UNEDITED TRANSCRIPT

THE PARLIAMENTARY STANDING COMMITTEE ON PUBLIC ACCOUNTS MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON TUESDAY 3 MARCH 1999.

HEC. SPECIAL DIVIDEND

Mr BOB KIMBER, COMPANY SECRETARY AND ACTING CHIEF EXECUTIVE OFFICER AND **Mr JOHN DEVEREAUX**, GROUP MANAGER, FINANCE AND BUSINESS, AURORA ENERGY, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIRMAN (Mr Schulze) - Gentlemen, as you would be undoubtedly aware, we take evidence in public, under the relatively new act that we have. That is generally the desirable thing. If there are any matters which you feel are perhaps commercial-in-confidence or of that nature, the committee will consider in such situations of taking evidence in confidence, but it would need to be demonstrated to the committee in the first instance that there would be serious problems if you were not able to do it that way.

There is a transcript of the hearing, so we have Hansard here to have all that down for us. The transcript can be made available to witnesses, if they require them, of the matters they have discussed.

You are probably familiar with the Public Accounts Committee Act under which we operate. That was changed a year or so ago and certainly gave this committee the capacity to embrace a wider range of inquiries than we had had in the past. In the past we were not able to be particularly proactive and generally operated on reports to Parliament, but now we have a capacity to look at all statutory authorities and statutory authorities in our act has a very, very wide definition.

As you are aware, we have had correspondence to you indicating the nature of our inquiry, which basically is looking at the special dividend required of the Hydro-Electric Corporation - a GBE - and their capacity to pay that. There is of course a strong interrelationship - there has to be - between the three companies that now exist - that have now formed out of the old Hydro, as we knew it. I understand that Aurora is a state-owned corporation, so is somewhat a little differently structured and comes under different rules, if you like, than do GBEs. But it is important for this committee to have a full understanding of your operations to see what impacts and interrelationships there are between your operation and the Hydro-Electric Corporation and their financial circumstance. As you have pointed out in your letter, the Regulator of course has a bit part to play in the whole game as well. The committee does need to understand the big picture first.

I understand, Mr Kimber, you are wanting to run through certain matters with us, in the first instance. We would certainly appreciate it if you can give us an overview of your operation and what has developed since Aurora has become corporatised and perhaps your relationships you have with the other two elements. Following that, we will then ask questions on the various headings that we have determined. We would be happy if you would proceed.

Mr KIMBER -Thank you, Chairman. With your leave, I would just like to make some introductory remarks and reiterate some of the key points from the written submission. Firstly, as an introductory point, the earlier correspondence was with Dr Dan Norton, who was the CEO at that time. He left our organisation at the end of last year. There is currently a recruitment process under way in relation to that. I am currently acting as a CEO; my substantive position is actually company secretary and manager, Legal Services. With me today is my colleague, Mr John Devereaux. He holds the position of group manager of Finance and Business for the company and he is therefore the member of our senior management team best equipped in relation to financial matters. My background being legal, I expect that I will probably be deferring to him in relation to some of the matters of financial detail when they arise.

Chairman, we offer the committee our full cooperation and will endeavour to answer any matters that are raised. If on some issues it is necessary that we get additional information, we will be happy to do so in writing as promptly as possible.

The issues which were raised by Dr Norton in his response last year were in response to the committee's request to investigate the implications of the operations and activities of the Tasmanian electricity entities and the implications of the State Government's special dividend requirement. As was indicated in that correspondence, the State Government in fact has not sought a special dividend from Aurora Energy. There is, as you pointed out, Chairman, a difference between the operation of a GBE and an electricity entity - or electricity company. The HEC is governed by the GBE act, which provides for dividends in the normal course of business. The legislation also provides for government to require a special dividend at any time from the HEC. Similar provisions do not however apply to Aurora Energy. Aurora Energy was a company formed under the authority of the electricity companies legislation but it was formed as a proprietary limited company under the Corporations Law. As such, it is covered by the provisions of the Corporations Law and its own memorandum and articles of association. The articles of association of the company provide for a particular regiment in relation to the payment of dividends, specifically - and the memorandum and articles have in fact been tabled in Parliament. They were tabled towards the end of July, I believe -

Mr KEN BACON - Soon after.

Mr KIMBER - or soon after incorporation. The provisions in the articles, article 42, provides that the amount of any dividend, whether the interim is final, special or otherwise, is to be paid by the company to its shareholders, is the amount determined by special resolution of the shareholders after they have consulted with the directors and after they have considered the written recommendations of the directors but shall not exceed an amount recommended by the directors. So there is certainly a control and a check and balance there in relation to any dividend amount which is payable by the company.

So far as the timing is concerned for the purposes of that article, the directors are to provide their written recommendations to the shareholders within four months after the end of each financial year. For Aurora Energy that will not occur until after the end of the current financial year that we are in. There is a provision in there for when that dividend is to be paid. So that the point that I am making is that although there has been a government indication as to the likely level of dividend which will be sought from Aurora Energy and that is consistent with our expectations, the process in relation to that has not yet been formalised and it may in fact be that the directors wish to have a particular input into that dividend level determination after the current financial year is completed. I thought I would just draw that distinction between that provision and the GBE provision, which no doubt the HEC will be able to indicate to you what is involved.

The Government, as I have said, have indicated however, through policy announcements, that Aurora will be required to pay a proportion of its after-tax profits - an indication being 50 per cent as a dividend payment. This arrangement, as I have indicated, is consistent with our business planning. In addition, we will continue to be liable for the range of State taxes and tax equivalent payments. This is an aspect in which there is some overlap between our operation and the GBE act, but there are certain provisions of the GBE act which apply to Aurora Energy and those are the provisions which relate to the payment of tax equivalents and guarantee fees. We will continue to be liable for those. Those anticipated tax liabilities have been properly factored into our business planning process and the Government announcements so far as impacting on those provisions has not altered that position.

In relation to capital investment, our three-year financial projections show a level of investment which remains within what the Aurora board considers to be an acceptable and responsible range over that period. Mr Devereaux would be able to take you to further details in relation to the capital investment projections if you require.

The Government's dividend policy does not constrain our capacity to invest in new infrastructure, nor to undertake necessary ongoing maintenance. Of course, in relation to this, it is to be noted that the dividend that Government are seeking from us is a proportion of after-tax dividend so that operational expenditure, infrastructure and maintenance are taken off before we get to that figure.

On the issue of debt, I confirm the earlier advice in the correspondence from Dr Norton that the special dividend policy we do not believe will impact on our projections in relation to debt reduction.

We have informed the committee that the company will require additional borrowings, projected at $35 million within the 1998-99 financial year, in order to fund the known and anticipated withdrawals from the Retirements Benefits Fund Superannuation Scheme. I am able to expand on those details if you require. This will lift total debt, excluding the remaining RBF liability, to $384 million. Our total debt, excluding again RBF liability, is then projected to steadily decrease from the 1999-2000 financial year onwards. These projections are subject to adjustment and review as part of our normal business planning process but, again, we do not envisage that the dividend policy will impact or require any substantial change to that business planning.

Chairman, as you indicated, we have a critical independent influence on our operation and that is as a result of the operations of the electricity Regulator, Mr Andrew Reeves, in his role as both electricity Regulator and Administrator of the Electricity Code. As part of his pricing responsibilities as the electricity Regulator, and in this respect he has taken over from the role of the more familiar GPOC Commissioner and as regulator he has responsibility in relation to electricity prices. He is required to examine and review the appropriateness of our infrastructure expenditure and the impact of that expenditure on the prices and conditions for the supply of electricity and related services. The results of the review by Mr Reeves will be an input into the electricity pricing investigation which was outlined in the earlier written submission.

Furthermore, in his capacity as administrator under the Tasmanian Electricity Code, the Regulator authorises the establishment and conduct of the network and reliability planning panel which is established under that code. The responsibilities of that panel include an independent examination of the reliability of our system, the quality of electricity supply and our capital expenditure, with a view to seeing that there is an appropriate delivery of reliability and that the capital expenditure amounts are appropriate.

Also under the direction of the electricity Regulator is the determination of tariff pricing for the period from 1 January 2000 with expectation that it will apply for a maximum period of five years following that. The new tariff determination will follow the independent pricing review by Mr Reeves and this is currently in progress, although in its, as yet, early stages so far as the involvement of the Regulator is concerned. We are yet to submit our submission to the Regulator. Part of the process is developing that submission and for our board to then sign off. It does involve a public process of public consultation and our submission becomes a public document.

The Regulator's responsibilities are to review all aspects of the company's operations, including infrastructure expenditure, in addition to the operations of all other participants in the Tasmanian electricity supply industry. It is going to be the outcome of that process and the setting of figures by the Regulator and what he will allow so far as a regulated return on our assets - which is going to be the single most critical determinant of our financial viability, and it will be the factor which will then influence on our capacity in the future for investment in new infrastructure. We see that as being the most critical path that we have to travel over during the next six months.

Chairman, that concludes the opening remarks. Mr Devereaux and I will be happy to field any questions you may have. So far as your general inquiry as to how the businesses are operating I believe that, certainly speaking from our company, we are on a good financial footing. The first six months have seen our financial targets in general coming in on target. The relationships between the three entities are now on a commercial footing so that we have negotiated contractual relationships with the other entities. Part of the disaggregation process involved the establishment of those contractual relationships and during the next six months there will be a review of the pricing background to those contractual relationships to put them on a formal commercial footing. The contractual relationships themselves are formal, but in the initial disaggregation process they are on the basis of a cost recovery, as distinct from a fully negotiated commercial position. That is one of the exercises for the three entities to go through during the next six months. I trust that has been a helpful introduction.

