Herald* in the last couple of days that the Premier was asked about this issue, I think in or about the vicinity of the Stockton ferry, when she was in Newcastle. Did you receive any communication that the Premier or any of her staff might perhaps be making some sort of an announcement with regard to the smelter on that day?

Mr COOMBE: No.

The Hon. TREVOR KHAN: Have you in any way any idea of what she may have been talking about when she said—in words or similar words—there were a few things to sort out before she could make some announcement with regard to the smelter?

Mr COOMBE: No.

The Hon. TREVOR KHAN: There has been no indirect communication either through the energy reform committee or anyone else with regard to what they are doing with your contract?

Mr COOMBE: I have had no contact from the energy reform committee—I would suggest it would go back almost 12 months—of any of the members of that.

The Hon. TREVOR KHAN: Has Delta communicated that something might be in the pipeline and all might be rosy?

Mr COOMBE: I have met with the CEO of Delta—it was in a phone call actually—and I said that we would like our contract honoured because since the announcement just recently that the reform has now stopped and that Delta Coastal and Mac Gen will stay in State hands, I phoned the CEO of Delta saying, "Now you are in the old system I have a contract that I would like honoured. How about signing the contract?" There was a discussion that occurred there. But, once again, the Delta Coastal units are not the most reliable units, so there are some issues with regard to the reliability of supply long-term. Once again, we are keen to get a contract. We want a contract. As Alberto has said, for sustainability of our business we need to have a horizon a little bit longer than seven years to make pretty substantial investments.

The Hon. GREG PEARCE: Have you had any advice as to potential compensation or claims for damages against the Government as a result of them reneging on the deal?

Mr COOMBE: No. What we have though is we have put Delta on notice that there is a potential for us to seek compensation—

The Hon. GREG PEARCE: And that would be many millions of dollars?

Mr COOMBE: —and that would be quite substantial. We do not want to go into legal battles. That is not the easiest way of resolving an issue, in my view. But certainly there is that issue. We both worked in good faith to get a contract, both sides agreed to that contract—we have actually physically signed that contract. We delivered signed copies of the contract to Delta back in November. So they already have those contracts that have been signed and we would like them to sign that as well.

The Hon. GREG PEARCE: Could we go back to the circumstances? Could you just explain fully how you were advised that the electricity reform group had kyboshed the deal? Who actually spoke to whom and what did they actually say?

Mr COOMBE: We were advised by the CEO of Delta, who contacted a consultant that we use—he phoned him and then I got a phone call on a Friday evening on that. That is how we found out that our contract had been stopped. It was late Friday afternoon, maybe about six o'clock or seven o'clock at night.

The Hon. GREG PEARCE: You obviously have expressed a little bit of concern?

Mr COOMBE: I was quite upset about that exercise, yes.

CHAIR: So the committee never contacted you?

Mr COOMBE: No.

CHAIR: The committee contacted Delta and gave Delta an order and Delta then conveyed that order to you?

Mr COOMBE: Correct.

The Hon. TREVOR KHAN: Just so we are clear, the contracts that you signed, or your company signed, were contracts prepared by lawyers acting for Delta?

Mr COOMBE: That is correct.

The Hon. GREG PEARCE: And they were fully concluded?

Mr COOMBE: They were fully concluded and they had been approved by the board.

The Hon. TREVOR KHAN: And I take it that the contracts that you signed were contracts that were unaltered in the sense that what you were presented with at the end of the day by the solicitors acting for Delta you signed, or your company signed?

Mr COOMBE: Correct.

The Hon. TREVOR KHAN: So they got back what they asked for?

Mr COOMBE: Yes.

Dr JOHN KAYE: I will just go back over some of the territory Mr Khan and Mr Pearce have covered just to clarify a few things. In the period between the July signing of the binding heads of agreement in Oslo and 5 November was there ever any discussion that there was a need to get the approval of, in the first instance, the Minister for Energy and subsequently the Treasurer because this was not a commercial undertaking of the board?

Mr COOMBE: No.

Dr JOHN KAYE: I should say, to make it clear, that what I am saying is the board of Delta Electricity?

Mr COOMBE: No. We knew that the shareholding Ministers had to agree to such a substantial contract, but the word coming from Delta was that it was a rubberstamp because this was a commercial deal.

Dr JOHN KAYE: So it was understood by you that Delta had negotiated this not as some kind of community service obligation to protect employment—

Mr COOMBE: Absolutely not.

Dr JOHN KAYE: —but purely as an activity that would enhance the value of Delta Electricity?

Mr COOMBE: I can assure you that the negotiations were not in any way a community exercise; they were quite a substantial power deal for Delta Electricity. The arrangements that we have are certainly very commercial.

Dr JOHN KAYE: Then we go to 5 November. At some stage late in the afternoon of Friday 5 November you are informed by the chair of the board or the managing director of Delta—

Mr COOMBE: No, the CEO.

Dr JOHN KAYE: You are informed by the CEO of Delta. Were you informed in writing or were you informed verbally?

Mr COOMBE: Verbally by phone.

Dr JOHN KAYE: Were you ever given any documents in writing that told you that the heads of agreement had been broken?

Mr COOMBE: No.

Dr JOHN KAYE: So to this day you have the heads of agreement and you have no document that contradicts the heads of agreement?

Mr COOMBE: No.

Dr JOHN KAYE: So you are only working on the basis of what you have been told?

Mr COOMBE: And by their actions. Because if they are going to honour the heads of agreement then why will they not honour the contracts?

The Hon. GREG PEARCE: It is now February and they have not signed.

Dr JOHN KAYE: You say they have not signed the contracts?

Mr COOMBE: They have not signed them. We signed contracts back in November and delivered them to Delta's head office.

Dr JOHN KAYE: Just to go back to 5 November, did you seek at any stage written confirmation or any written explanation as to why the heads of agreement were being broken?

Mr COOMBE: We have received no documentation—

Dr JOHN KAYE: Did you seek any documentation?

Mr COOMBE: We asked for meetings because we could not understand it, but we have not had any response either from anybody.

The Hon. TREVOR KHAN: Nor from Kristina on 26 November.

Dr JOHN KAYE: That is correct. Let us go to 6 November. Having been told on 5 November that your contract was not to be honoured, on 6 November you are told that documents—and you may not wish to tell us what those specific documents are—documents relating to your—

Mr COOMBE: Existing contract.

Dr JOHN KAYE: The existing contract, as in not the July 2010 contract but the contracts that would be in force until 30 June 2017?

Mr COOMBE: Correct.

Dr JOHN KAYE: Those documents were to be revealed to the—

Mr COOMBE: The data room.

Dr JOHN KAYE: The data room?

Mr COOMBE: That is correct.

Dr JOHN KAYE: You then sought a court injunction against that and you were successful in getting that court injunction?

Mr COOMBE: Yes.

Dr JOHN KAYE: Does that court injunction have an expiry date on it?

Mr COOMBE: On 17 January there was an agreement reached between the State and Hydro and we got assurances that our documents were not going to be disclosed and so therefore our injunction and our legal proceedings ceased.

Dr JOHN KAYE: So at this stage you are on a promise and a prayer from the New South Wales Government that those documents would be not released?

Mr COOMBE: Correct. I think it is more than a promise; they have guaranteed that they will not, and I take it on its value that they will honour that.

Dr JOHN KAYE: That was in writing?

Mr COOMBE: That was in writing.

Dr JOHN KAYE: That one was in writing?

Mr COOMBE: That was in writing.

Dr JOHN KAYE: Can you tell us what documents they were that were to be released?

Mr COOMBE: It was all our power contracts.

Dr JOHN KAYE: Including price, terms and conditions?

Mr COOMBE: Everything; it was the total contracts that we have.

The Hon. TREVOR KHAN: The stuff that Eric would not tell us about.

Dr JOHN KAYE: Can you very briefly outline to this Committee your concerns about that information being released?

Mr COOMBE: Those contracts have a lot of confidentiality written into them so that the likes of Delta cannot expose them to public scrutiny because they are in confidence. They have sensitive terms. Obviously price is the most important, but certainly there are other things in it that are quite sensitive as well so we have a confidentiality agreement; we can't disclose, they cannot disclose and effectively that binds everybody else. So when we heard that the Government had actually requested—I am not sure whether it was the reform committee or not who had actually requested that those documents be delivered from Delta to the data room—we objected to that and took an injunction.

The Hon. GREG PEARCE: Who did you hear that from?

Mr COOMBE: I got a phone call on Saturday morning from the CEO of Delta. He phoned me telling me that he had been instructed to surrender our documents.

Dr JOHN KAYE: He had been instructed or requested?

Mr COOMBE: It is a moot point. He was told he had to deliver them.

Dr JOHN KAYE: He was told he had to deliver them?

Mr COOMBE: Yes.

Dr JOHN KAYE: Was there a section 20N order?

Mr COOMBE: I believe there was a section 20N issued.

Dr JOHN KAYE: Issued to?

Mr COOMBE: To Delta.

Dr JOHN KAYE: To deliver those documents?

Mr COOMBE: That's correct.

Dr JOHN KAYE: The Treasurer on a number of occasions has said to both this Committee and to the House that we should not be concerned about what happens in the data room because participants in the data room are bound by confidentiality agreements and all will be well. You clearly do not agree with the Treasurer on that. Could you explain why you think the Treasurer was not correct in saying that?

Mr COOMBE: We regard the price for power to be one of the most sensitive issues in our business and whilst there are confidentiality agreements written, the more people who know that information the more chance of it leaking. Even though there are confidentiality agreements signed, et cetera, et cetera, we are always suspicious genuinely that that sensitive information that is the most important information for us could be gotten through to the general area because we are in competition. The aluminium industry is a price taker, not a price maker so therefore our operating costs are very, very sensitive and therefore we want to keep as much of that information as private as possible because our competitors would know exactly where we sit on the curve.

Dr JOHN KAYE: So Hydro does not accept the assertion by the Treasurer that the confidentiality agreements signed by those people who have access to the data room are adequate to protect the confidentiality of the data provided by, in this instance, yourselves?

Mr COOMBE: I would say that is correct, yes, at the end of the day, yes.

Dr JOHN KAYE: That is interesting. Can I just go to one other issue, which is where do you go to from here? Well, let me ask you this: as I understand it, you now have two places to look for a future contract, one is to the gentraders and the other is to the publicly owned generators who will continue to trade into the market in the traditional sense. Do you see, for an energy-intensive industry such as yourselves, a complexity associated with that which will reduce your ability to negotiate a new contract?

Mr COOMBE: Not really. I think the issue always is we need a long-term contract and who can provide one. We believed that we had one up until the beginning of November and here we are now trying to rescue that contract, primarily. After spending two years of negotiating you really want to hang on to what you have got; you do not want to start that two years all over again, I can tell you.

Dr JOHN KAYE: I appreciate and understand that concern but in the event it turns out that the controllers, that is the holders of the gentrader contract for the power stations where you thought you were getting your forward contracts on electricity will not deliver, if I am correct, you would then either have to go to the gentrader Eraring, who also owns their own load, or you would have to go to Macquarie Generation, who have signed a contract, ironically on 6 November, with your competitors?

Mr COOMBE: Correct.

Dr JOHN KAYE: Is that a complex situation for you? Is that a situation you would find difficult?

Mr COOMBE: Not really; it is an issue that I have to try to seek a power contract to give the longevity and the sustainability to the smelter at the end of the day, but the problem I have is that having spent two years negotiating, I do not want to throw that two years away because, as Alberto said, as you get closer and closer to the end of your existing contract you start to make decisions and these negotiations—it is not a standard contract like you go to your energy supplier and sign a bit of paper. It does not happen like that. These are quite complex and quite detailed negotiations and, as I said, they are two years usually in the making so I do not really want to spend another two years negotiating if I can actually secure a long-term contract with what I believe my existing contract that I had signed—

Dr JOHN KAYE: But your existing contract is with Delta Electricity?

Mr COOMBE: Correct.

Dr JOHN KAYE: Delta Electricity, as far as its front end to the market, is only half the body it used to be because half of its power stations, half of its capacity to generate is now no longer controlled by Delta Electricity; they could not sign a contract in respect of those power stations?

Mr COOMBE: I am not here to answer for Delta Electricity; I am only here to answer for Hydro Aluminium.