CHAIRMAN - Yes, thanks, Mr Kimber, that is certainly helpful to the committee and I am sure out of that there will be quite a few questions. Perhaps in the first instance we will perhaps look initially at your corporate structure and your accountability circumstance. I understand that the current structure evolved from a view to selling the structure that you are now in. The fact that you are now continuing as a commercial entity and not being sold off, I wondered whether that was under review or do you see that as a satisfactory way of continuing operating as an indefinite thing, and not a GBE arrangement?

Mr KIMBER - There were certainly some contractual arrangements which were put in place specifically in anticipation of a possible sale. Perhaps the best example of that might be arrangements in relation to what we term 'shared services' in that there were some services which were part of the HEC which were divided up with people going in different directions; other services remained within the HEC with a contractual arrangement to provide those services to the new entities - for example, the information technology services and Treasury services.

That was designed, I would think, in anticipation that a new purchaser coming in would most likely want to have a look at their own types of organisation in relation to the way in which those services are delivered. It is not appropriate in the long term for us to continue on with a continued shared service provision from the HEC and the organisations are certainly at the moment reviewing some of those aspects of it to see what a more appropriate arrangement might be. That is an exercise that is going on at the moment.

The division of assets, liabilities and debts - I might have to lean on John here if I start getting off the track because he was more directly involved with the financial details of this - were designed to place all of the entities in a sound financial position to be able to continue as operating entities with appropriate balances of debt and assets. The fact that sale is no longer on the agenda I do not think influences or changes that initial position. There has been a review by the entities of the financial relationships and divisions. That was carried out towards the end of last year to see whether there needed to be any readjustment of balance between the entities. The three entities resolved that no, there did not need to be any refinement or readjustment of those and the stakeholders have been advised by the financial officers and the CEOs of the respective entities.

CHAIRMAN - So you see the current corporate structure as prevailing into the longer term with some review of your organisation structure - and you perhaps might be able to provide that to us at some stage - in terms of your management structure and number of employees and in what classifications.

Mr KIMBER - Certainly. I would really see that now the three entities operate independently with their own management teams and boards determining their own future strategies, their own managerial structures and requirements and where they are to go for the future. We are certainly now operating on the basis that we are operating as an independent business with our structures being designed to most efficiently and effectively carry out the business for our shareholders. I am sure the HEC and Transend networks are doing exactly the same thing.

CHAIRMAN - On that structure, you mentioned that you pay tax equivalents and guarantee fees, and so on, to the Government, the same as GBEs. Is that within the articles of association? That is written into -

Mr KIMBER - That is a provision in the Electricity Companies Act.

CHAIRMAN - The Electricity Companies Act defines that.

Mr KIMBER - Yes.

CHAIRMAN - Right. In your letter you spoke about the 50 per cent dividend. That is only an indication of your shareholders' requirement, but you did point out, I think, clearly to us, that the shareholder can determine whatever it might be but I understand there are still limitations under Corporations Law of a maximum it could be allowed for.

Mr KIMBER - The provision so far as the payment of dividends by an electricity company, as distinct from a GBE, is not something that can be just determined by the shareholders. Under clause 42 of the articles, the shareholders can resolve how much the dividend is to be up but it has to be after consultation with the directors and is not to exceed an amount recommended by the directors. That is the fail safe or the double check so far as the company is concerned. That issue only arises, as I indicate, after the completion of our financial year. So we are not going to get to the stage of there being a formal dividend determination until following the financial year 1998-99.

CHAIRMAN - You say it cannot be an amount higher than what the directors limit it to.

Mr KIMBER - Yes.

CHAIRMAN - There would be fair pressure on the directors from the shareholders, I would imagine, in some situations.

Mr KIMBER - I would not argue with that, but the directors of course have got their duties as directors, ... with the Corporations Law.

CHAIRMAN - I might be wrong but I thought Corporations Law itself limited the amount of dividend that could be paid in respect to earnings.

Mr KIMBER - The Corporations Law provides that dividends may only be paid out of profits. I do not know if there is a percentage.

CHAIRMAN - So up to 100 per cent of profits then, on that basis, could be recommended and called for by the shareholders then. That would be the upper limit. I just wanted to get that clear.

On that corporate structure and accountability model, have the members any questions in relation to that particular area of our interest?

Mr FLETCHER - I ask a question to clarify the situation. The impact of ministerial orders on the government-owned corporation, are there any or is there a capacity to issue ministerial orders?

Mr KIMBER - There is provision under the articles for the shareholders to direct, so effectively I think the answer is that the shareholder may direct the directors and -

Mr FLETCHER - And there is a process of issue and tabling in the Parliament.

Mr KIMBER - There is a tabling provision in relation to that, part of the annual report has to include any specific directions given by the shareholders to directors.

Mr FLETCHER - So if the ministerial order were to be that 70 per cent of after-tax profits be paid, and that was in conflict with the judgment of the directors, which would take precedence?

Mr KIMBER - I think you would find that that would then be tabled eventually so that there would be parliamentary scrutiny of that situation with, presumably, the background to the necessity for that direction being given, so that if you have a conflict between the directors' views and the shareholders' views there would be public scrutiny of it in this situation.

Mr FLETCHER - So the fiduciary duty of the directors is to the owners and if the owners use their process to make a decision and follow the process by tabling in the Parliament, and getting the approval of the Parliament, Parliament is speaking ... the owners, the taxpayers, then the directors would be obliged to meet that obligation.

Mr KIMBER - Yes.

Mr RATTRAY - I would like to ask Mr Kimber, in the event of the minister wanting more money than the 50 per cent, eventually that is a profit that they are going to take off you besides the 50 per cent, how does that affect the overall future of the actual running of Aurora and being able to meet the needs of the people in the wider community to deliver the service to the clientele that is part and parcel of the business?

Mr KIMBER - I suppose it is a broader question. It is really the same question as to any figure that is put there. It is after all a proportion of after-tax profits so that it is not something that would be likely to interfere with operational efficiencies. All we can say is that the figure which is being presently indicated of 50 per cent fits in with our planning and does not impact as far as we are concerned on operations. Previously the HEC, I might say, had been in that environment the dividend policy had been 50 per cent of their after-tax profits so it is not a change -

Mr CHEEK - So the Government has already said that they would like a 50 per cent dividend, they have already requested that, or the shareholders have indicated 50 per cent?

Mr KIMBER - I think there has been an indication that is likely to be extent of the request but there has not been any formal correspondence or direction to us so far as that is concerned, as indeed there cannot be under the articles until the completion of the financial year and the consultation with directors.

Mr CHEEK - Just following on from what Mr Fletcher said, if it actually came back to Parliament and Parliament directed they wanted an 80 per cent dividend pay out, the board would still have the power, if they wanted to, to say 'No, we can't do it' and to recommend a 30 per cent dividend. Is that the case?

Mr KIMBER - I think the scenario is that at the end of any financial year there will be discussions between shareholders and directors, with the directors making a recommendation as to an appropriate dividend amount. No doubt the shareholders at that stage would consider that and have input and discuss that level with the directors. It only then arises, if there is a disagreement between the directors and the shareholders as to an appropriate level, that the matter would then escalate and it would escalate presumably by way of a formal direction by the shareholders to the directors and that would then eventually be subject to scrutiny by Parliament as part of the reporting process. I believe it is part of the annual report. I think there is a requirement that any directions given details have to be provided.

Mr CHEEK - The directors still have the final say and the power to say, 'No, we can't afford to pay that out, it would have an impact on the company that would disadvantage the company and we can't do it in the final analysis', is that correct?

Mr KIMBER - I do not know. I think I would really have to get some advice on that issue because it is not totally clear to me what would be the legalities of that situation of a shareholder having that power with that other provision in the articles saying it is not to exceed what they recommend. So I do not know the legal answer to that issue.

Mr CHEEK - Just following on on that structure, Chairman. How many board members do you actually have and who are they?

Mr KIMBER - The board has recently been increased. Prior to Dan Norton leaving, the board consisted of the chairman, John Hasker, Gerald Loughran and Dan Norton. Dan Norton's resignation as CEO took effect at the end of December. He remained on as a director until new appointees took up their position on 15 February, I think, and those appointees were Mark Addis, who is the secretary of the Department of Infrastructure and Energy Resources; Susan Parr, who is the CEO of St Helens; Tina Sexton, who is an infrastructure coordinator at the Magistrate's Court and a qualified chartered accountant; and Mel Cooper, who is a retired bank employee, a union official -

Mr CHEEK - What experience have they had in the electricity industry?

Mr KIMBER - I would have to perhaps provide you with the details concerning their CVs to be able to provide you with those details. Mark Addis has had extensive experience in the banking industry; I am not sure whether he had direct experience in the electricity industry.

Mr CHEEK - So it would be fair to say that none of those new appointees have had any experience in the electricity industry?

Mr KIMBER - So far as their direct experience is concerned, that is correct.

Mrs JAMES - Mr Kimber, I was just wondering if there were to be a conflict between the directors and the shareholders, say, some considerable time before the end of the financial year - and I take it your financial year is 30 June and the Government's Budget will come forward earlier - whether there would be an interim report to Parliament. If you waited for the annual report then there could be a problem resolving that conflict.

Mr KIMBER - I think that is a fair comment.

Mrs JAMES - You do not know whether there would be an interim report?

Mr KIMBER - There is nothing provided for in the articles to handle a situation of an interim report.

Mrs JAMES - Not for immediate resolution.

Mr KIMBER - That is correct.

Mr CHEEK - That would be the normal process for the company to have an interim report, would it not?

Mr KIMBER - It is a rather unusual company to have that sort of provision in there. Normally, if you have a dispute with shareholders and directors, it might escalate a bit beyond a situation of there being documentation tabled in Parliament. If the shareholders had their way you would have a replacement of the board or a special general meeting of the company, so although it is formulated under Corporations

Law, there are some unusual provisions to it.

Mrs JAMES - So there is no immediate formal mechanism for resolving such a conflict, but I take it that it may get down to the wire with negotiations.

Mr KIMBER - That is correct. There is none that I know of, but I would expect commonsense would prevail and there would be a way to work through it.

CHAIRMAN - So with this situation at the moment, the Government, I take it, is currently framing the Budget and within that they will have to make an assumption of dividends. Then you will learn from that maybe what the dividend is to be required of you.

Mr KIMBER - I think the assumption which is being made is that there will be the requirement on our company of 50 per cent of its after-tax profits and I have no indication that that will be other than acceptable to our directors. I do not anticipate there being a blocker.

CHAIRMAN - The directors at this stage would not have any idea of what after-tax profits are likely to be, would they?

Mr KIMBER - I think so. We have made indications as to what our anticipated returns would be, yes.

Mr CHEEK - Can I ask on that point, Chairman, can you tell us what your six-monthly profit was?

Mr KIMBER - I think so.

Mr CHEEK - What your half-year profit result was?

Mr DEVEREAUX - $4 million after tax. That is subject to finalisation of our taxation payment.

Mr CHEEK - And that has met your projections?

Mr DEVEREAUX - Yes, it has.

Mr CHEEK - Is that above the projections?

Mr DEVEREAUX - It is just about on projection.

Mr CHEEK - Right on. I think the revenue was estimated for 1998-99 to be $144 million net, so that is based on that revenue?

Mr DEVEREAUX - Yes.

Mr CHEEK - I do not know whether you want to go further into that at this stage, Chairman, or whether you want to just stick to the structure.

CHAIRMAN - We are moving towards that area. I was going to suggest perhaps we have a look at the corporate plan that you mentioned in your submission; how it looks out in the longer term, and then flow down from that the detail costs and figures that might be current and relevant. On that, perhaps you could outline a bit further to us - I think you do mention in here a three-year corporate plan. Did I read that or might it have been in one of the other submissions?

Mr KIMBER - We referred to three-year financial projections so far as capital investment was concerned.

CHAIRMAN - Yes. Could you give us more detailed information on that and what is projected there? You have just mentioned your current profit level being on target and I am wondering what your targets were out these three years that you have a plan for.

Mr DEVEREAUX - Chairman, are you asking for the explicit after-tax profit figures as we are projecting them at the moment?

CHAIRMAN - Yes. If you give us your trend over the three years and which way you are going. I think members will probably then ask specific questions on figures that they would like in terms of projected profits over the next three years, and the like.

Mr DEVEREAUX - There are probably three key indicators of profitability that the committee needs to be aware of, Chairman, and those are the earnings before interest and tax, which is projected for the end of the current year to be around $66 million; profit before tax and abnormals are projected to be around $25 million; profit after tax of around $8 million.

CHAIRMAN - That is current. How does that vary over the three years for your projections?

Mr DEVEREAUX - It projects out increasing each year: the second year, $8.8 million after tax, and the third year, $21.5 million.

CHAIRMAN - To what do you attribute that big jump in the third year?

Mr DEVEREAUX - The data that we are talking about here is based on Aurora's projections of various outcomes largely emanating from the rearranged pricing structure which will be in place, as indicated in our letter, from 1 January 2000. Those projections are based on our anticipation of the impact on Aurora, based on commercial earnings that the organisation should be able to receive.

Mr CHEEK - So without that tariff pricing, without that pricing being known, it is fairly to make the projections?

Mr DEVEREAUX - Yes, it is. We model a range of projections, Chairman, based on a number of key variables which will determine pricing but, as indicated in our letter, at the end of the day prices will be determined by the regulator and we will be price takers rather than price makers.

Mr FLETCHER - I would like to pursue this line of questioning to some degree because it seems to me that fundamentally why this committee is meeting is to determine the capacity of the HEC to pay a $40 million special dividend sustainably into the future. I guess the quantum of that $40 million is based on assumptions that the other arms of energy will produce profits at certain levels over that period of time so the three corporations are all contributing to the revenue of the State, which I think is very fair and reasonable. But Aurora's future projections are based on certain assumptions with regard price and, Mr Devereaux, you have said that you are price takers and the variable there, or the factor that influences the outcome most, is the maximum price that will be identified by the Regulator in the not too distant future and that will be a limiting factor on you for the next five years.

Mr DEVEREAUX - That is not -

Mr FLETCHER - But surely the reasons why we are here today and the reasons why Aurora is a separate corporation is because of the impact of the national competition policy so the most important determinant in establishing your price, and therefore underpinning your forward projections, is going to be the minimum price you get, not the maximum price that you are allowed to charge. I wonder if you would give me your projections with regard to the movement of price in various tariff areas, for instance, the movement of price over the period zero to five years and five years to ten years with regard the domestic tariff, with regard the small business tariff and if there is a further tariff of big users before you get to the major industrials, that sort of area, because I would be interested in what you are projecting, given the competition that the market is going to introduce, as opposed to what is likely to happen in the national grid or in the Victorian market particularly, I think, which is really serious competition for us.

I have given a fairly comprehensive preamble there but, if we could deal with the domestic market first of all, I would like you to project for me your assumptions with regard to the movements in the domestic pricing of power in the period zero to five from now for the next five years and then five to ten years?

Mr DEVEREAUX - Chairman, could I make a couple of points here. One of the key points that we need to bear in mind is that in determining prices applicable for 1 January 2000 onwards the Regulator will adopt a building block approach, weighing up a range of competing factors. The components of the building blocks will be the energy price, which will go to the HEC, it will be the distribution charge which is levied on the monopoly assets owned by the distribution side of Aurora, it will be the retail component of Aurora - the cost and the retail margin associated with the retail side of the business - and it will include the transmission use of system - the charge for transporting the electricity across the transmission system.

In terms of projections and the data that we have provided to Treasury to date in terms of coming up with the forward projections for the combined three entities, Aurora only looks at its component of the building block approach so, in terms of our forecast, they are based on the return that we expect to get from the use of the distribution assets and costs associated with that and the retail margin that we expect to get from the retail side of the business, so that is one component one of the building block.

Mr FLETCHER - Okay. So in the domestic market, can the domestic user expect that price of distribution to increase in the period nought to five and five to ten years?

Mr DEVEREAUX - That will be something which will be determined generally by the regulator, not by us.

Mr FLETCHER - I understand that. So you are saying the impact of the Regulator to set a maximum price will have a greater impact than the competition applying a downward pressure?

Mr DEVEREAUX - In the period of the next price path which will be a maximum of five years and a minimum of three years, depending on where the Regulator pitches the term of the pricing, over the next three years it is unlikely that there will be substantial impact from competition.

Mr FLETCHER - I accept that. So I can conclude that over the immediate five years the distribution cost is going to be upward moving to the degree that the Regulator will allow it?

Mr DEVEREAUX - That would be correct, although having said that, Chairman, the usual methodology for determining distribution pricing is actually a CPI minus *x* factor and therefore in real terms the Regulator may well determine that prices for distribution should go down.

Mr FLETCHER - Could I then move on to small business because, in promoting the disaggregation and selling the virtues of competition in the past we, in the Parliament, have been provided with information that competition coming from the mainland - the national grid or the Victorian/south-east Australian grid - is forcing the price for small business to go down, does the same rules apply for small business as for the domestic market? Will there be more competition in the small business area over the next few years?

Mr DEVEREAUX - Chairman, some of you may recall there was a 1996 review of prices conducted by the Government Prices Oversight Commission. As a result of that review the prices for business, including small business customers in this State, have declined, whereas the prices for domestic customers have basically remained flat in real terms. That is a trend that the Regulator may wish to continue given all the factors that he needs to take account of in making his price determination or he may determine that prices for both sectors are appropriate at the moment or choose to vary the two.

Mr FLETCHER - So I can conclude, from listening to your evidence, that it is likely that the downward cost of distribution will increase for small business in the next zero to five years?

Mr DEVEREAUX - Sorry, the downward cost of distribution -

Mr FLETCHER - Well, the distribution as a part of the total cost of the energy to the small businessman will decrease over the next zero to five years.

Mr DEVEREAUX - I am not sure that you can call the analogy between a reduction in the cost of the distribution side of the building block and directly relate that to small business because tariffs at the moment are not a factor of the same building block approach; they have been determined on the basis of historical outcomes which are being, as a result of the 1996 process, brought more into line with market arrangements elsewhere.

Mr FLETCHER - What I am trying to make here - and I am sorry for staying with this - I am not clear in my mind with regard to where you are coming from. We seem to be at cross-purposes. I believe there is a need to reduce the cost of energy to those in the small business sector. I think that is an important task that we have. I am trying to determine whether the new structure of Aurora Energy Pty Ltd and its base-case scenario indicates that there will be a reduction, or your contribution to that energy cost will be reducing, in the next zero to five years and five to ten years. Can small business reasonably predict that the cost of energy is going to come down as far as Aurora is concerned?

Mr DEVEREAUX - If I can just make the distinction there, Chairman. Again, the very points Mr Fletcher refers to are very serious considerations that the Regulator will need to take into account in determining tariff outcomes, and including small business tariffs that are applicable to small business outcomes. In terms of what Aurora's projections are in relation to its distribution component of the building block, we are in the midst of our submission to the current pricing review which will determine prices applicable from 1 January 2000. That submission is not complete and will need to be approved by our board, of course, before it is submitted to the Regulator.