Dr JOHN KAYE: I completely understand that.

Mr COOMBE: Therefore, I am only really interested in making a contract with Delta. I already have an existing contract with Delta, which will go to 30 June 2017 and I would like that contract to be extended to 2027.

The Hon. TREVOR KHAN: And, indeed, you still may have a binding contract after that date?

Mr COOMBE: Most likely, I hope.

The Hon. TREVOR KHAN: As a matter of law.

CHAIR: Thank you for answering the questions. We appreciate your cooperation with the inquiry.

The Hon. LUKE FOLEY: The Government does have questions. Thank you, gentlemen, for appearing. I took the opportunity to question Treasury representatives who sit on the Energy Reform Group's Steering Committee about why they have treated your company like this and I do not think they shed much light on the reasons why. Could I put to you what I put to them that could it be that Tomago was allowed to proceed with its contract with Macquarie Generation whereas Delta was not allowed to proceed with its contract with Hydro because Tomago's parent Rio Tinto is a far larger player on the global scale than your company or its owners? Would you care to comment on that?

Dr JOHN KAYE: A bigger campaign donor to Labor.

The Hon. LUKE FOLEY: John, pipe down. If you had your way every aluminium smelter in the country would be shut tomorrow so don't start.

Mr COOMBE: I have no real comment on that. Really, it is for either Rio Tinto or Tomago to answer those questions.

The Hon. LUKE FOLEY: Can we turn to the future—

Mr COOMBE: Yes.

The Hon. LUKE FOLEY: —taking up from Mr Kaye's questions. Mr Chairman, I would like to table a news release from the Premier of New South Wales dated today and take the witnesses to it, if that would be acceptable to you?

CHAIR: Do you have copies for Committee members?

The Hon. LUKE FOLEY: Yes, I do.

Document tabled.

The Hon. LUKE FOLEY: If I could perhaps read from it and you will get a copy in a minute:

Thursday 10 February 2011

Premer Kristina Keneally today vowed to do everything in her power [to] protect jobs at Kurri Kurri's Hydro Aluminium Smelter.

The Hon. GREG PEARCE: Bit late.

The Hon. LUKE FOLEY: —

Ms Keneally today confirmed the NSW Government has written to Macquarie Generation regarding last week's cabinet decision to rule out further privatisation of electricity assets.

"The NSW Government has made its position clear - there will be no further energy asset sales," Ms Keneally said.

The Hon. TREVOR KHAN: Is this instead of her giving evidence, Luke—

The Hon. LUKE FOLEY: —

"That decision clears the way for Macquarie Generation to enter into negotiations with the owners of Kurri Kurri's Hydro Aluminium Smelter for a new electricity supply contract.

"I encourage both Macquarie Generation and Hydro Aluminium to work quickly towards a mutually beneficial agreement.

"And let me be absolutely clear on this: I vow to do everything within my power to get these parties to reach a deal.

"This company has made a long-term contribution to NSW - and I thank them for their ongoing contribution to the Hunter Valley's economy and jobs in the region.

"With the completion of the energy reform process, the negotiation process can now begin again.

"The NSW Government has always supported job growth and security in the Hunter - that's a proud achievement we share with Hydro Aluminium.

The real threat to any future deal and therefore the job security of Hydro Aluminium's workforce is Barry O'Farrell's refusal to reveal his plans for [the] future of the remaining state owned electricity generators.

The Hon. GREG PEARCE: Is this serious or a joke?

The Hon. LUKE FOLEY: Mr Coombe, could I ask you, do you see a contract for a period beyond 30 June 2017 with Macquarie Generation or another generation company?

The Hon. TREVOR KHAN: Point of order: This is clearly an ambush by the Labor members.

The Hon. LUKE FOLEY: I am asking a question.

The Hon. TREVOR KHAN: It is clearly an ambush. It would be my point that this hearing should be adjourned at this point.

The Hon. LUKE FOLEY: You do not want the company fixed? We are trying to get a solution, Trevor, not grandstand politically. We are trying to get a solution for this company.

The Hon. TREVOR KHAN: What I don't want to see is, Luke—your blokes have stuffed up this deal from the start—

The Hon. LUKE FOLEY: Mate, I raised it here, you didn't. You didn't say a word.

The Hon. TREVOR KHAN: Your blokes have stuffed it from the start.

The Hon. LUKE FOLEY: I drilled Treasury about it; you didn't say a single word.

CHAIR: Can you all just be quiet. We have a point of order.

Dr JOHN KAYE: Point of order: My point of order is that I cannot hear the point of order.

The Hon. TREVOR KHAN: These witnesses should be given an opportunity to consider—

The Hon. LUKE FOLEY: On the whole that they might be fixed up; you wouldn't want that, would you?

The Hon. TREVOR KHAN: I absolutely do.

CHAIR: Let Mr Khan finish his point of order.

The Hon. TREVOR KHAN: These witnesses should be given the opportunity to go out of this room and consider this media release. They have not been provided with any communication from the Government up until you provide a media release. It is not appropriate for these witnesses to potentially be commercially damaged by your stunt.

The Hon. LUKE FOLEY: I want to ask them a simple question.

The Hon. TREVOR KHAN: They should have an opportunity to consider their position further before this hearing proceeds.

The Hon. LUKE FOLEY: I asked a simple question.

The Hon. TREVOR KHAN: It is just outrageous.

CHAIR: I think it is an abuse of the procedures of this Committee to drop this document on the Committee and also on the witnesses.

The Hon. LUKE FOLEY: It came out this morning.

CHAIR: As we have had a point of order, I am happy, as Chairman, for you to continue answering questions as to whether you feel you are in a difficult situation and you do not wish to continue or we can continue and after you have considered this information, you may wish to give us another submission in response to what the Premier has said because there may be still relevant information we should get from you today while you are here. I do not want to waste your time by terminating your appearance before the Committee.

The Hon. LUKE FOLEY: To the point of order—

The Hon. GREG PEARCE: He has already ruled.

The Hon. LUKE FOLEY: I have not asked my question yet. I have one question—one question only of the witnesses. I would be more than happy for them to go away, consider the company's position and make further submissions to the Committee. I would be more than happy. I am the one member of the Committee who raised this issue with other witnesses.

The Hon. GREG PEARCE: No, I raised it before you did. Read the transcript.

The Hon. LUKE FOLEY: I think it is only fair that I be allowed, having heard all the other questioners in silence, to ask one question. It is only fair, Mr Chairman.

CHAIR: I make it clear to the witnesses, as this is new information, that you may reserve your right to answer the question until you have discussions with your board.

Dr JOHN KAYE: I move that we have a five-minute adjournment.

CHAIR: We will adjourn for five minutes.

(Short adjournment)

CHAIR: As the witnesses have returned we will resume the hearing. Are you happy to proceed with the question that Mr Foley was asking?

Mr FABRINI: Yes.

The Hon. LUKE FOLEY: I simply want to ask if you see a contract for a period beyond 30 June 2017 with Macquarie Generation or another generation company as a real solution to your plight and a real solution to securing the future of Hydro Aluminium Kurri Kurri Pty Ltd?

Mr FABRINI: Thank you for the five-minute break. We believe that we have a legal contract with Delta and also that we have a legal contract for the extension; however, we would be willing to discuss further possibilities for the future. One thing that is very important is that time is of essence. We saw here that the Premier mentioned that she would like to see this resolved quickly, which is positive. That is basically our position for now.

The Hon. LUKE FOLEY: Thank you, gentlemen.

CHAIR: As you have said you wish to persist with the contract that you had with Delta. You worked for two years to get a final contract and you have signed the contract. But Delta is now privately owned and that energy reform committee no longer has any authority to issue them directives. Is there any way for you to recommence negotiations with Delta now to sign the contract? What action have you taken to do that?

Mr COOMBE: As I said earlier I phoned Greg Everett, the CEO of Delta, earlier this week and advised him that as far as I was concerned the contract that we had signed for the extension was legal and binding and I asked him now that the reform process had stopped would he now mind signing the contract. He said that we could have some serious issues with regards to reliability because the only generating capacity that Delta now owns is the coastal ones and they are not as reliable. But certainly I raised it with him that it is still a viable—not necessarily viable but certainly an opportunity and an option for us to discuss this matter with him. It is not the best outcome.

CHAIR: He may be in a position where he cannot supply perhaps the full—

Mr COOMBE: Correct.

CHAIR: —amount of power that you require?

Mr COOMBE: Correct.

CHAIR: That would require some adjustment to the contract.

Mr COOMBE: Yes.

CHAIR: But you would be prepared to negotiate if necessary.

Mr COOMBE: We need to have a power supply that gives us the full volume of power that we need. We do not like to have bits and pieces. For us it is about the reliability of the power supply. That is really where the problem will be.

CHAIR: If Delta cannot guarantee that now—

Mr COOMBE: Correct.

CHAIR: Then you may be forced to have two sources of power or re-negotiate with one large supplier?

Mr COOMBE: Correct.

CHAIR: Such as Macquarie?

Mr COOMBE: Correct.

The Hon. GREG PEARCE: In terms of the risk to the State and the liabilities left over from these transactions, we now have to add to the Cobbora Coalmine and add to all the other things the liability to supply your contract? Potentially Delta—

Mr COOMBE: Potentially.

The Hon. GREG PEARCE: If your contract is still valid and you say it is?

Mr COOMBE: Correct, yes.

The Hon. GREG PEARCE: Then Delta has the liability now, the Government, the people of New South Wales still have the liability to actually supply your electricity, which could be I assume several hundreds of millions of dollars per year?

Mr COOMBE: Correct.

The Hon. GREG PEARCE: Added on to the other liabilities that have been associated with this deal?

Mr COOMBE: Correct, yes.

CHAIR: You obviously worked very hard to get that contract. You said you worked for two years.

Mr COOMBE: Yes.

CHAIR: Do you think that underlying this delay or collapse is a desire to re-negotiate the price? That you actually did get a good deal and that is what is underlying this whole hesitation now in proceeding?

Mr COOMBE: Mr Chair, I would love to renegotiate the contract because I would like to have a lower price.

CHAIR: I know but I think the suggestion is that they want to renegotiate it upwards?

Mr COOMBE: Remember that with the deal that we did for the extension both Delta and ourselves believed it to be commercial. There was no doubt in anyone's mind at the negotiation table that the deal that was done was commercial in all regards.

CHAIR: It was good from both points of view: the supplier and the purchaser?

Mr COOMBE: I would say it was the deal that we did; I am not saying we are so happy about it but certainly I do not believe that Delta has got a problem with it.

The Hon. TREVOR KHAN: But there is no guarantee that Macquarie Generation will take the same view as Delta? That they would supply on the same terms as Delta? You do not know.

Mr COOMBE: The issue with Macquarie Generation is a brand new issue. I read the press release just a few minutes ago and that is the reason why we had the five-minute adjournment to work out what we would like to do because it is going to be a new exercise and, as Alberto said, timing is of the essence really here. These things take a long time.

The Hon. TREVOR KHAN: The first you know that a contract that is worth hundreds of millions of dollars is to be re-negotiated with another electricity supplier is when you are handed a media release by somebody from the government side?

Mr COOMBE: Yes.

The Hon. TREVOR KHAN: Is that how your company normally does business?

Mr COOMBE: No.

Dr JOHN KAYE: Mr Coombe will you take on notice the following question?

Mr COOMBE: Yes.

Dr JOHN KAYE: That media release was put out at 10.48 a.m. this morning, as I understand it. Had your company received any communication from the Premier or the Treasurer or the energy reform group in respect of the statements made in that media release?

Mr COOMBE: No.

Dr JOHN KAYE: You know for sure that prior to 10.48 a.m.—

Mr COOMBE: No.

Dr JOHN KAYE: —you had not been—

Mr COOMBE: No.

The Hon. TREVOR KHAN: Does the term "Keystone Cops" ring a bell?

CHAIR: You have indicated you have all these plans for maintenance, investment development and so on and that is on hold now, what time limit is there for you to have certainty? Do you need to have certainty within a month, two months or three months? The reason I am asking you that question is that you know that we are facing a State election on 26 March.

Mr COOMBE: Yes.

CHAIR: And that press release could be a worthless piece of paper.