As I mentioned earlier, we model a range of scenarios to determine what the impact would be on certain outcomes for Aurora, including the distribution component and -

Mr FLETCHER - Mr Devereaux, what I am trying to determine is the sustainability of your projections. You have a base case for future projection. Is the assumption used in that projection one of a reducing price to small business - a significant overall user? Is the assumption used in your base-case projection one of reducing price to the small business sector, or one of increasing price?

Mr DEVEREAUX - I do not think it is base case, Chairman. A base case would assume no change.

Mr FLETCHER - No change at all, so no reduction.

CHAIRMAN - On that particular area of questioning. I think it has been acknowledged that the commercial sector has been paying a relatively high amount, and some suggest there has been cross subsidy in that regard. I think the Regulator has touched on this in the past in the Prices Oversight Commission and I think the general view was, as I understand it, that that was going to be put right over a period of time. But would you see that as your role in putting that right and analysing that, or more the Regulator's role to do that?

Mr DEVEREAUX - Chairman, that would be, in my view, the Regulator's role, but having said that, the Regulator and Aurora have actually jointly commissioned a study of the relativities of tariffs between Tasmania and the national markets. That study has indicated that our tariffs are not terribly much out of line with what is currently prevailing on the mainland.

CHAIRMAN - The Regulator's task - earlier you talked about a return on assets as perhaps a view you would be taking in making your submission to the Regulator, and Regulators on the mainland, I note, have allowed certain commercial returns as percentages. I guess you would be following that game pretty closely to see whether you can make claim to get a certain return on equity - and I would be interested in your comments on that - or whether the Regulator simply takes the other view and says, 'I can't allow you a commercial return on your asset valuation because I am going to determine that your prices have to be competitive with national prices'. So there are those two directions that people may come from.

I would note that you mentioned the Prices Oversight Commission report of some years ago where the commissioner indicated it was not sustainable to charge prices such that would give a reasonable return on equity and asset value without putting up the wholesale price of electricity quite dramatically. So he was unable to do that, and at that stage, I think, the prices came out were more to be kept in line with what they had been and other prices elsewhere rather than to allow a proper reasonable return on investment. I am interested in your comments on those matters and which way you feel it should go.

Mr DEVEREAUX - Chairman, again I can only speak in my capacity as an officer of Aurora, so I will preface my remarks with that opening. In terms of Aurora, Aurora is a distribution retail business and the return that Aurora generates is dictated by two key aspects: one is the return on the distribution assets of the business because it is fundamentally a monopoly in the State. The Regulator determines the return applicable to those assets and that return is the weighted average cost of capital which is applied to the cost of the assets, the value of the assets. Two key points there: it is actually the Regulator who determines the value of the assets in the first place, and it is also the Regulator who determines the appropriate return on those assets.

CHAIRMAN - So he could be working back and say, 'This is a reasonable price to be competitive. You should get a 7 per cent or 8 per cent return on your assets, so your assets are then worth *x*'. He would work back that way, would he?

Mr DEVEREAUX - That is one way he could go about it.

CHAIRMAN - Which could reduce the asset value of your operation quite substantially.

Mr DEVEREAUX - It could well do, but the fundamental return on the assets is, as I mentioned, determined by the Regulator by application of that weighted average cost of capital.

The second key element of the return for Aurora is the retail margin returned from the retail side of the business, which again the Regulator will determine. The component that I have not referred to, which is implicit, of course, is the actual cost structures that are associated with the distribution and retail activities. The Regulator also determines what is an appropriate cost structure for a distribution side of the business and for the retail side of the business. So it is the Regulator who determines all aspects of the income to the distributor, the income to the retailer by way of margin, and the costs of operating the business.

Mr CHEEK - Just going back a little bit to when you were giving your projections for those three years, and you had $8 million for this financial year - which I presume would give a 50 per cent dividend payout of $4 million to government - then $8.8 million, then you went up to, I think, $21.5 million for the third year. Is that because your projections show you will be charging higher prices in that third year to have such a big jump in profit levels?

Mr DEVEREAUX - Chairman, that does not follow because the Regulator will determine end prices.

Mr CHEEK - But how did you arrive at the $21.5 million?

Mr DEVEREAUX - By application of the weighted average cost of capital that we believe is appropriate to the business as a commercial return on the assets.

Mr CHEEK - But if it is only $8.8 million in the second year and it has gone up $13 million in one year, I just do not understand fully how that can happen. Can you explain that in a little more detail, please?

Mr DEVEREAUX - We would be anticipating an increase in the value of the assets in that third year.

Mr CHEEK - An increase in the value of the assets. So it does not mean higher pricing?

Mr DEVEREAUX - Not necessarily, no, not at all.

Mr CHEEK - So if your assets are increasing how does that increase your profit - your operating profit? If you are increasing the value of your assets, how does that increase your operating profit?

Mr DEVEREAUX - By direct application of the weighted average cost of capital to the value of the assets.

Chairman, as I mentioned before, some of the projections that we are looking at are based on what we believe is an appropriate commercial return for Aurora.

CHAIRMAN - This is more your argument than necessarily what the Regulator will accept.

Mr DEVEREAUX - That is exactly right. In terms of looking at the building block approach, the Regulator will take here the inputs from each of the electricity businesses and obviously look at the net end result that that would have on prices to consumer. In taking that path he might determine that what is projected will not deliver an appropriate outcome and needs to modify the end result.

CHAIRMAN - So when you make a submission on pure commercial lines looking for a return on asset and a percentage and all these other things, as a pure commercial entity, are you coming from a direction that is not necessarily taking into account totally the price of energy in other jurisdictions and whether you need to be competitive with that? How does that play in your submission? In your submission you would have a significant amount of work done, would you not, on energy prices elsewhere, and how competition - if there is any real competition introduced in Tasmania by Basslink or Gaslink - will affect you?

Mr DEVEREAUX - Certainly, Chairman, one of the factors of course that does drive our profitability is the energy price that we pay as part of the building block approach. It is certainly Aurora's view that to remain competitive into the future we will need to have a competitive energy price and there are a range of views as to just exactly what a competitive price for energy is into the future. So, again, we will have one view on that which we will put to the Regulator as to what that is.

Mr CHEEK - So the Regulator sets the retail margin and the retail margin stays the same, you do not change that at all. What is the retail margin?

Mr DEVEREAUX - That is expressed in either percentage terms on total revenue or dollars.

Mr CHEEK - In percentage terms?

Mr DEVEREAUX - Percentage terms?

Mr CHEEK - Yes.

Mr DEVEREAUX - Currently the return on retail customers is 2 per cent.

Mr CHEEK - So if the Hydro had put up prices, for instance for the $40 million special dividend payment they had to put up prices to be able to sustain that, that would impact fairly heavily on you as far as you would still be charging the same margin and therefore prices, I presume, would have to go up quite significantly.

Mr DEVEREAUX - I do not think you can draw that analogy because, as I mentioned before, at the end of the day the impact to Aurora will be what its return on its assets is and what its retail margin is.

Mr CHEEK - But if you are having a higher charge from the Hydro and you have obviously got to get a margin that will have -

Mr DEVEREAUX - But the Regulator also sets the energy price as part of his pricing determinations.

Mr CHEEK - Yes, okay. If there was a reason for him putting it up, taking that into account, all ... would go up as well and that would be set by him.

Mr DEVEREAUX - Yes.

Mr CHEEK - What about debt repayment, have you factored that into your projections as far as paying off your debt that is now $385 million over this three to five years, how much debt is going to be repaid?

Mr DEVEREAUX - I cannot quite give the exact figure but we certainly have factored into our forward projections a debt repayment program which is appropriate for the organisation and the expectations of the shareholder.

Mr CHEEK - Can we have those figures on what you expect to repay in debt over that period?

Mr DEVEREAUX - Chairman, I can make those figures available for you.

CHAIRMAN - I would appreciate that.

Mr CHEEK - Just still on the operating, your employees were 930, is that roughly what they are now? I think this was at the beginning of the financial year, so is that roughly what they are at this stage?

Mr DEVEREAUX - I think they have actually reduced slightly from the 930 level but in that ballpark.

Mr CHEEK - So do you expect to be reducing the work force to gain further efficiencies?

Mr DEVEREAUX - I think it is fair to say, Chairman, that Aurora Energy, as in any business in a competitive environment, is looking at all the efficiencies that it can gain from its operations and in fact is obliged to do so under the Tasmanian Electricity Code. What that translates to in terms of actual employee numbers I am not in a position to comment on at the moment. We are certainly looking for efficiency gains.

Mr CHEEK - With your interest payments, what does your interest rate cover at the moment? What percentage have you got there?

Mr DEVEREAUX - What sort of numbers are you looking at there -

Mr CHEEK - What sort of interest payments are you making at the moment?

Mr DEVEREAUX - Our annual interest bill is - Chairman, I am not sure we should be quoting these numbers or whether these need to be considered commercially-in-confidence.

CHAIRMAN - You do not have a lot of competition?

Mr DEVEREAUX - No, okay. The interest bill at the moment is $40 million a year.

Mr CHEEK - $40 million a year?

Mr DEVEREAUX - Yes, and the interest cover on that is around about $1.6 million.

Mr CHEEK - How much of the debt is rolling over this financial year?

Mr DEVEREAUX - I would have to take that question on notice in terms of the detail. I have an approximate figure in my head but I would need to give you some written detail on that.

Mr CHEEK - Thank you. Could you also give us an indication of your projections on interest rates - I know that is crystal-ball gazing - but what effect any rise in interest rates will have on that debt - I mean, 1 per cent, what difference it would make to your bottom line?

Mr DEVEREAUX - What we have in place, Chairman, is that we have a long-term debt benchmark which has been determined by independent advice which is pitched to give us the minimum possible exposure to variations in interest rates. So 1 per cent interest, again, I have not got that particular number on the top of my head but it is relatively minimal in terms of the profitability of Aurora.

Mr CHEEK - Do you actually own the poles and wires? Is that part of Aurora?

Mr DEVEREAUX - The distribution -

Mr CHEEK - Yes, so you actually own the poles and wires?

Mr DEVEREAUX - That is correct.

Mr CHEEK - What sort of maintenance have you factored in for those over the next three years?

Mr DEVEREAUX - Chairman, as part of Aurora's operating environment we have both operating expenditure directed at maintenance of the assets and capital expenditure directed at maintenance and replacement of the assets. The amount of expenditure that we direct towards those assets is based on a very detailed risk assessment of the condition of the assets and, as I mentioned, that is backed both into operating costs and capital costs.

Mrs JAMES - Is that where the $35 million you are going to borrow will go?

Mr CHEEK - That is the superannuation -

Mrs JAMES - That is to repay the super.

Mr DEVEREAUX - That is for a one-off explicit payment.

Mrs JAMES - But you would have to replace that, would you not, from another source?

Mr DEVEREAUX - Replace the $35 million?

Mrs JAMES - Yes.

Mr DEVEREAUX - No, that is just a one-off outright restructuring of the balance sheet to address the requirement for repaying withdrawals from RBF.

Mr CHEEK - So to simplify it, can you give me a figure on what will be spent on maintenance of the assets for this financial year?

Mr DEVEREAUX - As an example, in the forthcoming financial year, 1998-99, we are looking at spending $37.7 million by way of capital on the distribution assets. But contained within our operating cost structure is further maintenance on the assets, including vegetation management and such.

CHAIRMAN - It would seem there are still quite a few areas to explore with you. Have you any time limits this morning? We had allocated up until twelve o'clock but I was just wondering whether you have time to take a short break -

Mr KIMBER - I am at your disposal.

CHAIRMAN - I think at this point I might adjourn the meeting for, say, fifteen minutes while we can just take a break and get our minds and everything else into gear.

SHORT ADJOURNMENT

CHAIRMAN - I will declare the meeting to be resumed. Mrs James indicated to me that she would like to ask a few questions.

Mrs JAMES - Yes. I have been rather interested in what has been going on in South Australia and I daresay Mr Kimber and Mr Devereaux are probably aware of recent statements by the Premier. I was wondering if any Tasmanian government has the ability to impose charges, such as South Australia are talking about, perhaps by way of levy - and there is an existing levy, I understand.

Mr DEVEREAUX - I guess, Chairman, the short answer would be, yes, because there is one.

Mrs JAMES - There is one. So they could increase that; they have the capacity to? That would be over and above Aurora's funds then?

Mr DEVEREAUX - I am not sure what the capacity is to vary that existing levy. In fact there has been legislation which has been approved by the Parliament to remove the levy from domestic customers. I presume it can be taken off and put on.

Mrs JAMES - That can be used over and above any tariff increase that you might be considering?

Mr KIMBER - That levy is not actually a levy on customers; it is a levy on the income received from Aurora from retail sales.

Mr DEVEREAUX - Cleary that is obviously a matter of government policy in terms of the application of that particular levy.

Mrs JAMES - Would that come within the Regulator's jurisdiction? Perhaps he is the one I should be asking.

Mr KIMBER - The initial GPOC determination took into account the existence of the 5 per cent contribution as a tax, and so it would certainly have to be taken into account by the Regulator as part of the costs of the organisation, if it is subject to a 5 per cent tax on its retail income.

Mrs JAMES - Thank you. As there are substantial South Australian increases that are proposed, I was wondering how, if a government were similarly minded here, if they could do it by levy or is it outside Aurora's arrangements.

Mr DEVEREAUX - It is outside of our arrangements.

Mrs JAMES - And so it could be done, but subject to the Regulator's imprimatur.

Mr DEVEREAUX - Yes.

Mr FLETCHER - I would just like to go back to two questions: one is the profitability under the base-case scenario projection, and then ask questions with regard the capacity of Aurora Energy Pty Ltd to meet competition, or to provide competition, given its status.

Mr Devereaux, you explained to us at an earlier time that profit after tax was one of the key performance indicators that we should focus our attention on, and then you went on to explain that under the base-case scenario the profit after tax in 1999 was estimated to be $8 million; the following year, $8.8 million; and then a very substantial jump to $21.8 million in the third year, 2001. You further explained to me in considering that base-case scenario that the scenarial projection was on the basis that there would be no change in price; it was the same price structure throughout the term.

It seems to me that if you are going to have a very substantial increase in profit in year three without any increase in price, even though there is a revaluation of your assets by the Regulator, the revaluation itself means nothing unless you alter the prices or you substantially increase your sale of the product - your distribution of the product - by a very great amount, or you substantially reduce your operating expenses in some way to enable that greater profit. It seems to me that if you have explained to me that you are not going to change the price - the projection in the base case is not to change the price to deliver that profit in the third year - there has to be some other reason for that that you have not explained to us or, alternatively, your base-case scenario was flawed - which I do not consider that it would be. So I am wondering if you would focus on the $21.8 million again and explain to the committee why or how, given that the prices are pegged, that we are going to deliver that outcome in 2001.

Mr DEVEREAUX - Chairman, just again to reiterate, in terms of our projections we do not look at the global outcome because ours is only one input into the building-block approach and therefore our input is just that - one input into the considerations that the Regulator will have in determining the final price outcomes which are applicable to our customers.

Having said that, if I could just flick quickly to the second part of the question, certainly in the submission that we make to the Regulator, one of the key messages that we will be seeking to deliver is that Aurora needs to be well positioned to be able to deal with competition in the marketplace when it arrives.

Mr FLETCHER - Well, Chairman, if I might intervene there because my questions were meant to be two separate questions and I have not asked the second question yet. The question I am asking at the moment is for an explanation as to why - your letter to the committee and indeed a great deal of what you had planned for the future is based on your base-case scenario. That seems to me to be the scenario or the projection that is accepted by Aurora Energy Pty Ltd as being the most likely outcome. There are certain assumptions that are built into those projections. You have explained to me that the assumptions are that the Regulator will take certain actions but that the price of energy will not change.

When I questioned you at an earlier time about the variations in price over zero to five, five to ten years, you explained to me, no, the base case is on the basis that there will be no change in the price that Aurora is getting for the product they are distributing. Given their price is not going to change and the profit is going to go up dramatically, what is the reason for that dramatic increase in profitability in the base-case scenario?

Mr DEVEREAUX - There are a range of factors which will determine overall profitability within Aurora. Some of them are, as Mr Fletcher has indicated, the input prices for the energy that we would purchase would be a major determinant; it will be the efficiencies that we can secure within our operations to deliver better financial performance; it will be the return that we get on our assets as indicated before, and the retail margin. It will be a combination of those factors which will determine our ultimate profitability.

Mr CHEEK - Earlier you said to me that the increase to $21.8 million was because your assets were going to increase. That was the answer, I think, you gave me earlier -

Mr DEVEREAUX - In value; that is the primary reason.

Mr CHEEK - In value - but if you are still getting a return of 5 per cent and that is set at 5 per cent, if you have assets of $100 million that would give you a $50 million return. If they go up to $200 million that means you will get $100 mill return, but to get that profit you have still got to get it from somewhere. To increase prices would be the only way or otherwise increase your market share. No doubt the Government, if you have shown them those projections, will be expecting $10 million or $11 million from what you have projected in profit. So it has to come from somewhere. The answer you gave me earlier about the increase in assets does not make much sense to me because you still have to get the money from somewhere if you are going to have that profit.

Mr FLETCHER - I think that is the nub of what I am about. If there is an increase in assets, the increase in revenue can only come about by an increase in market share or an increase in the price that you are charging if you do not increase market share. And yet your base-case scenario says that you are not going to increase the price, the price is consistent throughout the term of your forward projection. So I go back to my original question: is the scenario flawed or is there a factor there that we do not know about that has not been explained to us at this stage?

CHAIRMAN - Yes, and further expand on the question, if you like. I have just written down here, 'The more you spend on capital the more you can charge under your scenario', except that you had earlier said that the Regulator in essence, if he constrains you to, say, mainland prices to be competitive, is devaluing your asset base anyway. That is the framework of the concern the committee has.

Mrs JAMES - Or efficiency from better assets.

Mr DEVEREAUX - More efficient operation of the assets, yes.

CHAIRMAN - So we still need a bit more information from you to try to resolve that matter for us.

Mr DEVEREAUX - Chairman, I am not sure what I can add - to go to Mr Fletcher's point about projections. As I mentioned, they are an input which has not been finalised, as I mentioned before, in terms of our submission to the Regulator in terms of what we see as being appropriate as far as commercial returns go for Aurora.

CHAIRMAN - So again, the $8 million that you are getting next year and $8.8 million next year is not an appropriate return, in your view, from the investment in the capital.

Mr DEVEREAUX - That would be the argument that we would put.

Mr CHEEK - But the $8.8 million for the next financial year, 1999-2000, will be based upon the price that is set by the Regulator this year, will it not?

Mr DEVEREAUX - It is indeed.

CHAIRMAN - So therefore the $21.8 million will be based on that price too.

Mr DEVEREAUX - On a price which the Regulator determines, yes.

CHAIRMAN - And this profit is based on the Regulator accepting your submission to him on how you believe you can operate.