Mr FABRINI: Yes. In terms of modernisation there is no project going and there will not be any project going as long as we do not have the contract—no project for future investments will go until we have the contract signed, and for a very simple reason: we cannot invest the money if we do not have a guaranteed long-term vision of at least 20 years, around 20 years. So it will not go. In terms of maintenance, we are keeping our normal maintenance at this moment. We re-evaluate on a quarterly basis and we do that also in comparison to the other companies of the corporation. On a quarterly basis we evaluate and we take decisions moving forward. This is how we operate at this moment.

CHAIR: It is clear that the Hunter Valley desperately needs all the investment it can get, and jobs made available to the workforce. So there are now $130 million in doubt that may not be invested in that area unless your company can get some definite assurance that it can proceed.

Mr FABRINI: Correct.

CHAIR: I hope that by having you appear before this Committee it has given the Government a jolt, which is the reason for the media release—

The Hon. LUKE FOLEY: An electric shock!

CHAIR: A jolt to try to force it to seriously examine your predicament. It is a small beginning but I hope it brings about success for your company, which has made a great contribution to our nation through its work and its employees as well. We thank you for your faith in Australia and what you have been doing. That faith should be rewarded with cooperation by governments, Delta Electricity and other suppliers of power.

The Hon. GREG PEARCE: May I clarify one point? This Committee has uncovered the fact that, after taking out all of the liabilities, the coalmine and so on, this deal has probably yielded the people of New South Wales about $300 million. What you have told us today is that if your contract with Delta has to be honoured, even that few hundred million dollars might go down the drain as well.

Mr COOMBE: Yes.

The Hon. GREG PEARCE: That is leaving aside the damage to the Hunter from lack of jobs and loss of investment?

Mr COOMBE: Yes.

CHAIR: Thank you, and may you be successful in the future.

(The witnesses withdrew)

HUGH OUTHRED, School of Electrical Engineering and Telecommunications, University of New South Wales, on former oath:

CHAIR: We thank Professor Outhred for agreeing to appear before the Committee again to give us a further update. The Committee wishes to hear your response to more recent developments in the power industry and the failure of the Macquarie gentrader offer to proceed with no tenders. Do you wish to make an opening statement?

Professor OUTHRED: Perhaps just very briefly. I think the decision not to proceed with the remaining sales creates an opportunity, of course, for Parliament to rethink the future of those particular power stations without encumbrances, and that is obviously, I think under the circumstances, a positive thing. However, of course there is a negative and the negative is to do with the sales that have already been made. So the future of the remaining power stations cannot be considered without taking into account the changed circumstances in which they will be operating. I think I will stop at that point and just leave it to questions to explore the issues.

The Hon. GREG PEARCE: Thank you again for coming in. As has been expressed before, the Committee is very grateful for your expert advice to us on these issues. What are the implications of having the gentraders on the one hand and the other generators still in State government ownership?

Professor OUTHRED: Given the present ownership structure of particularly the Delta portfolio, that now really has two parts to it. For one part, the western part of the portfolio, the board of the company presumably—assuming it all remains within one company—that is in charge of those assets for Delta West has an asset management role now; whereas for the remaining part of the portfolio, which is usually called Delta East, it really has to operate a full business with those assets. So it will still be undertaking the electricity trading, still undertaking fuel purchasing and making all decisions about those units. So as a practical matter if that situation is to continue, it may be worthwhile actually splitting that portfolio into two parts just to clarify the tasks the boards have.

Because of the reduced size of the full business—in other words, it is now Delta East, not Delta total as it was before—it will be a riskier business than it was before because it has fewer physical assets to operate and there will be less diversity with respect to breakdowns. There will be smaller volume of fuel to buy. There will be other issues of that type that will generally increase the costs of that particular full business compared to if the previous version of the full business which had the larger portfolio. So, roughly speaking, that would be the changes I would see for the Delta portfolio.

For Macquarie Generation it is another story of course. It remains as a full trading business as it did before. It is a very large business in the sense that it has a very large amount of generating capacity in the portfolio as well as a development site. But in terms of how that business is to be operated, there are now two kinds of complications. One would be the unresolved future for the business in the sense that Parliament had previously decided on a gentrader strategy and what will the new Parliament decide? What will future Parliaments decide? So I suggest there would be a new significant uncertainty there with respect to the intentions of the owners of the business. Secondly, in terms of the market into which it is operating an important part of the operation of the business—and this applies also to the remaining part of the Delta business, Delta East—is derivative trading.

Now the counter parties for generators for derivative trading are primarily the retailers. Having sold the retailers—EnergyAustralia, Integral Energy and Country Energy—that process has created three dominant retailers on the buying side: the new Origin Energy portfolio, the new TruEnergy portfolio and the AGL portfolio. Apart from that, according to the latest figures I have seen from the March report last year of the Independent Pricing and Regulatory Tribunal, there is only about a 6 per cent market share for the remaining retailers. So essentially it is a triopoly that would be on the other side of the market. That will probably tend to suppress the derivative prices that Macquarie Generation would be able to attract compared to a previous situation where there was probably more open competition because there were the three State-owned retailers plus the private retailers—the previous versions of Origin and Tru and AGL—all competing for market share. So I would suggest that probably the cashflow, the income that Macquarie Generation can achieve now, has probably reduced compared to its previous circumstance.

There is the other complicating factor, which is: What do we make of the new coal arrangements? What is not clear—well, the concept as it is available in the public domain was that the new coal facility that is to be constructed and operated by the Government was to offer coal to the various owners of the buying side, if you like, of the gentrader contacts. How that is affected by this situation is hard to say. Does that mean, for example, Macquarie and Delta East now have to, as it were, fend for themselves in terms of acquiring coal? Do they get some share of that new arrangement? I do not know, but that is an important question. If they do not get any share of that arrangement then they will be faced presumably with higher coal costs because it certainly appeared that that arrangement would end up with coal prices lower than the general market. So they would then see, presumably, higher costs compared to the power stations that are operating under the gentrader agreements. So all of that would seem to imply that the financial future for the remaining assets will be less desirable than it would have been before the process commenced.

Now on the positive side, as I said, what we have got is a situation where at least there is a clear-cut possibility for the new Parliament deciding what to do with those assets. One option that really does not seem to have received much consideration is the climate change question, which I discussed in my earlier submissions. I just repeat more or less what I said then: sooner or later governments will have to take climate change seriously. When they do, one of the most important options for New South Wales is a strategic, planned, careful retirement of the existing coal-fired power stations. That is one of the most important options available to New South Wales to make a contribution to reducing climate change emissions. So if and when Parliament decides to do that it does mean that there are not encumbrances over Macquarie Generation assets or over the Delta East assets.

The Hon. GREG PEARCE: Professor, one of the issues that we talked about last time you were here was the Owen report—and thank you for your supplementary submission. I want to check that I have this right because it is very hard, to be honest, to read the statement of opportunities documents that are produced by the Australian Energy Market Operator [AEMO]. But my understanding of the last report is that the low reserve condition point in New South Wales based on existing and committed generation has moved out now from 2014-15 to 2018-19. Is that correct?

Professor OUTHRED: Well, all I can do of course is read the report. If you really want a definitive answer you should ask AEMO about that directly, but that is how I understand it.

The Hon. GREG PEARCE: Of course. That means if the proposed generation is taken into account there is sufficient supply available beyond 2018-19.

Professor OUTHRED: Yes. Also an important point to make is that in those assessments AEMO is concerned with the ability to meet peak demand so it is not really concerned about the type of generation that is available to do that. The base-load generation is the most capital intensive form of generation that we have, apart from some of the renewables. But if we leave those out and just talk about fossil fuel generation, if there is an emerging problem with meeting peak load, the first response is to build much cheaper plant, which is combustion turbines. The lead time for that should be no more than two to three years, depending how much preparation has already been done by potential proponents.

The Hon. GREG PEARCE: To summarise, according to the Australian Energy Market Operator and your expert advice, there is no looming crisis in supply before 2018-19?

Professor OUTHRED: Absolutely not.

The Hon. GREG PEARCE: To summarise your earlier evidence, instead of de-risking the energy market in New South Wales you see that the outcome for Delta East—or Delta Coast, as I think it is actually called—is greater risk for that company, which has continued to remain in Government hands, that with the sale of the retailers Macquarie is likely to have reduced income and is more exposed at the derivative trading? Yes?

Professor OUTHRED: Yes.

The Hon. GREG PEARCE: Further, both Delta and Delta Coastal or Delta East and Macquarie are further exposed to risk in relation to coal supply and the cost of coal?

Professor OUTHRED: Possibly, yes. We do not know, or I do not know, how that will be dealt with.

CHAIR: I would like to clarify an answer you gave a moment ago. You referred to retiring the coal-fired power stations. What would they be replaced with—gas or nuclear power?

Professor OUTHRED: A range of options would be possible. However, the most important thing from a climate change point of view would be to replace them with a lower emission option; in other words, one that produces fewer CO_2 emissions per unit of energy generated. The options available would include gas-fired generation—for example, combined cycle gas turbines; renewables of various forms, such as wind, solar and perhaps biomass; and, as you pointed out, nuclear energy, subject to government policy.

The Hon. GREG PEARCE: With those additional risks to the government-owned assets and the overall transaction completed to date with the sale of the retailers, what is your outlook for future electricity prices given all of those factors?

Professor OUTHRED: We need to separate two things. The risks that the individual businesses are exposed to may or may not flow through to purchase of electricity. In a sense they are slightly decoupled ideas. We do know that very significant additional costs are being incurred that are very likely to cause electricity prices to rise whether or not we have the privatisation process. Those are because substantial investment has been approved by Australian Energy Regulator into both distribution and transmission networks. You can read about that in the reports from the Australian Energy Regulator. There are also, anecdotally at least, reports in various places of increasing capital costs associated with most forms of electricity generation due to international competition for their fundamental inputs such as steel, concrete and skilled labour. Of course, as well as that we see a trend towards rising fuel prices for internationally traded fuels such as coal and, looking to the future, gas. As a result, there are many inbuilt pressures that are very likely to increase costs.

It is unclear to what extent the privatisation process could or would reduce the cost seen by consumers because, first, those private companies would have to identify greater efficiencies than the prior owners and, secondly, they would have to be willing to pass them on to the consumers if any savings arise. They will pass them on to consumers only if there is adequate competition. If there is not adequate competition, why should they do that? They will keep the profits. They are the sort of things we need to look into. As I said last time I appeared, given the nature of the privatisation process in New South Wales and the way that the transactions have now been set up, it is unlikely that they will have the effect of increasing competition. Large players already in the industry have acquired the gentrader rights and retailers that have been sold and, therefore, the transactions that have been made do not of themselves increase composition. Rather, they tend to reduce it.

The Hon. GREG PEARCE: So, in your view the transactions as they have occurred will tend to reduce competition?

Professor OUTHRED: Yes.

The Hon. GREG PEARCE: Can you give us any guidance on the retention values of the assets that may now be with the State? Has there been an impact on that? Do you believe that the methodology used by Treasury to get retention values for the sale process is acceptable? Do you have any comment?

Professor OUTHRED: Yes, certainly. Retention value is both a key and a controversial issue. It is also one for which there can only be opinions, not objective facts, because we are talking about a future value. There is a number of different strategies for arriving at an estimate for retention value. One is to look at an estimated replacement cost for a new asset and then at the remaining life of an existing asset compared to its original design life. One would then simply take a fraction of that and say that the asset is now 20 years old and it has another 20 years life and if we were to replace it would cost x and therefore its remaining value is something of the order of x divided by two, or a little less allowing for the fact that in the second half of its life it will not be as useful as it was in the first half. That is a generalisation. Of course, some of the important assets that have been sold have different remaining lifetimes. However, if we worked that way, we would end up with estimates of about 40 per cent of the replacement value. That would tend to place the replacement value, according to the estimate that I ventured last time, probably about three times what it appears that they have been sold for. So, working out retention value that way, we would come to a position that the assets have been sold for something like one-third of their retention value calculated in that manner.