Mr DEVEREAUX - That is correct, and if he does not accept that then we would then revert to one of the alternative scenarios that we would be painting.

Mr FLETCHER - So your proposition to the committee at this stage is that your next presentation to the energy Regulator will be that he should significantly increase the value of the assets and therefore significantly increase the amount of energy that Aurora can raise as a result of that valuation?

Mr DEVEREAUX - That argument, if progressed to conclusion, would imply that the return that Aurora generates on its assets by application of the weighted average cost of capital to the value of those assets would increase. That would be the argument that we would propose.

Chairman, I am hesitant to progress down that path terribly much more because, as I mentioned, that is part of a submission which is in progress at the moment which has not been approved by Aurora's board and therefore it is somewhat speculative in the potential outcomes.

CHAIRMAN - You have indicated that it is coming from a commercial direction and it is based on getting a return on your asset value, but you acknowledge that if the Regulator sets it lower than that he is essentially reducing the value of your company.

Mr DEVEREAUX - There are a number of levers which the Regulator could pull to impact on the return that Aurora generates, as indicated in our letter to you.

Mrs JAMES - And that would have tax implications as well.

Mr CHEEK - How often does the Regulator review the pricing?

Mr DEVEREAUX - This is the first review since his initial pricing review in 1996 and the terms of reference indicate that the maximum term for the next price set would be five years.

Mr CHEEK - I am sorry to just return to that and I know you are getting sick of it too. In 1999-2000 it will be based on what the Regulator sets and therefore in 2000 and 2001 it will be on the same basis of what he has set, but you still have that $13 million jump in profit. It is based on your submission and what the Regulator will set, so it still does not explain that huge jump in profit based on the same premises.

Mr DEVEREAUX - As I mentioned, that will be the proposed argument in terms of the scenario that -

Mr CHEEK - It is also the also the argument for the $8.8 million too.

Mr DEVEREAUX - Not quite the same. The $8.8 million is actually based on current prices and the current revenue-sharing arrangements which were part of the disaggregation process. During the disaggregation process there was an allocation of revenues to each of the entities and the return that you see reflected in the 1998-99 year results from that allocation of revenues.

Mrs JAMES - Can you cope with increased power sales? Are you anticipating increased power sales, say, with magnesite coming on stream, and those sorts of things?

Mr DEVEREAUX - Again, those sorts of considerations are factors that we will need to take into account as we progress further down both our business planning and price submission processes.

Mrs JAMES - You have the capacity?

Mr DEVEREAUX - We certainly have the capacity, yes.

Mrs JAMES - That would account for an increase as well. Have you taken that into consideration?

Mr DEVEREAUX - At this point ... do not include any benefits or detriments that might arise from that particular proposal.

Mrs JAMES - Based on present -

Mr CHEEK - Can I just put it another way, then. Can you explain the components of the increase from $8.8 million to $21.5 million? Not the actual increase of $13 million. What is it going to be made up of and what amounts? You know, is $5 million through efficiency gains, $2 million in another way?

Mr DEVEREAUX - I do not have that detail available to me right at this moment.

CHAIRMAN - I do not know whether there is some material - I suppose it is the sort of stuff you get in your annual report - that would enable us to give further analysis to this matter. What the committee is struggling with is going from $8.8 million suddenly to $21.5 million through a period of time during which the Regulator will have made determinations for, which would seem to be constant determinations, unless he makes allowance for jumps throughout that five-year period or whatever period he determines it to be.

Mr DEVEREAUX - Chairman, again I just refer to the fact that the data that I was referring to there is part of the data that is a component of our usual business planning process which is subject to change as information becomes available to us. What you have there is a scenario which will be refined as we progress through the year as certain events become more clear as to their impact, not the least of which is the pricing determination. Our projections will need to change accordingly. Therefore, if we find that arguments we are proposing are not accepted, then we will need to vary our projections accordingly.

CHAIRMAN - There would be base figures that would have developed these profit projections and within those base figures we would need to see those base figures to see where that sudden increase came from; whether it was efficiency gains or whether you expect the Regulator to allow you to charge more at that point in time or some other similar factor.

Mr DEVEREAUX - Chairman, I can assure you that the base-case scenario that we were proposing at the time that the information was made available to State Treasury at your request is not the same as the base-case information that we are currently using, because information has become available to us which will change our view.

Mr FLETCHER - Chairman, I think that is important. Are we getting the old base-case scenario information or are we getting the current base-case scenario information?

Mr DEVEREAUX - What you are looking at that I just quoted from is from previous submissions that have been provided, I think, in late 1998, Chairman.

CHAIRMAN - When would your current submission be complete and signed off by the board?

Mr DEVEREAUX - Our timetable at the moment is for the submission in its final form to be completed by about the end of this month, but then it will need to go through a process of being approved by our board and then formally submitted to the Regulator. At this point I am not sure that the Regulator's terms of reference indicate what time submissions should be received, but that is our timetable, Chairman.

Mr CHEEK - I understand they may change, but you have been able to give a precise figure of profit for that third year. So it would seem to me that you would also be able to give a very precise figure about the changes in costs or increase in revenue to arrive at that figure. You have given it, it is a precise figure you have given so therefore the changes should be very precise too to arrive at that figure - either in revenue, lower cost, efficiencies. That is what I am trying to get at. Because of the precise figure I cannot see why the correlation cannot be for a precise figure on the change as well.

CHAIRMAN - Or is it some abnormals that might have changed because of the jump?

Mr DEVEREAUX - No, no, Chairman. As I mentioned, the primary issue there is simply the value of the assets. That is the primary determination.

CHAIRMAN - I see. So you assume the value of the assets have gone up and you want a higher return, and the value of the assets jumped up as a result of capital expenditure that you are planning -

Mr DEVEREAUX - No, Chairman. It is simply an up-to-date assessment of the value of the distribution assets.

CHAIRMAN - Revaluation of assets.

Mr DEVEREAUX - Yes. Now, again, the value of the assets is something which is being independently determined by the Regulator as you alluded to previously and his determination may well be not the same as that which we have factored into those projections.

CHAIRMAN - The determination of asset value then, I do not know, that would be based on what they can earn, would it not, rather than looking at them in the material sense and replacement cost.

Mr DEVEREAUX - That is kind of a circular argument, Chairman, which is fundamentally correct in that if you start with the prices at one end and work backwards that will drive the value of the assets.

CHAIRMAN - Well, is that not the process that we have in front of us that has to occur?

Mr DEVEREAUX - Not quite, Chairman. In terms of adopting the building-block approach the Regulator will receive submissions from HEC, Aurora and Transend, each arguing for its own component in the building blocks, which will ultimately determine prices at the customer end. In terms of the asset value, there has been an independent audit conducted by the Regulator using an engineering firm, SKM, and that independent assessment of the value of Aurora's assets will in fact be the determinant of revenues which subsequently flow.

CHAIRMAN - Well, unless the Regulator takes a view, and I understand he is able to, that energy prices - say, your asset values of the three components are pretty high and if we look historically at return on assets from the authority before it had been disaggregated it was very, very small, commercially you would be looking at two or three times that, I would imagine.

Mr DEVEREAUX - Again, Chairman, I can only speak for Aurora's position and that is that we would be arguing for a commercial return appropriate for our business and that is reflected in the weighted average cost of capital.

CHAIRMAN - So that means then that if the Regulator, for instance, took the other track - and I understand he would be able to - and said, 'Energy prices in Tasmania have got to be competitive with other jurisdictions on the mainland and that is my prime determinator' and works back from there, not giving too much weighting to what you and all the others say your assets are worth, or on what basis you value them is a big question anyway, and therein your asset valuations would not have much meaning anyway. In the context of that and the fact that the Regulator may well take strongly into account, and there are indications of that, the mainland prices and want to keep them within bounds of that, do you look at mainland prices and will your submission contain anything on that? Would you, for instance, take a position that the current mainland prices, say in Victoria, are not sustainable in the long run and are being sold at under cost and thereby there will be rises there which will enable rises to occur here which you can gain benefits from?

Mr DEVEREAUX - Chairman, are you talking there in relation to the wholesale energy price in Victoria or the customer end?

CHAIRMAN - I was thinking the customer end in terms of, I think, the Regulator would be looking at what the customer has to pay and whether it is competitive, how that affects industry and small industry in Tasmania as against the mainland, I guess. Whether you are wanting to remain competitive and hold and attract industries here moves further into the political scene but he, nevertheless, can look at maintaining competitiveness with the mainland situation and use that strongly, I suggest, in his determinations and the retail end and the small business would be certainly within his parameters.

Mr DEVEREAUX - Yes, Chairman. As I mentioned before, Aurora's position would certainly be that we would like to see outcomes from the pricing review process which will ensure that Aurora is well positioned to deal with competition when it ultimately arrives in Tasmania, which means taking account of explicitly the price structures which are prevalent in mainland Australia.

CHAIRMAN - How soon do you think competition will be before it arrives in substance?

Mr DEVEREAUX - Chairman, I think it is fair to say that there is a form of competition which is already existing in this State in the sense that some of our larger customers have already been approached by mainland utilities, so in a sense it is here now, but certainly when the Basslink project is complete then real competition will be at our doorstep.

CHAIRMAN - Those entities would be buying power from the Hydro-Electric Corporation, would they not?

Mr DEVEREAUX - Which entities are that, Chairman?

CHAIRMAN - The ones you are talking about from the mainland.

Mr DEVEREAUX - At the moment, no, they would be buying from the mainland electricity pool - wholesale energy pool.

CHAIRMAN - I see, and using Basslink as the conveyance.

Mr DEVEREAUX - Yes.