Another way of calculating retention value is to apply the type of calculation you might use if one owned, for example, a hotel. You would look at the occupancy rates and try to estimate what they would be in the future and what you might be able to charge per room and thereby estimate the future income stream and then discount that back to a present value and then say what the asset is worth is what the discounted future income stream amounts to and then subtract costs and so on. That is the way that the Treasury seems to have undertaken the calculation according to the evidence that I have seen.

If you are going to do that then the analysis is typically done using what is called a "discounted cash flow analysis". The critical question is the discount rate used. If you use a discount rate of zero, you add up all the future income streams and you get a number. Normally economists would say that you should not do that; you should use a discount rate above zero. The higher the discount rate used, the more you are tending to discount or ignore the future income and you are looking at a shorter window of time. This comes down to a common type of criterion used in private industry, which is just payback time. A private company might have an investment criterion that says it will invest in something only if it will pay back in three to five years. That would be typical a payback time for a large industry. If you did the calculation with a zero discount rate, you would get a much higher value than if you used a payback time concept.

The third issue is again coming back to the climate change question: Are we talking about a carbon future that is unconstrained—that is, we do not care how much carbon we release—or a carbon-constrained future? As far as I can see from the evidence, Treasury has not considered a carbon-constrained future. I may be wrong; it just was not discussed in the evidence and my assumption therefore is that it did not do that. If it did look at a carbon-constrained future, it would be more or less equivalent to going to a higher discount rate. In other words, you would say, "In the not too distant future we will have to stop using this asset because it produces so much carbon." Then you would reduce the asset value. In a carbon-constrained future, you might say that the price that has been achieved is about right because these things may have only a few years of life left before rules and regulations come in that prevent them operating or apply such a high tax or permit purchase requirement that they are no longer profitable to operate. You can see how we can come up with almost any answer we want.

The Hon. GREG PEARCE: And they did.

Dr JOHN KAYE: You referred to a "carbon-constrained future" and said that the value of the power stations or value of control over the power stations is reduced. That appears not to be consistent with an earlier answer you gave about phasing out the power stations and the importance of having control over coal-powered power stations and being able to shut them down in a phased and carefully planned manner and to replace them with other forms of energy generation. Would it not be true or could you give consideration to the proposition that the retention value should be adjusted to account for the flexibility that public ownership or public control provides in terms in terms of climate policy?

Professor OUTHRED: That is an important issue. In my submission I referred to the option-value approach, which would certainly look at that. The option-value approach extends the discounted cash flow approach to try to provide a systematic method across all scenarios and all possible uses of the asset. It is correct to say that in the presentation I just made I did not raise an important point. In a carbon-constrained world, from the point of view of the owner of the asset it is simply an internal commercial decision as to when to stop using the asset or when to walk away from it. There is a lot of grey about when they would actually do it. However, from a societal point of view, given what we call the essential nature of electricity and the need to try to avoid blackouts, we would actually like to have a much clearer and predetermined retirement strategy that clearly took into account the public interest.

One of the weaknesses of schemes like carbon taxes or permit trading is that they do not really clarify when the retirement will take place. In other words, they do not truly take into account that aspect of the public interest. So, as I said in my initial statement, one of the benefits of not having sold all of the generation assets is that the New South Wales Parliament now has full control over when those assets are retired, if that becomes formally part of a climate change response strategy. That is an important value because it allows you to have much greater control over the reliability of supply question. Obviously, if you have a preannounced and clear-cut retirement strategy, that makes it easier for private investors—if you are relying on them—to plan to commission new power stations in a manner that will fit in well with the strategy. From a business point of view, a private owner would tend not to release a proposed retirement date in the public domain because the uncertainty has commercial value to the person who has the knowledge about when that retirement will be. To be able to gain that can certainly create problems for your competitors. Therefore, the uncertainty becomes a business asset in its own right. It is that sort of value that perhaps Dr Kaye had in mind.

Dr JOHN KAYE: Thank you for that. I refer to the issue you addressed with regard to Delta Central and Macquarie Generation. You outlined a number of reasons for a decline in the public value of the power stations in this quarter-privatised electricity industry. Can you also address the situation faced by Macquarie and Delta and the residual public owners of Delta where they are trading electricity into a market where their competitors own, by my calculations, about 75 per cent or 80 per cent of the load?

Professor OUTHRED: Yes. As I indicated before, I think the practical outcome would be that they would not be able to achieve the same cash flow from derivative trading that they would have in the prior state. That is what my statement was aimed at conveying. It is also important to note that the purchasers of the retail assets, plus the other major players—that is, AGL, Origin and TRUenergy—are in the business of building peaking capacity. That gives them additional flexibility in terms of their risk management in the spot market, or cash flows associated with that. Presumably they would design their business strategy through being able to consider the option of either entering into derivatives with the remaining fully State-owned generators or building their own peaking capacity or other means of managing the peak price risk. As a result, I suspect that the fully State-owned businesses would not be able to achieve the same revenue through derivatives that they might have in the past; in other words, they will become less profitable.

Dr JOHN KAYE: In other words, they have been thoroughly Cinderella-ed.

Professor OUTHRED: I am not sure whether Cinderella had that problem. I think it was more like a shoe problem, wasn't it?

Dr JOHN KAYE: I will turn briefly to your supplementary submission in which you refer to the Owen inquiry. I appreciate your having addressed a question on notice regarding the Owen inquiry that I had put you verbally during your previous appearance at the inquiry. Would it be fair to summarise your supplementary submission as stating that the Owen inquiry does not provide a valid underlying reason for the current power transactions?

Professor OUTHRED: Yes. I think the Owen report, or the report from the Owen inquiry, had important witnesses with respect to what seems to be the key question—that the Government was interested, given its later statements; in other words, the privatisation process. The way in which it seems to have been used since that time in the Government's policy statements to me is not consistent with the material that was presented through the Owen inquiry process. In particular it is this issue of the criticality of selling the existing assets. I think that was an overused claim.

As I stated in, I think, my earlier evidence, from my point of view ownership is not the key issue in achieving a competitive market outcome. If you have private owners, you have a certain set of problems to manage. If you have public owners, you have other problems to manage. There is no simple "one is good" and "one is bad". In the case of private owners, what we find in any market situation is that the private players will try to influence government policy and they will try to influence market rules. They will do one thing or another to try to improve our financial outcomes. In the case of, say, the State-owned assets, the State governments themselves, as representatives of the people, often get confused between the two roles they have; one as equity owner, and the other is protector of the broad public interest. So either way, you have the challenges to solve.

Dr JOHN KAYE: It would be fair to say, would it not, that the Owen inquiry failed to examine the difference between base load power and peaking power and failed to account for the Australian Energy Market Operator [AEMO] forecast being really about a peaking power problem, not a base load problem?

Professor OUTHRED: The inquiry was about more than just that issue. I think here I would like to distinguish between the inquiry process itself and some of the evidence that was brought forward on the one hand and the final report on another hand, and then the way the report has been used since. There are three separate issues here. The way the report itself was written tended to focus on certain issues which were a subset of the total issues it might have addressed. As a result, it certainly did not discuss some of the issues that I would have liked a report on, if I had been running the inquiry. In terms of the actual and language used in the report about issues that it did discuss, I would have used different language about those issues. But, as you can see, I am not really wanting to get into a blow-by-low criticism of that report, for fairly obvious reasons. One of them is simply that that is now historical and I think we have to deal with what we are facing now.

Dr JOHN KAYE: Although, of course, you would have heard evidence given by the Treasurer, the Premier and the permanent director of Treasury that they were relying on the Owen inquiry report to justify the gentrader transactions. It is still true that that report has life in this debate.

Professor OUTHRED: Yes, and it may be that if that issue is really material to the report from this inquiry, then I think a formal assessment of the Owen report and the process would be the way to go rather than, if you like, a piecemeal picking out of individual issues. That may be something that the Parliament chooses to do, but I think it should be that—a formal assessment of the totality of the exercise, rather than picking on individual pieces.

CHAIR: One of the issues that came up during our inquiry and became a revelation was that the Government boasted its success in selling off the gentrader rights for $5.3 billion but omitted to mention that it had to spend what could be $1 billion in developing the Cobbora coalmine as well as providing subsidies for that coalmine. When we questioned the Treasurer he said, "We didn't bother deducting that $1 billion from the $5.3 billion because we are going to sell it at some future date and therefore it is still worth $1 billion." Do you think the Government has made a miscalculation of the value of the coalmine in 10 or 20 years time, in view of the whole question of carbon and the impact of a possible carbon tax? Would there be many people who would want to buy a coalmine in 10 or 20 years time and pay $1 billion plus the interest increase over that period?

Professor OUTHRED: That is a very important question. Unfortunately, if you read more broadly what people are saying about investment in electricity generating capacity throughout Australia and in other countries, all of the investors now are saying that their hands really are tied until societies come to the landing on whether or not to try and do anything about climate change. It really is a critical issue. Unfortunately, societies—and this of course applies at the individual level as well as through parliamentary processes and so on—are all conflicted on this issue. I am conflicted and everyone else is conflicted.

I have just come back from teaching a two-day course in Melbourne, Victoria, for a Victorian public authority of the Victorian Government where exactly the same issue came up. It comes up in all the work I do now. We will have to make formal social choices about this because all that any private investor is trying to do is make a profit within the rules of the game. Society sets the rules of the game. If we leave aside the genuine crooks, who really are just looking for loopholes in the law, and if we stick to what I call legitimate business, what legitimate business needs is a clear-cut set of rules and it needs to cover the investment time frame. That is unfortunately where we are now at.

I sympathise with all of the conflicted organisations—whether it is Parliament or whether it is private companies or whether it is individuals. We are all conflicted around this, but somehow we are going to have to get away from this; otherwise, we will have problems going wrong in our society. It will just be the choice of one kind of problem or another. At the moment the kind of problem we have, if we just speak about electricity, is that no investor has a clear idea about what the best technology options are or what the best fuel options are. No-one does. Nobody can value a coalmine in a 10-year time frame. Everyone is just taking a punt on that.

CHAIR: So in a way it is misleading for the Treasurer to say that we would recoup that value and therefore deduct it?

Professor OUTHRED: Yes. He may be right, or he may be wrong. It is like me betting on a horserace at this stage. With my skills in horseracing, that would be a pretty random outcome. Maybe the Treasurer has better skills than I do.

CHAIR: Professor, have you been able to determine where Macquarie Generation and Delta Coastal access their coal? Are there any subsidies built into those arrangements that you are aware of?

Professor OUTHRED: No, I do not have knowledge about their particular contractual arrangements. These are normally regarded as commercial-in-confidence matters, but certainly the general scuttlebutt is that existing long-term contracts that they may have had are coming towards a close—not necessarily all at the one time—and that they will be needing to enter into new contracts for coal.

CHAIR: Do you see any advantages to the two corporations with a gentrader contract also having a retail arm?

Professor OUTHRED: I think we need to separate out the interests of the owners of the assets from the owner of the gentrader trading rights. The owners of the trading rights, assuming the purchase goes through to completion, are Origin Energy and TRUenergy. I guess they are now the owners of the gentrader rights that have been sold. Again we cannot be entirely sure about this because we are short on facts in the public domain, but it appears as though they are probably going to get a good deal. The risks probably have been asymmetrically placed, so to speak, with the owners of the assets with respect to risks associated with future ability to meet contractual obligations due to physical performance or poor physical performance of the plant. That seems to be where the main uncertainty lies. The other uncertainty—

The Hon. GREG PEARCE: That is still the Government?

Professor OUTHRED: Yes, that is still the Government. That is the asset owners. Also, as I understand the arrangement, they remain responsible for ongoing maintenance. We do not know to what extent the commercial arrangements that have been set up adequately cover the costs of ongoing maintenance, taking into account the fact that maintenance costs tend to escalate through the lifetime of the generators. Certain items of equipment start to fail. It can be uncertain just what the replacement cost are because partly that has to do with the amount of damage that might be caused if an item fails. The example I used before is the Qantas A380 aircraft. If you have an engine explosion that goes out through the casing, then significant additional damage is done beyond replacement of the part. There are those sorts of uncertainties in it. What we do not know is how well they have even taken into account in the contractual arrangements that have been set up.

CHAIR: Through previous witnesses, we saw how it now has become very complicated by having half-privatised and half-public ownership. Do you believe that a future Government should pursue the sale of Macquarie Generation and Delta Coastal to have it all in private ownership rather than fifty-fifty?

Professor OUTHRED: I think there is a hard choice to be made. There is the sale choice or what I would call the retention and staged retirement choice. Those to me are the two key options that are available. They both have their strengths and weaknesses. It really depends on addressing that broad climate change policy question that we have already discussed. That is really the key issue. Ideally that decision would be made prior to making the choice as to whether to sell or retain the assets. You could still go down those two paths, sell or retain, having made such a decision. For example, if a decision was made about firm retirement dates, those could be built into the sale contract. I think what would be a mistake now would be to go ahead with sales without a full and thorough consideration of climate change response strategy.

The Hon. GREG DONNELLY: Professor, I wish to return to a question I asked at the previous hearing. I wish to revisit it to obtain some clarification. To refresh your memory, I mention that I was asking you a question about the location of base load power stations. I will read your answer and ask you to comment further. I was asking you the question about the location and you said:

> It is a little more complex than that when you observe what governments do in practice. Most governments have regional development policies, other concepts about utilising resources within their state borders and so on, which mean that they still retain a legitimate interest in related matters. So they do have an interest in seeing large projects going to regional areas. But in deciding whether to give preference to a project of that type—

that is, a baseload station—

> they should not be thinking about that purely as an electricity generation project. If they were thinking about the project purely from the point of view of electricity generation, they should be entirely indifferent about where it is located through the national electricity market as far as so-called baseload generation is concerned, except for the concern about the possibility of the transmission lines being somehow interrupted or broken.

That is the way you explained it in your evidence at the last hearing. Can you elaborate why you think there is a desire by State governments to have sufficient baseload generation in their jurisdictions to provide, I suppose, a sense of comfort that there is going to be a capacity to supply the persons living in that State or Territory?

Professor OUTHRED: Yes, and certainly that is observable in many countries. With the traditional model under which we used to operate in New South Wales with the Electricity Commission of New South Wales you see the power station serves a number of purposes. Obviously, if we are talking about a coal-fired power station, one is that it creates employment in the coalmines: of course, during construction there is job creation, jobs for the duration of the construction period, and then ongoing employment in the power station itself once it is built. All of those things are attractive to governments on a regional development basis. The other reason it has been attractive in where you have a cheap fuel—whether it be coal or hydro, which is typically what it is—is that it then becomes a basis for negotiating low electricity pricing arrangements with what we call electricity-intensive industry. The classic case of that is the aluminium industry.

In Australia prior to the commencement of the National Electricity Market the State governments of Queensland, New South Wales, Victoria and Tasmania all had electricity-intensive industry development policies. Those typically involved selling electricity at a low price, arguably too low, to the aluminium smelters as part of an overall State strategy. Now that we have created the National Electricity Market and a lot of the assets have been sold, the possibility for having ongoing arrangements of that kind—particularly the low electricity price for an aluminium smelter as an example—is not easily set up in the way it was in the past. In the past the Electricity Commission would have had a total cashflow from selling electricity to everyone in the State and the fact it was receiving less than reasonable cashflow from a relatively small fraction of that, roughly 15 per cent or 20 per cent, you could make up, as it were, by charging a bit more to the rest and nobody would really notice.

Typically, commercial and small industrials were paying more than they should on an economic efficiency basis, but because of their so-called inelastic pricing of elastic customers, it was perceived not to matter too much. That was the strategy. Now with our National Electricity Market arrangements it is less possible to do that. Instead, we have the combination of the National Electricity Market spot market into which generators sell electricity, plus derivative markets. If those derivative markets are open and competitive, then the aluminium smelter has to take its chance along with everyone else. So you would get a different commercial-operating environment.

It would still be possible for governments to continue to operate with an electricity-intensive industry policy if they so wished, but you can see now that the cashflow would have to come more from the State Government accounts, so to speak, rather than being quarantined specifically in the electricity industry, either because, if you were still owning and operating the power stations, you would get less return on assets back into the government accounts or because you were finding some other way of directly subsidising the industry out of State funds.

The Hon. GREG DONNELLY: On this issue of a new Parliament looking to the future, you raised the idea of gas turbine-type generators, wind/biomass and nuclear perhaps being part of a mix of generating power. Were you making that comment in the context of baseload power, peak power or a combination of both?

Professor OUTHRED: A combination really of all assets. For example, we could have a power system that operated using only natural gas, providing there were sufficient natural gas resources available. From that you would be supplying baseload, intermediate and peak requirements. It is possible to do that. It is possible also, of course, if you have appropriate renewable energy resources to do the same thing. Traditionally, for example, until we had the cable across Bass Strait, Tasmania operated as an island and most of the time all of the electricity was generated from water. There are a range of different possibilities here and typically what has been done to date is to try to use the cheapest combination of resources to meet the electricity demand. The problem now with cheapest is that we have things like climate change impacts to consider. So, those issues should be thought about as part of the total cost structure. That tends to change the relativities between the different fuels you might use.

Under those scenarios it becomes less desirable to use carbon-rich fuels and more desirable to use ones that have lower carbon emissions per unit of energy. In general terms that would mean the worst in Australia would be brown coal, which we do not have to worry about in New South Wales, then black coal, which we have got, of course, in New South Wales. So black is better than brown coal; gas is better than coal in this sense; and then renewables and other low-emission technologies, such as nuclear, are better again in terms of your ranking in moving towards lower carbon emissions.

The Hon. GREG DONNELLY: Assume for a moment that we accept the premise of your argument as being correct, to the extent that there is not an established national position that comes to terms with this climate change argument you have presented, in your view, what is the likely impact on the current set of baseload generators operating in Australia, a number of which are coal power fired? To the extent that there is uncertainty at this level, what is your assessment about what is going to happen with those generators?

Professor OUTHRED: If we just look at the way they are operating technically and not worry about the climate change issue for the moment, the existing set of generators on the whole are performing their tasks very well. There are no real obvious problems there.

The Hon. TREVOR KHAN: Does Hazelwood fall into that category?

Professor OUTHRED: As I said, if we leave aside climate change, Hazelwood can keep operating until, like me, it falls apart. For the moment I am leaving aside climate change. The electricity statement of opportunities from AEMO that we referred to before essentially says that and talks about new capacity that would be needed and over time some retirements of those assets as they age and fall apart. That is the unconstrained carbon view. If we are not going to worry about climate change, then we can just let all that continue to run. Climate change comes in because we then need to think of it as a strategic campaign to reduce emissions. Ideally, we would shut down the oldest and dirties power stations first and move in order through towards cleaner ones. That would be the ideal strategy.

In that ideal strategy Hazelwood, which has been mentioned, would be an early retirement. So would some of the older power stations in New South Wales. Munmorah would probably be the first to retire in that strategy. But in that strategy the key thing is an orderly process because the orderly process of retirement is needed to create or to improve the certainty for new investment. Then, basically in any new investment one way or another through policies, carbon pricing or whatever, we want to ensure that any new capacity is low emission. In that strategy, gas is an intermediate position. It is certainly not zero emission, but it is a useful stepping stone towards a lower carbon future.

The Hon. GREG DONNELLY: To the extent that a particular coal-fired generator was slated as one that should be closed because it is a high emitter of CO_2 and actually was owned by private enterprise, how would you envision closing down that generator? What would be the map of dealing with that scenario?

Professor OUTHRED: Of course, the particularities are for the particular business to manage, but in the context of the National Electricity Market, any generator planning to retire is required to notify AEMO—the Australian Energy Market Operator—with sufficient notice of that process. Basically it is a two-year notice. Once it has made the decision, within a two-year window it is required to notify AEMO. That information then gets broadcast to the whole market and allows all potential new investors to plan their strategies to respond to the gap, if you like, that is opening up—that window of opportunity. That is the process. In practice, in New South Wales, of course, the Tallawarra power station illustrates how that works, also the present state of Munmorah power station and the old part of Vales Point power station illustrate that process in action. If we just take Tallawarra, which has now completed the process, the State Government retired the power station, the site was cleaned up and then it was sold to a private investor. That is really a very sensible strategy.

On the site of what used to be an old coal-fired power station we now have a modern combined cycle gas turbine plant and because of the more compact nature of that plant you can actually put more new megawatts onto the site than the old megawatts. It means that you do not have a space problem. You do not have to find space in the State for new capacity because the existing sites can be repowered to a higher power rating than they were before. In terms of the staging, what do you do in the middle once the power station is decommissioned before the new one arrives? That can be picked up by the remaining power stations. It just means that existing intermediate plants will operate a bit more. Also because we have the national grid, power stations in other States can increase their output a bit so that we do not have, as it were, a blackout for the duration of the time it takes between when the old power station is decommissioned and when the new one is built. There will be other facilities in place that will be able to fill the gap.

That is the type of strategy we want, but you can see that to make it orderly a key thing is when is that plant going to retire. That is a key issue. But for a commercial player, if it is previously owned by a private player, they will gain that and use that as part of their business strategy because it is valuable to them because they may wish to re-occupy the hole, so to speak, and make it difficult for their competitors to do so. That is the reason it is better in the broad public interest to have a clear predetermined retirement strategy; that will allow competition, you can then allow private companies to compete to replace them.

CHAIR: It sounds like your recommendation to any future New South Wales government.

Professor OUTHRED: It actually is a recommendation I made to a prior inquiry. You may recall that following the Owen inquiry there was a review and I made a formal submission along these lines to that review process and did meet with that committee and said more or less what I am saying now.

CHAIR: Thank you for appearing before our inquiry a second time and giving us the benefit of your professional knowledge of this issue. We appreciate it very much.

(The witness withdrew)

(Luncheon adjournment)

BETTY CON WALKER, Principal, sworn and examined:

ROBERT GRAHAM WALKER, affirmed and examined:

CHAIR: I declare the hearing open and I thank our witnesses for appearing before the Committee at short notice. We realise you are very busy people but you wrote such a very good submission we thought you should perhaps have the final word as you will be the last witnesses before the inquiry and you have got an overview of the whole inquiry now and all the issues.

As you are aware, at the beginning of each hearing I have read out a statement regarding the Committee and the issue of the prorogation of Parliament, and there are copies of the legal advice from Mr Bret Walker, SC, as well as the Clerk of the Parliament, supporting the inquiry's legitimacy in conducting the inquiry. Just for your benefit, those documents are at the rear of the room. Do you wish to make an opening statement?

Dr BETTY WALKER: Just a brief statement to say that because such an issue has been made of the financial needs of the State and that being one of the rationales for the sale of the electricity assets we thought we would take the opportunity to update a briefing note that we previously submitted as part of the inquiry. I think you may have a copy of that now. There has been further information since we last submitted that submission to the inquiry, so we felt we should update it because the picture presented following the release of further information is that the State is in an even better shape than at the time of the budget in June 2010. So what you will have in front of you is an update, for example, of the budget result, which at the time of the budget was shown to have turned around from a deficit of $990 million to $101 million surplus, but the State finances report, which was released in October 2010 shows an even bigger surplus of close to $1 billion in the State's finances. So we have shown that information.

We also believe that the forward estimates presented for the budget results in the budget paper will be shown to have been underestimated as well. We also updated the information on the gains in general government revenues. You will see, and I will not go into any detail here, but in just one year—the 2009-10 year—there was an increase in the revenue estimated in the budget of almost $3.4 billion. So there was $3.4 billion more revenue in the Government's hands than estimated at the time of the budget. That is just from June to October. That kind of turnaround makes you wonder as to whether other revenue forward estimates are also underestimated. We also updated the issue of debt, which the general government sector as at June 2010 showed debt to gross domestic product a ratio of 2.2 per cent. That compares with the average for the OECD countries of just under 65 per cent. So based on all of that we have concluded certain things which we can discuss, but there are some other updates and some additional information presented in this paper which I will turn over to the professor now.

Professor ROBERT WALKER: Page 6 we start forward with some new information in an effort to address the Committee's questions, particularly looking at what might be the problems arising from the partial sale of energy agencies, that this can lead to additional risks which have not previously been incurred, on balance, by the Government. In particular, there are particular risks associated with the arrangements for the pricing of transmission and distribution services. It is not at all clear whether contractual arrangements for these have been used to sweeten the deal for private sector bidders, whether they will, in fact, lead to a future loss of revenues to the State. The State is continuing to own the poles and wires; we do not know what has been charged for access and use of those and what rates of return the residual businesses will earn as compared to what they might have been earning before.