Mrs JAMES - I think it was Fred Hilmer who said the money invested in the power stations in Victoria was slow capital - that is, low returns until they are ready to shift and there is already a move on for higher prices, so that will have an impact upon the lines the Chairman was saying, but that was not my question, unless you care to comment on that. Would it be true to say that to achieve the $21.5 million we have been talking about that the outcome would be increased sales efficiencies and/or increased prices of power.

Mr DEVEREAUX - Whilst I mentioned earlier that in terms of our current modelling that we are looking at a base-case scenario which is predicated on virtually no increase in real terms - that is one scenario. In terms of delivering that kind of outcome that you just referred to, it would be a culmination of additional asset values, a weighted average cost of capital appropriate for the business, we would be looking at some volume growth and application of CPI in some areas of our pricing.

Mrs JAMES - It is all about where money is coming from, is it not? Would it be true to say that you expect it to come from increased sales, from efficiencies and if that did not meet the $21.5 realisation on your assets then you would have to look at increased power prices with the Regulator determining what that might be.

Mr DEVEREAUX - Again, I just go back to the point I made earlier and that is that the numbers I quoted earlier from our projections that were completed around the end of last year, our current projections certainly will not be the same numbers as those and there will be a range of factors that we bring into the calculations and projections as we progress through our business planning cycle.

Mr CHEEK - Did you say CPI increases? So you are allowed to add on a CPI increase from what the Regulator sets?

Mr DEVEREAUX - I guess Aurora in its deliberations can assume lots of things but at the end of the day the prices will be determined by the Regulator as part of that independent pricing review.

Mr CHEEK - And the extra volume you are talking about, where do you expect that to come from?

Mr DEVEREAUX - That comes from a range of sources across our customer base.

Mr CHEEK - Can you give an example?

Mr DEVEREAUX - Not specifically, but certainly in terms of load forecasts for various sectors of our market are showing growth. Some areas are not but some are showing growth and therefore we have modelled load increases, modest but they are there.

Mr CHEEK - With the major users, they buy direct from the Hydro, do they, or do you actually supply some of the major industrial users that have contracts?

Mr DEVEREAUX - All customers in Tasmania purchase electricity from Aurora.

Mr CHEEK - Comalco?

Mr DEVEREAUX - All.

Mr CHEEK - Do they?

CHAIRMAN - But the contract flows through.

Mr DEVEREAUX - Yes, it does.

Mr KIMBER - The contract was assigned to Aurora as part -

CHAIRMAN - Yes, and you cannot even make submissions in terms of increases in prices in relation to those contracts then.

Mr DEVEREAUX - Yes. The pricing arrangements for major industrial customers are not part of the Regulator's deliberations.

Mr CHEEK - And that is about two-thirds of the customers anyway, is it not - the major users as far as volume goes?

Mr DEVEREAUX - Two-thirds of volume is a close approximation, yes.

Mrs JAMES - Do you think the financial viability of Aurora could be at risk? I notice the second last paragraph of the statement by Mr Kimber, a lot depends on what the Regulator does there, where it says 'The outcome of that process and not government dividend policy will be the single most critical determinant of the financial viability of Aurora Energy'. That seems to be a pretty dramatic sort of statement.

Mr DEVEREAUX - Yes, that is pretty much a statement of fact. As I mentioned before, the Regulator determines asset values, the rate of return on those assets, he determines the allowable costs within the business and he determines the retail margin, so at the end of the day our future very much hinges on the outcomes of the pricing review that the Regulator will undertake.

Mrs JAMES - It affects your investment and your infrastructure and services.

Mr DEVEREAUX - Yes.

Mrs JAMES - Who is he answerable to? Is he the power of one?

Mr KIMBER - The structure has changed from being a GPOC commissioner in which he could make recommendations. He now makes a determination.

Mrs JAMES - All powerful. It seems to me that if you feel his decision may place Aurora at some risk of financial viability, that seems to me to be a pretty big question.

Mr DEVEREAUX - To pick up on Mrs James' question, I am sure that the Regulator - I cannot speak for the Regulator of course - but he will have a range of factors which he will need to consider in his determination, one of which will certainly be the financial viability of the various organisations which he is making price determinations for.

Mrs JAMES - I wonder about human fallibility sometimes.

Mr FLETCHER - I was just going to make an observation that the energy Regulator has the powers conferred on him by, we, members of Parliament. What he is is what we made him.

CHAIRMAN - And there are certain powers vested in the Treasurer in relation to his guidelines.

Mr FLETCHER - I would like to reach a conclusion in my mind. I would like to conclude something in my mind and I am asking you to comment on that. I would like to conclude that the current thinking of Aurora Energy Pty Ltd is that their submission to the energy Regulator will be for an increase in valuation, an increase in the return on the assets, therefore considerably increasing the revenue of Aurora Energy but that revenue will be minimised to a degree by both efficiencies and the input prices of energy coming from Transend and the HEC. Is that a correct conclusion?

Mr DEVEREAUX - That is a reasonable conclusion. That will be the argument that we will be putting as part of our submission, as I mentioned, which is not finalised yet, but that is essentially the thrust.

Mr FLETCHER - Okay. The second point - and I am finished after this - the reason we are all here is that the national competition policy determined that there needed to be competition in the utilities. The old Hydro was disaggregated, Aurora Energy is with us at this time, I believe or I want to believe, that the competition is going to drive the price of energy down. It is going to produce efficiencies in some mystical way that competition does, that delivers the service and reduces the price and sustains the profitability of the business at the same time. It seems to me that if prices are forced down by competition then Aurora Energy, as indeed the other components of the energy utility market, have either got to increase market share or lose profitability if they sustain the price or increase the price - I suppose that is the other thing - and you seem to be suggesting to me that increasing market share is not on at this stage and therefore it becomes a matter of increasing price or losing profitability. I have a feeling that so much of our State's future is predicated on strong cash flows or strong dividends and tax equivalent flowing from the utilities to the Consolidated Fund, that we are under considerable risk if this cannot be sustained. If competition is driving the price down, then we have only got efficiencies and market shares available to us, if we are to sustain the cash flows, sustain the Consolidated Fund and deliver the outcomes that I am sure all Tasmanians want to be delivered, can I conclude that? Do you have an argument with that proposition?

Mr DEVEREAUX - The only point you missed in the earlier part of your comments just now was the efficiency gains which can be delivered and in terms of if you take the analogy of decrease in prices resulting from competition without delivering efficiency gains then ultimately profitability would be impacted. But certainly Aurora has a role to play in delivering efficiencies in the manner in which it delivers electricity to its customers.

Mr FLETCHER - So you are saying to me now that Aurora, as a corporate entity, can operate much more efficiently than the old HEC was able to operate in the distribution of energy.

Mr DEVEREAUX - I could not make any comment, Chairman, in relation to the comparison to the old HEC but certainly Aurora, as in any business in any competitive environment, is actively seeking to drive efficiencies through the business.

Mr CHEEK - Just on that particular point, Chairman - the efficiencies, can you tell us where you are going to find them - is it fewer jobs, less capital investment? Can you just tell us the areas where the efficiencies will come from - just a rough idea, I guess?

CHAIRMAN - It comes back to the numbers you are projecting to employ, I guess, down the track.

Mr DEVEREAUX - Chairman, I guess at the end of the day it is not exactly rocket science to predict that substantial cost reductions in any business relate largely to labour and certainly we would not be any different to that. I certainly would not be making any forecasts about the relativities of efficiencies compared to our current labour cost which essentially translates to jobs. But we certainly believe there are opportunities for us and we have conducted benchmarking exercises to give us a feel for how we compare relative to other comparable businesses.

Mr CHEEK - And how do you compare with labour with other businesses throughout Australia?

Mr DEVEREAUX - It does not look so much directly at labour, it looks at the various input costs to the various components of our business.

Mr CHEEK - But just on labour, how do we compare?

Mr DEVEREAUX - Again, in terms of labour the studies do not focus on labour in terms of number -

Mr CHEEK - But they do have a payroll benchmark throughout the industry.

Mr DEVEREAUX - Labour productivity in the distribution side of our business is demonstratively quite good.

Mr KIMBER - We are not just seeing efficiency on the basis of just numbers, we are looking at doing what we do smarter, more efficiently, more effectively and when you really have a hard look at the way you do operations it is amazing what you can find. We have work teams out there who now know that we are dealing with bottom lines which are critical. We have men in the field who are making suggestions to their managers as to 'Why don't we do it this way. We'll start that way. We can fit more work into that particular time frame'. It is organisational cultural change towards doing things and there has been a big change in the culture in Aurora which is driven towards efficiencies without there being necessarily reduction in people.

Mrs JAMES - Steel poles instead of wooden ones?

CHAIRMAN - All those things generally result in reductions at the end of the day. In getting back to figures, do you have projected numbers in terms of employment over the three years of your plan?

Mr DEVEREAUX - Chairman, at this point in time we do not because, as I mentioned earlier, we are currently in the midst of our business planning process and one of the outcomes from that will be the corporate plan which we will submit in the normal course of events. Just to pick up on one point that Mr Fletcher made and I did not get a chance to comment on, was the capacity to grow market share. I guess it is fair to say that whilst our capacity to grow market share in terms of the current electricity market in Tasmania is somewhat limited, there are opportunities for various parts of our business which we are looking at as part of the business planning process and, as I mentioned, we are in the midst of that right now and therefore the kind of projections and the financial forecasts that we make will be changing, particularly over the next two months -

CHAIRMAN - We will just have to keep tuning in.

Mr DEVEREAUX - Indeed.