In fact, I think Parliament has been kept a little bit in the dark because the annual reports of the electricity agencies have not disaggregated their profitability by business segments, even though I am aware that boards of those agencies have been given information about that. It has not been published and it has been quite a public policy issue, I think, for several years that if there are proposals for the Government to retain the poles and wires businesses Parliament has not been told what they are earning at the moment and what they might earn in future under these other arrangements where private firms will have access to them. We do not know what pricing arrangements have been put in place there.

Moving forward through the submission, one thing that might be noted is on page 8. Some time ago former Premier Iemma and former Treasurer Costa were arguing that we needed to spend $15 billion to keep the lights on, and that was obviously an exaggerated report to anyone who read the detail of the Owen committee report. The detail of that is in the submission but we would just simply note that a recent statement by the Australian energy market operators in 2010 reported that the need for new generating capacity in New South Wales is less urgent than is claimed in that Owen report several years ago. They forecast the need for new capacity by 2016 or 2017 and possibly a year or so later, not 2013 as previously claimed. The report also detailed a substantial number of publicly announced gas-fired, wind and black coal generation proposals in various stages of development, matters that I think contradict earlier claims that unless the New South Wales Government sold off its electricity assets the private sector would not invest. Plainly the private sector is investing.

We go on to offer some commentary about the merits of privatising parts of businesses that are currently earning a real return of around 24 per cent per annum on shareholders' money. It does not make sense to us. It is also likely to make the State more dependent on volatile stamp duty revenues because if you lose a stable source of revenues from electricity then you are going to be more dependent on other own-source revenues. Finally, I just point out that we are very concerned about the failure of accountability in this area for executive government essentially to sell off valuable State-owned resources without disclosure to Parliament or the community. We cannot see the contracts, we do not know what the deal involves, we do not know what the transfer prices are with the retained businesses and, despite I read in the press a comment by the Treasurer that he would release retention value once the bidding process has concluded, I gather that has not occurred and claims are being made about commercial confidentiality.

In our submission earlier we made the point that, okay, if that is the case maybe Treasury could produce a statement outlining their methodology of calculating retention value—black out the figures; treat it like an FOI application, but show what are the components, what has been counted, whether it counts the subsidy on coal, whether the figures are risk-adjusted and, in particular, if you are calculating retention value—that is a term, incidentally, I think I invented some years ago when talking about privatisation—

The Hon. GREG PEARCE: You are to blame!

Professor ROBERT WALKER: Yes, in a paper published in the *Australian Journal of Political Economy and Labor*, reproduced in our book on privatisation. We indicated that retention value must count projected cash flows, including tax equivalents and other payments and guarantee payments. But in all of this exercise is a key element, which is the calculation of the discount rate to work out the present value of future cash flows. I am aware from documents I have seen, including, for example, documents tabled about the Cross City Tunnel, that it has been common to use discount rates of 17 per cent or even more, and the higher the discount rate the lower the retention value. So I think it is critically important that we see at least the methodology that has been used to calculate retention value. Theoretically, I prefer to see a range of numbers, some kind of sensitivity analysis as well, but given the high discount rates that have been used in published guidelines and so forth within New South Wales it is instructive to look at what happens in other countries.

On page 11 we have set out some figures from a recent report from the UK Treasury indicating what discount rates they use. They range from 3.9 per cent up to around 10 for the risk use of projects. So we conclude that if the New South Wales Treasury used a higher discount rate than 7 per cent, this either represents an acknowledgement that the State has retained responsibility for a high level of risks or, alternatively, they have managed the numbers to understate retention value.

Dr BETTY WALKER: There is also a comment about a response that the Committee has received from the Treasury Secretary.

Professor ROBERT WALKER: That is right—on page 10.

Dr BETTY WALKER: It starts at the bottom of page 9.

Professor ROBERT WALKER: I note the comments from the Treasury secretary saying that $5.3 billion will strengthen the State's balance sheet and the proceeds are a cash financial statement and as such increase the assets by the full $5.3 billion. Balance sheets do not only just show assets, they show liabilities. Secondly, we have had the experience in New South Wales of the sale of the State Bank of New South Wales by the former Coalition Government for a headline price around half a billion dollars, which ended up, because the State was guaranteeing bad debts over the first $60 million, the net return to the State, for those who care to read the State accounts year after year, particularly the accounts of the Crown reporting entity—I am not sure that is one of the more esoteric midnight reads for many people—but we have calculated that the net return to the State has been $80 million from a headline price of $500 million.

Dr BETTY WALKER: 576.

Dr JOHN KAYE: Could you give us those figures again, please?

Dr BETTY WALKER: It started at $576 million, that was the price of the sale—$576 million. The Coalition Government guaranteed all bad debts in excess of after the first $60 million, so each year, if you looked at the budget papers—

Professor ROBERT WALKER: Or a percentage?

Dr BETTY WALKER: Or a percentage of that, you then find out how much was paid out back to the purchaser out of that money. When you go through that process—our last count was that we were left with $80 million, which, in private hands, it was about half the first year's profit.

Professor ROBERT WALKER: So the headline price was nothing near like what the State got. The details of this are set out in our update on the book *Privatisation: Sell off or Sell Out* published by Sydney University Press.

Dr JOHN KAYE: In two years we were worse off?

Dr BETTY WALKER: Yes.

Professor ROBERT WALKER: So we do not place much credence on figures talking about the gross proceeds, unless you look at what else is associated with these deals and particularly what guarantees or obligations the State might be assuming in future years. It is true that balance sheets—I mention they do not show the value of businesses. For example, State Lotteries, I think, was sold for around $400 million but its net assets were under $50 million. That is because balance sheets only show the assets and liabilities of a business; they do not attempt to value a business.

Dr BETTY WALKER: They show the fixed assets rather than the business.

Professor ROBERT WALKER: The sale of a business is going to involve proceeds as something which was not previously recognised on balance sheets and so a lot of that would be recorded as a profit. In fact, it is a bit illusory because of the conventions of accounting but even so the gentrader transactions, from what I have read, involve the sale of certain previously recognised assets, hence the claim that 100 per cent of those proceeds will increase the assets on the State balance sheet is plainly wrong. I also mention liabilities and so forth. One of the concerns I have got as a student of public sector finances is to note that the ownership of the electricity businesses has been a stable source of revenues for the State and if you sell it off the State is going to be more reliant on their residual unsourced revenues, which are the volatile property taxes, so it is going to be harder to manage the State's finances, I think, in future because there is likely to be a much more volatile revenue stream for the Government. Is there anything else?

Dr BETTY WALKER: No.

CHAIR: To clarify the point you are making, you quoted the State Bank example. With the claim of the gentrader sale of $5.3 billion, what would you say is the real net figure then for the people of New South Wales?

Professor ROBERT WALKER: We cannot really tell because we have not seen the deal; we do not know what is the deal, what compensation will be paid to gentrader operators if the outage, if the poles and wires have some difficulties; in other words, what are the contingent liabilities—

Dr BETTY WALKER: All you can say is that it will be significantly less from what we know from the information we have.

CHAIR: It could be as low as $400 million, would that be an exaggeration?

Dr BETTY WALKER: Possibly not but we do not have enough information to give an absolute figure like we do with the State Bank after the event. Here we do not even have the information to make a judgement right now. We do have a number of indicators that erode the $5.3 billion but we are not quite sure how many more other indicators there are that we have not been told about that the professor has just gone through.

CHAIR: Such as the Government has to actually build Cobbora coalmine and supply the coal at a discount rate?

Dr BETTY WALKER: Yes.

CHAIR: What does that equal in dollars?

Professor ROBERT WALKER: I have not seen the figures for the construction of the coalmine but essentially there is both the investment and the opportunity cost of selling something cheaply; likewise the subsidies on access to the transmission systems and distribution systems. I do not know what rate of return they have been earning to date. Plainly the directors of those companies have some idea but they have not published it. The Auditor-General has not insisted that it be published, so we are in the position where the Government has entered into deals and it is very hard to assess at what future cost to the taxpayer.

CHAIR: When you said the directors would know, would that possibly be the reason why eight directors resigned and would not sign the contracts?

Professor ROBERT WALKER: I expect so; I expect that they thought it was a bad deal.

CHAIR: We will move on to Mr Pearce.

The Hon. GREG PEARCE: Thank you, Professor Walker. I have seen some work you have done previously where you have taken the cash flows from some of the public trading enterprises [PTEs] and projected out values for those PTEs using normal valuation methodology.

Professor ROBERT WALKER: Can you remind me where that was; I cannot recall it?

The Hon. GREG PEARCE: You have done it at various stages, where you have taken the projected earnings of some of the PTEs and put a value against them in terms of return on equity.

Professor ROBERT WALKER: I have certainly done that for the water industry. I recall at that time that the industry commission was suggesting it was only earning a 2 per cent rate of return and I suggested that the figures should be corrected because the rate of return should count developer contributions and subsequently I think my view was confirmed by both the accounting profession and the Auditor-General. He made those agencies restate their accounts.

The Hon. GREG PEARCE: I was wondering whether you had actually done a similar exercise for the generators?

Professor ROBERT WALKER: No. I have counted what their profitability has been, that is all, and the average profitability has been fairly stable.

The Hon. GREG PEARCE: Which is the figure that you quoted before—24?

Professor ROBERT WALKER: For the six agencies excluding TransGrid it is about 24 per cent per annum and I might explain that that includes the use of public sector accounting methods. In the private sector companies like BHP and Rio Tinto value assets at historical cost and depreciation charges are a percentage of historical cost. In the public sector assets for public trading enterprises are valued based on replacement prices not historical cost. That means the depreciation charges are higher in the public sector than they would be for a private sector listed company and hence I would suggest that the rate of return of 24 per cent is probably very conservative. It could be nudging 30 per cent per annum at the moment.

The Hon. GREG PEARCE: I am trying to get you to a point where you might be able to help us a little bit more in understanding the methodology to get to retention values and whether the evidence we have had from Treasury in any way helps us in deciding whether they have actually come up with a retention value that is realistic or whether they have come up with something that suited the deal, to put it bluntly. If you have anything you can do in terms of helping us on that, I would be very appreciative.

Dr BETTY WALKER: What we do know is information published in the budget papers in terms of the payments to the budget from the electricity sector as a whole, including forecasts, these are estimates based on retaining all the assets, I presume, I am not sure because there is no—I think in the budget papers they actually do say they did not include sale of the assets but when you do look at that, on page 6 we do have a table which shows the actual payments to the State, table 9, from all the electricity agencies and you can see that the figure for 2009-10 was in excess of $1.2 billion, and expected to increase significantly in the three years to 2013-14. Presumably that took account of the recent IPART increases in prices which would land in the lap of the Government if all assets were retained. The estimate for those five years up to 2013-14 is that the Government would earn over $7.5 billion from these agencies.

Professor ROBERT WALKER: But the business could be more valuable than that.

Dr BETTY WALKER: Yes.

Professor ROBERT WALKER: Because it is increasing in value if you are rolling back extra money and new investment.

Dr BETTY WALKER: I was going to go on to say that additionally the Government has been spending on these agencies something like $3.3 billion, around $3 billion a year in investments, in improving. We know that in the current sale the beneficiaries of that investment will be Origin, for example, because the Government has been spending the money and that money has come from the agencies themselves because they are businesses that make profits and they retain some earnings. The $1.2 is not all their profits; that is just what they pay the Government. They also retain earnings for their own investments. The combination of those shows you really how rich these agencies are in terms of their earnings and also their expenditure.

In fact, the Government itself is estimating an expenditure in the electricity sector of almost $21 billion over the next five years. We were told by Costa and Iemma that there was a $20 billion hole in the State's revenues that we had to fill by selling all these assets. It seems to me that the hole has been plugged. It is a craziness to be using these assets to do something that they were never intended to do.

Professor ROBERT WALKER: Theoretically, if you wanted to value those businesses you discount their projected cash flows using the Government's cost of capital. A crude method of arriving at a value that is widely used in the securities industry is to simply look at price earnings ratios. If you look at price earnings ratios for AGL or Origin Energy and do some sums around that, it is at least giving you some indicative range of prices. Perhaps another indication of value is what impact the announcements of sales, if they are consummated, has already had on the prices of Origin Energy shares. It seems to have been regarded as a good deal for the private sector to buy assets very cheaply.

The Hon. GREG PEARCE: In your earlier comments you mentioned in terms of cash flows an element that was sort of missed. When Mr Roozendaal appeared, or it might have been the Treasury officials, they admitted lost dividends and tax equivalents were, I think, $600 million, then in written replies to questions they actually put the figure at $800 million because they added in the guarantee fees as well, so there are three elements, are there not, to the return?

Professor ROBERT WALKER: They are the three elements that were in my paper on how to calculate retention value from 1978 or 1998.

The Hon. GREG PEARCE: Those guarantee payments are now gone as well?

Professor ROBERT WALKER: Yes, that is right.

The Hon. GREG PEARCE: You talked a little bit about Owen and suffice to say the Committee is not too impressed with how Owen sort of worked out, but on page 8 of your paper you talk about the AEMO 2010 report, suggesting the need for additional generation to 2017-2018. My reading—and Professor Outhred this morning agreed—that if you take into account planned or proposed generation, it actually shifts the supply out until after 2018-2019, would that possibly be right?

Dr BETTY WALKER: Even this Government document states that if you assume low growth in the economy it takes it out to 2017-18 anyway. The 2016-17 assumes medium or high growth, so it is not unrealistic to assume that it would go beyond that. If a number of these private investments go ahead, which are outlined in that same Government report, then that could be even further. It depends on what happens there. This Government paper actually lists all those planned or proposed at their various stages.

Professor ROBERT WALKER: That is assuming there are no initiatives on demand management.

Dr BETTY WALKER: Yes.

Dr JOHN KAYE: Which paper is that, please?

Dr BETTY WALKER: It is called "Electricity Statement of Opportunities".

Dr JOHN KAYE: That is the AEMO report?

Dr BETTY WALKER: The AEMO report, yes.

Dr JOHN KAYE: Which year?

Dr BETTY WALKER: It was published in October 2010.

The Hon. GREG PEARCE: I am not sure which was the chicken and which was the egg but Owen sort of coincided with Standard and Poor's coming to this view that the State needed to get rid of its electricity assets or put money aside to build baseload, which eventually led to going on credit watch when the original deal fell over, when the Labor Party members would not vote for it, and subsequently the mini budget and the rescheduling of capital expenditure and putting aside $4 billion for potential baseload. What is your view on all of that fiction?

Dr BETTY WALKER: Firstly the State was never placed on watch–that is the first thing. Secondly, we have two major rating agencies that rate this State—that is, Moody's and Standard and Poor's. At the time that the Government was using—Costa was using Standard and Poor's there was a Moody's report that was very detailed and explained that the water and electricity agencies could take on more debt if they wanted to invest because they are self funding. That was never highlighted by the Government. We included a reference to that report in our submission to the Unsworth committee. On that day or the next day there was a link from Treasury to the Standard and Poor's statement, which was a one-pager, and there was a link to Moody's. From that day on I went back to check and see whether it was still there and it was not there.

The link to Standard and Poor's remains to date, the link to Moody's was deleted and remains deleted as of last week—I have not checked today so perhaps it is back. It seemed a rather selective process of using the comments by Standard and Poor's which was very pro-privatisation and Moody's which was a more reasonable analysis and detailed analysis—I can provide it if anyone is interested at some point—but it was many pages of analysis of that whole area. But even if our credit rating had been reduced by one element, one notch, with triple-A if we went to double-A plus the cost to the State would be minuscule. At that time Iemma and Costa and even subsequently Iemma unfortunately was also given this advice—sorry, Rees—they were claiming that one notch would add $500 million per year in interest payments to the State.

The Hon. GREG PEARCE: That was Roozendaal's number.

Dr BETTY WALKER: An absolutely absurd statement. We did the sums. Firstly, the borrowings do not mature at the same time. There are different borrowings at different times so they will not mature overnight. We did some sums at the time and there were $7 billion worth of borrowings that would mature within the next year. If we had that downgrading by one notch our calculation was that it would be between $7 million to $14 million per year—note, $7 to $14, not $500 a year. We are talking about a budget of $60 billion per year. I think that is pretty small if we are going to look after the infrastructure of the State, if that is the cost of not selling very valuable and essential services for the State. So there is no sense.

The Hon. GREG PEARCE: The Owen, Standard and Poor's, Iemma, Costa, Roozendaal song sheet was that unless the thing was privatised we would run out of baseload and the Government was going to lose its triple-A rating. That is all rubbish, is not?

Dr BETTY WALKER: All of that has been found not to be correct.

Professor WALKER: Yes.

The Hon. GREG PEARCE: That was a yes.

Dr BETTY WALKER: Yes; not only on the credit rating but also on the need, on the capacity need.

The Hon. GREG PEARCE: The key difference between Standard and Poor's and Moody's is that Standard and Poor's sees the investment in the private trading enterprises as a weakness whereas Moody's actually sees it as a strength—

Dr BETTY WALKER: Yes.

The Hon. GREG PEARCE: —because of the revenue arguments you have put before?

Professor ROBERT WALKER: Standard and Poor's does not rank highly in my estimation. I have had a couple of dealings with Standard and Poor's. The first instance was when I pointed out that Premier Greiner's claims to have a balanced budget were based on simply talking about the transactions of the Consolidated Fund, not of the budget sector—it is now known as the general government sector. Moody's immediately put the State of New South Wales on credit watch at that stage yet the information I was citing had been in the public domain from the Australian Bureau of Statistics for many years. So I do not think—you know, I used to fly people into New South Wales and spend a few nights talking to Treasury people and go home. More updated, a colleague of mine has calculated that Standard and Poor's managed to give a triple-A credit rating to packages of derivative securities one every 20 minutes just before the global financial crisis.

Dr JOHN KAYE: These are the CDOs are they?

Professor ROBERT WALKER: CDOs, yes, one every 20 minutes for a triple-A credit rating—that is quite shocking. When Standard and Poor's published the report to which you refer about electricity privatisation I looked at their website and they indicated that they would happily explain some of their reports. So I contacted their media office and I must say my requests were quickly shuffled from person to person, no-one was available to answer them and to this date I have not got an answer. The simple I question I asked was: would you agree that capacity to repay is strengthened by having stable cash flows rather than volatile cash flows? If you agree with that, why then do you say that selling off a stable source of cash flows is going to enhance the credit rating? They still have not replied to that.

CHAIR: You are suggesting there has been some shopping for the most suitable rating agency to get the result you want?

Professor ROBERT WALKER: I would say that credit rating agencies and, in this case, governments have a symbiotic relationship: they get paid to rate. The Northern Territory does not get rated—it prefers to spend money on advertising.

Dr BETTY WALKER: No State was rated until the late 1980s, they borrowed happily until then without any issue as to whether they were rated or not. It is historically a relatively newish development. On the Owen report, if you look at the introduction you will note the final paragraph in the introduction—I do not have it with me—but it states that the report was actually written by various officers and they name the departments. So what we have here is a so-called independent person whose report was prepared by those who are most interested in this issue—namely, Treasury and any other department who was interested in this issue. It is a very specific paragraph—I am paraphrasing here—but it more or less tells you that the report was prepared by officers from these various departments. Now one might say you expect to get resources to do all this but it also tells you that obviously if people are research officers and working from a particular angle then they are going to write along those lines—

CHAIR: They are not going to be so critical?

Dr BETTY WALKER: Yes, nor is Professor Owen a financial expert so for a commentary on credit ratings—I think he is a technical person in that sense so he was not really an expert on the finances of the electricity industry. That is why there should be some caution as to how that report is interpreted.

Dr JOHN KAYE: Thank you for another excellent report. Can I take this somewhere slightly different? In the evidence presented by the Premier, the Treasurer and the head of the Treasury department, they all made a great show out of the fact that these transactions would de-risk the economy, de-risk the State—they would take the risk away from the State's budget. Can we unpack that statement fairly carefully? Starting with the issue—and leaving aside the fact that the Government owned both sides of the supply and demand equation—looking at the generators on their own can we ask the question: how volatile was the income from the generators and how bad in terms of running a State is a bit of volatility year from year?

Professor ROBERT WALKER: I do not have the figures in front of me. There was some volatility—sorry, I think some of the distributor's trading activities in the electricity market did lead some to show some liabilities that were pretty volatile. But just coming back to the question of de-risking, I think they were equating de-risking with avoiding the need to make capital investment. I do not see the need to make capital investment a risk; I see that as an opportunity if you are earning 24 per cent.

Dr BETTY WALKER: And adding to the asset base of the State and creating more potential for further returns.

Dr JOHN KAYE: You talk about hedging. You talk about the fact that owning different parts of the industry hedges the risk for the State. Can you expand on that for the Committee? Can you explain how the situation that obtained before 15 December when the State owned three generating companies and three retailing companies, how that hedged?

Professor ROBERT WALKER: Just to place it in context, I think under recent arrangements 95 per cent of electricity generated in New South Wales is consumed in New South Wales. So the national electricity market is really on the margin and most of the external sources probably come from baseload generated in Queensland, which is of course higher to the North Coast and there are energy losses if you wheel energy long distances. My understanding of it is, and from talking to people who have sat in front of the screens, that we have trading in those electricity markets and sometimes a generator experiences maintenance problems and goes down, the electricity price spikes and others make a motza out of it. I have heard people predict that this was likely to happen before we introduced the national electricity market because it has been the United Kingdom experience. If we look at the movie *The Smartest Guys in the Room*—the story of Enron—we see some colourful examples of traders saying: "Burn, baby, burn" when there was a bushfire bringing down distribution lines and generating capacity like that. So the traders are there to make money for themselves.

Where you have a number of generators and retailers and distributors all owned by the same party what is a gain by one is a loss by another so it is not totally a zero-sum game but might approach it. Once we start having a private sector player in there they are likely to make gains at the expense of the State. Personally I have reservations about the institution of the national electricity market per se because it seems to have been advocated by the people interested in running trading businesses. It is not clear to me that it is actually producing a benefit for the citizens of this State. The first rationale for introducing it was to enable the sale of excess capacity within New South Wales. That is historically the story then some Treasury economists seem to think that competition is an end in itself. Indeed, I have seen that the mission statements of some electricity agencies and they have stated their aim had nothing to do with providing services to the community: their aim was to be an efficient trader in electricity in the national electricity market. It seems to me to lose sight of what government-owned businesses are there for.

Dr JOHN KAYE: Can I take you to the situation now faced by buying Macquarie Generation and Delta Coastal: two government-owned generators that do not have gentrader contracts, so that trading is the responsibility of—

Dr BETTY WALKER: Or subsidised coal.

Dr JOHN KAYE: Sorry?

Dr BETTY WALKER: Or subsidised coal.

Dr JOHN KAYE: That is an interesting question and we do not know the answer to that. That is a very important question that you raise there but I specifically wanted to ask you what your opinion was of the situation that those two generators now find themselves in where they are selling electricity into a market where up to about 85 per cent of the retail customers are being supplied by retailers who are owned by their direct competitors in that generation market. Do you think that disadvantages those two government-owned generators in terms of their capacity to sell contracts?

Professor ROBERT WALKER: It places them in a very difficult situation for the reasons you have outlined.

Dr BETTY WALKER: We have gone from a government monopoly, well almost a monopoly, because the Government provides about 95 per cent or 97 per cent of the needs of the State, to somewhat of a duopoly, a private duopoly or oligopoly, if you like. Whereas a government monopoly has great benefits because it has a better interest in the welfare of its population, a private duopoly or oligopoly does not. It is a big difference in an essential service. I mean in something that is not such an essential service it is no big deal you know, but in such an essential service it augurs badly for the consumer in terms of pricing and service.

Dr JOHN KAYE: Professor Walker, you acknowledge that Macquarie and Delta found themselves in a difficult situation now trading against their competitors who own most of the retail market. Is there a way, in any meaningful sense, to put a number on the loss of value for Macquarie Generation to find themselves in such a hostile market?

Professor ROBERT WALKER: It would be very hard to quantify. I am just thinking of whether there would be some financial instruments they could buy to minimise their risks and whether there is a price on those in the market.

The Hon. TREVOR KHAN: Somebody will try to sell them something.

Professor ROBERT WALKER: Certainly they face additional risks that were not there before.

CHAIR: Professor Walker you mentioned earlier that there is a big question mark over the retention value and that you are not aware of any methodology. Can you do a calculation of what you think was the retention value?

Professor ROBERT WALKER: No, because we do not have the detail about the side deals and what is involved in the contract. I come back to the point that I do not know what pricing is going to be put on access to transmission and distribution infrastructure.

CHAIR: If the sale price were $5.3 billion—and the Committee knows that that is an exaggeration—the retention value must obviously be less than that? The Committee assumes it would have to be just like a reserve price, you would not sell it for less.

Professor ROBERT WALKER: The retention value would be what it would be worth if you did not have these deals going on and if you continued to actually own it and enjoy all the cash flows from it. As I said before, it would be the present value of the projected cash flows derived from that business, and an alternative crude estimate, such as used in the securities industry, is to look at price earnings ratios.

CHAIR: All the future profits and income to try to get that figure?

Professor ROBERT WALKER: Yes, so once you get over 10 years or so, you would look at the present value is only incrementally added to it, depending on what discount rate you use. All the signs are that this is a highly profitable industry that will continue to be highly profitable—

CHAIR: Sadly from the consumers' point of view because the prices will continue to go up?

Professor ROBERT WALKER: Indeed.

CHAIR: You said that the offer probably included some, but you do not know what, sweeteners that were in the deal. Would one of the sweeteners be a reduced coal price from the Cobbora coalmine?

Professor ROBERT WALKER: Yes.

CHAIR: It is hard to put a calculation on—

Dr BETTY WALKER: And a guaranteed supply.

CHAIR: What would that mean in dollar terms as a loss to the State, to the taxpayer as it is really money being given away if the coal sold for only $30 a tonne, which is one of the figures?

Professor ROBERT WALKER: Yes, you could look at both the original investment and net it off against the projected future profitability if the coal were sold at market prices. So if you can quantify that at the difference between $35 and, say, $50 a tonne, it is $15 a tonne adjusted for distribution costs times the projected output over future years.

CHAIR: Should that be deducted from the sale price of $5.3 billion?

Professor ROBERT WALKER: Essentially yes, in terms of net economic effect, not necessarily in an accounting sense but in terms of its overall economic effect.

CHAIR: In many ways the Treasurer has deliberately confused the picture, as you said earlier, with the State Bank picture to get this grossly exaggerated figure of $5.3 billion.

Professor ROBERT WALKER: I would not impute motives to the Treasurer—I am not sure he understands.

The Hon. GREG PEARCE: We are all sure he does not.

The Hon. GREG DONNELLY: On the issue of baseload generating capacity, given that we have this national network that operates at least on the east coast, is it necessary for States and Territories to have their own domestic baseload capacity, to use that phrase, given that we actually have an east coast network?

Professor ROBERT WALKER: The figures that I last looked at indicated that about 95 per cent of electricity consumed in New South Wales was generated within New South Wales and so it is not practical to wheel energy from northern Queensland to southern New South Wales. Could I just make the point which I think we mentioned in our book that there is a tendency in Australia for public policy to be derived from what has been adopted overseas. The idea of a national electricity market developed in Europe and North America where, as you understand, baseload power stations try and run at close to full capacity and if you wind them up and down they break and it costs more to run them, and you top that up with peaking and so forth generation capacity. The whole idea of an electricity market evolved where you had peak loads in different time zones east-west. In Australia we have got most of our population on the east coast and they are distributed north-south. Apart from the fact that Queensland does not go for daylight saving we do not have that same spread of time zones and so the attractions of having a national electricity market are far less here than they would have been in Europe and North America.

The Hon. GREG DONNELLY: How does a given State—I will take the major States, Queensland, New South Wales, Victoria—determine when it actually needs a new baseload power station?

Professor ROBERT WALKER: I guess it depends on what stage of the capacity cycle they need it. History suggests that when there has been major investment in generating capacity the agencies face incentives to try to flog as much electricity as possible to get their money back. It is a step-cost function technically. You have to make major, big investments in base load in order to meet demand but having met that often you have got excess demand which is the background to the establishment of a national electricity market. The claim was that Pacific Power had excess capacity so we need to be able to sell some. Thereafter once capacity becomes tight you tend to see electricity agencies throughout the world deciding we want to manage demand, and encourage people to use less and so forth.

I think the debate about global warming has just changed that whole debate a lot now. I think people are a lot more cynical and suspicious of claims about demand for more capacity that we need to actually look holistically at what can be done about demand management.

Dr BETTY WALKER: Especially when in just two years since the Owen report we have gone from 2013-14 now to 2017-18 in such a short time. That is because of some increase in supply and a reduction in demand. So if that can be achieved in that short period then obviously there is scope for more reductions in demand.

CHAIR: There is a greater consumer consciousness to reduce their use of electricity.

Dr BETTY WALKER: Yes.

The Hon. GREG DONNELLY: On the issue of this future scenario of looking at a lower carbon generating electricity industry, it was put to the Committee by another witness that in terms of that framework looking into the future it would probably involve looking at the creation of power generation based on gas turbine technology, wind, biomass and nuclear perhaps. Do you agree with that statement?

Dr BETTY WALKER: According to this report—I refer again to the AEMO report—a number of publicly announced, as it calls them, investments are in gas and wind as well as coal. So the private sector is already thinking along those lines. These are private sector investments. So there is already a movement in that direction. Obviously that has to happen otherwise we will never move away from coal but it is going to take time. It is not something that can be done overnight or even within five years, it will take time.

The Hon. GREG DONNELLY: I am trying to clearly understand your position in relation to the electricity industry. If we treat generation, as the transmission, distribution and retail, those three segments that form the industry, is it your position that all of that should be publicly owned?

Dr BETTY WALKER: Absolutely. In this submission we have submitted today we actually ask that the Government renege on those contracts which apparently have not been signed finally yet.

The Hon. TREVOR KHAN: I do not know whether we know that.

Dr JOHN KAYE: We were told they were signed but not finalised.

Dr BETTY WALKER: Yes, the contracts have been signed but the settlement has not taken place.

Dr JOHN KAYE: That is correct.

Professor ROBERT WALKER: It could be a contingent sale—contingent on the Government providing further—

Dr JOHN KAYE: You need to ask Eric that.

Dr BETTY WALKER: Exactly.

CHAIR: So more sweeteners?

Professor ROBERT WALKER: I have got a bit of a view about contingent sales. I mean I noted that Bond Corporation used to record a profit from contingent sales of the Hilton Hotel and Rome Property, and that was totally inconsistent with accepted accounting practice internationally.

The Hon. GREG DONNELLY: In terms of a national energy market where there is, at least in other States, significant private ownership, how in the context of New South Wales we balance—

Dr BETTY WALKER: The problem we have with a partial privatisation of an essential service, as a matter of principle, takes you back to Telstra. The Coalition Government first sold the first tranche, which was one-third of Telstra, and no more was going to be sold but after that was sold we were told "We can't partially own this asset" and so the next tranche was sold and so on. So now we have a new Government that is trying to create a national broadband network—

CHAIR: A new Telstra.

Dr BETTY WALKER: And it needs Telstra. It is now buying into and having to negotiate with an asset it used to own. To our view, communications is another essential service, especially in this century where communications are such an essential part of industry and the community. We opposed the sale of Telstra as we oppose this because partial sale of any essential service leads to arguments and all sorts of rationalisations that the rest of it should go because we cannot half-own anything.

Professor ROBERT WALKER: I disagree with Betty a little bit on this.

The Hon. GREG DONNELLY: Complete government ownership of the generation, transmission, distribution and retail—is that your position?

Professor ROBERT WALKER: No, I would not take that strong position. We will argue about this later. I see merit in some public-private partnerships, for example, that involve co-generation where energy that would otherwise be wasted by going up the flue of a blast furnace is used to generate electricity. I find these are virtuous projects: they minimise waste.

Dr BETTY WALKER: Well, that does not argue against my point. You are saying retain our current assets but enter into other projects.

Dr JOHN KAYE: Do the witnesses want a five-minute adjournment?

Professor ROBERT WALKER: No, we are in violent agreement on this point, I think.

Dr BETTY WALKER: Yes.

Professor ROBERT WALKER: Obviously the private sector can have some place in generating electricity.

Dr BETTY WALKER: It does.

Professor ROBERT WALKER: I am not saying that they should be excluded from it. They already have a place and it is likely to increase.

Dr BETTY WALKER: But I think the question was: are we in favour of selling any part of the currently owned government assets?

The Hon. GREG DONNELLY: No, that was not the question.

Dr BETTY WALKER: I am sorry, I misunderstood you.

The Hon. GREG DONNELLY: I am trying to gather an understanding of what role you see the private sector can play in an industry such as the electricity industry?

Professor ROBERT WALKER: It is likely, looking ahead 50 years, we are going to get away from these major networks and have more localised generating capacity using renewables. I think that is inevitable so any private sector participating in that I am sure governments would welcome but that is at least 50 years off. In the meantime, whatever we have in the future I do not think it is desirable to have private sector duopolies controlling the electricity market because they will just be seeking to maximise their profits and I think that government investment is likely to be more benevolent. It is sometimes claimed that private sector involvement inevitably leads to greater efficiency.

I do not share that view, particularly in relation to highly capital intensive industries where employees are a minimal proportion of the overall cost of providing the service. Even if they were inefficient, it would probably be a minimal cost compared to the massive capital investment required. The fact is that governments can acquire capital far cheaper than the private sector. That is not to say, as that argument is sometimes distorted, that that means the Government should own everything. I have heard Treasury officials and others make that claim. We are not saying that at all; we are simply saying that it is a key role of government to provide some basic services that involve capital intensive industries, and it is appropriate that it do so.

CHAIR: At page 9 of your submission you refer to what you say is a silly statement; that is, if the contracts were cancelled by the Treasurer's office the cost could ultimately run to billions of dollars. You say that that is a silly statement. Have you calculated what the cost of cancellation might be if the incoming Government considers that as an option?

Dr BETTY WALKER: There is something called the "public interest". If the Government decides that after the population at large has spoken—in fact, 80 per cent of the population opposes this sale—

The Hon. TREVOR KHAN: Only 80 per cent?

Dr BETTY WALKER: According to the last survey I saw. You may have more up-to-date data.

The Hon. LUKE FOLEY: But they want to sell the lot.

CHAIR: Let the witness finish.

Dr BETTY WALKER: On the basis of public interest, I believe that the Government has certain rights to cease something that it began which it now recognises is a mistake. The Premier said, "We will not sell any more of the electricity assets now or after the election." If it is wrong now or in the future then it was wrong to sell any of it.

Dr JOHN KAYE: Hear, hear!

The Hon. TREVOR KHAN: You are not suggesting she has had a Damascus-like conversion? I do not think that is the reason she has come up with that statement.

Dr BETTY WALKER: On the same day that the Premier claimed that we would lose hundreds of millions of dollars the Treasurer said it would be billions of dollars. That is so silly and it is not a very good way to run a big asset transaction. You either know or you do not. They are the ones who know best the content of the contract in terms of how they can get out of it. All contracts have exit clauses, even in the population at large. Governments have certain rights in determining that they do not wish to proceed. If it costs a couple of hundred million dollars, compare that one-off cost with the $1.5 billion that all those agencies earn each year, and that figure is increasing. Let us put it into context.

Professor ROBERT WALKER: Richard Ackland had some interesting comments to make about governments' rights in relation to resumption of assets.

CHAIR: Thank you for appearing before the Committee. As I said, you are the final witnesses. Are you happy for your last submission to be made public?

Dr JOHN KAYE: I move:

That the submission be made public.

Motion agreed to.

Professor ROBERT WALKER: Yes.

CHAIR: Thank you again for your valuable contribution. I am sure the Committee will weigh up that information when it produces its final report.

Professor ROBERT WALKER: When you do expect the report to be available?

CHAIR: It will be tabled on 23 February.

(The witnesses withdrew)

The Committee adjourned at 3.04 p.m.