Mr RATTRAY - Mr Chairman, it is very interesting with all the emphasis put on efficiencies and so on, I need to comment in regard to that. I happen to come from the outlying areas in the north and I can quite assure you that the boys who are keeping the power supplies on, there is not too much more room to be taking too many of them away otherwise the power may not be on.

The thing that I am interested in is the $8. million this year and the $8.8 million and the $21.5 million . You say that we would have a $25 million profit and then an after tax of $8 million. Now to get this $21.5 million, have you given consideration to the amount of money extra that Aurora needs to turn over after efficiencies and so on to come to that scenario? Somewhere along the line you can do a lot of your internal reconstruction of what the outcome is, but it seems to be a lot of money and I wonder what percentage extra over and above your gross income for Aurora now you might need to obtain into the future. Have you done any work on that, John?

Mr DEVEREAUX - Yes, we have - through you, Chairman - but again, as I stress, we are in the process of finalising our corporate plan and our business plans right now so reliance on any of our projections to date needs to be taken with some degree of caution. But certainly I would make the comment, Chairman, that whilst the numbers are comparatively different, when you think about the fact that we are talking about an asset base of $800 million, in terms of percentagewise it does not take a lot of movement to make an impact of that scale.

Mr CHEEK - Just on that point too, if you are talking in response to Mr Rattray's question, it looks like on a revenue of $144 million you have about 6 per cent on the bottom line. If you project that out - and I know you are going to make efficiencies - to get $21.5 million you need a revenue of $350 million, which is another $200 million more.

Mr DEVEREAUX - I am not sure how you derive those sorts of figures.

Mr CHEEK - I am talking about the percentage of profit on revenue, which is about 6 per cent, if you are talking about $8 million, on $144 million.

Mr DEVEREAUX - The current distribution revenue is $135 million, the current retail component of that $45 million.

Mr CHEEK - I am just talking about the percentage on the bottom line as a percentage of your total revenue. If you are talking about $21.5 million you would need to have revenue of $350 million, if you are talking about 6 per cent on the bottom line, to give you that figure.

Mr DEVEREAUX - Again, Chairman, through you - you cannot make a direct comparison between the percentage increase in profit because, for instance, just to take those numbers, if we were to have some sort of expense impact which had an $8.8 million after-tax impact it would only take an expense of around, say, $15 million to have that sort of an impact on an expense base of some $90-odd million. You cannot make the direct comparison -

Mr CHEEK - And the efficiencies will come into play there. I understand that. You said you had a $25 million profit, I think, before abnormals. Was that right? What were the abnormals exactly from the profit in the 1998-99 year that you were talking about?

Mr DEVEREAUX - If I could just dwell on that. There are a couple of factors in there: one of them is that Aurora has a substantial effective tax rate because of the impact of depreciation and allowable depreciation on its assets which turns a net profit before tax, which is reasonably healthy, into a net profit after tax which is not to healthy. I need to make that point. In terms of the abnormal expenses, there are the usual redundancy component which has been a feature previously in the HEC and continuing through Aurora in terms of -

Mr CHEEK - What is the redundancy component?

Mr DEVEREAUX - Off the top of my head, Chairman, I think it was $2 million. The other component is the rebranding which was necessary to establish Aurora.

Mr CHEEK - $2 million for that as well. So they were the main abnormals you were talking about?

Mr DEVEREAUX - That is it.

Mr RATTRAY - Mr Chairman, do you think it would be possible for John and Mr Kimber to supply the committee with the current numbers of people within your system and how they have come down in the last, say, three years, or something like that, so get some sort of comparison to where we are going, and where -

Mr DEVEREAUX - Three years is a little difficult, Chairman, in that we have only been here since 1 July.

Mr RATTRAY - Oh yes - sorry, I was forgetting that.

Mr DEVEREAUX - We can certainly provide the figures since 1 July.

CHAIRMAN - I think the witnesses would understand the sort of information we are interested in and we will no doubt write for follow-up information on these matters, analyse that and see whether we would need you back at a later stage. That would be the general process, I would imagine.

Mr RATTRAY - I would be very happy about that because I am aware of one or two redundancies within the system and it would be very interesting to see just how you are running down or what you are going to do, or what your direction is for the future.

CHAIRMAN - Mr Fletcher, you had another question I think, and some might have to come back in written response too, I would imagine.

Mr FLETCHER - I have an interest in the competition aspect of it still, but from a slightly different direction this time. I would like to know what Aurora Energy believes will be the negative or positive impacts of the advent of Basslink, the Bell Bay power station sale and the possible advent of gas coming ashore; the advent of any other development such as gas or wind farms, and the like, because if you are distributor there ought to be positive inputs into your business and into your market share, perhaps.

Mr DEVEREAUX - Mr Chairman, they are very good questions and issues which we are addressing as part of the current business planning process to try to get a handle on what our expectations of those impacts are.

Mr FLETCHER - The interest I have is how you measure Basslink and, if there is a positive to Basslink, would you consider being an equity partner in Basslink?

Mr DEVEREAUX - Chairman, that is again a matter that our board and management are currently considering.

Mr FLETCHER - Could I ask through you, Mr Chairman, if Aurora might provide a written brief in relation to those questions to the degree that they can. Obviously there will be commercial-in-confidence information there but the thinking of the entity with regard those major issues for the future and how they might impact on your base-case projections over the next zero to five, five to ten years I think would be very important. Whilst there are always pressures on the Parliament to consider the here and now, we are considering an entity that has a sustainable future into the very long-term future and if we get our base right then we give encouragement to the customers, the downstream users to have confidence in the long-term future.

I would think these matters are critically important, they do affect my judgment about the sustainability of the revenue streams and the profitability and the capacity to pay taxes or tax equivalents and dividends and guarantee charges into the future. I think they are material and if they could provide us with a written brief on those issues I would appreciate it.

Mr KIMBER - These issues are currently the subject of very focused and intense consideration by both the management team and the board as part of the strategic planning process. I certainly would not be able to say we can give you our thoughts off the shelf at the moment because there is a lot of work going on right at the moment as to how we can best position ourselves to, firstly, meet any threats that arise as a result of competition and, secondly, how we can best position ourselves to maximise the advantage to the organisation. Not unnaturally, a lot of these thoughts are in early stages or different stages of development and, secondly, have quite significant confidentiality issues so far as we are concerned because they directly impact on how we are going to position ourselves in relation to other potential competitors coming over as a result or in advance of or with Basslink.

We will certainly endeavour to provide that material, but I trust, Mr Chairman, you will bear with us in the timing of it as to when we are able to deliver it to you because it is very much a current issue.

CHAIRMAN - In some things we have perhaps arrived a little early but we will hang about.

Mr KIMBER - We are certainly able to provide certain information on issues as we see them.

Mrs JAMES - The normal funding last financial year of the community service obligations, that would have had quite a significant impact on after-tax profit, would it not?

Mr DEVEREAUX - Sorry, what was the question again?

Mrs JAMES - I believe that the community service obligations were not funded last financial year. How much impact would that have had on Aurora? I believe it was $8 million overall for the three companies.

Mr DEVEREAUX - I had a number in my head more like $15 million.

Mrs JAMES - That was overall.

Mr DEVEREAUX - That was the pensioner CSO.

Mrs JAMES - Yes. There is a move to fund that now, is there not?

Mr DEVEREAUX - That is currently being funded.

Mrs JAMES - It is being funded now.

Mr DEVEREAUX - Yes.

Mrs JAMES - So that would have put you in a better position towards your $8.8 million? Has that made the difference of the -

Mr DEVEREAUX - No. The CSO was actually factored into the revenue-sharing arrangements as a result of disaggregation, so that was effectively in place from 1 July 1998.

Mr CHEEK - So what are your CSO obligations to be funded for this financial year?

Mr DEVEREAUX - The pensioner CSO.

Mrs JAMES - And the islands.

Mr DEVEREAUX - Bass Strait islands is currently funded to the HEC.

Mr CHEEK - How much was the CSO component?

Mr DEVEREAUX - Off the top of my head, Chairman, $15 million.

Mr CHEEK - Just for you, you are talking about.

Mr DEVEREAUX - Yes - sorry, $10 million for the pensioners and $4 million for Bass Strait islands.

Mr CHEEK - Did you say for the three entities or just Aurora?

Mr DEVEREAUX - Aurora is the interface with the customer for all Bass Strait islands, so yes.

CHAIRMAN - Do you look for full compensation for concessions to pensioners or do you believe as good corporate citizens you would be doing some of that anyway, like other corporate bodies do?

Mr DEVEREAUX - Chairman, that is a matter that is fairly explicitly dealt with in the terms of the funding of the community service obligation itself. By definition, a community service obligation is one which you would not undertake as a normal corporate citizen.

CHAIRMAN - Normal corporate citizens like Qantas and all bus companies, and so on, all give concessions to pensioners as normal -

Mr CHEEK - I give pensioner discounts in my business.

CHAIRMAN - and often provide uniform pricing geographically to disadvantage. So there must be a level which is normal community service obligations that corporate entities provide, so I suggest that it would not be proper to get full compensation or remuneration for those when you do them in the longer term. What do you say about that?

Mr DEVEREAUX - Chairman, the actual level of payment which is now funded directly by the Government was subject to extensive negotiation with the Government over the very issues that you just referred to and the level of funding has been determined as a result of the outcome of that process.

CHAIRMAN - And that determination, is that for the long term or that can be reviewed at any old time?

Mr DEVEREAUX - My understanding, Chairman, is that that is for the long term.

CHAIRMAN - You have a contract in place with the Government?

Mr DEVEREAUX - Yes, we do. We have a contract.

CHAIRMAN - You have done well.

Mr CHEEK - Mr Chairman, perhaps the private sector who give pensioner discounts can make application to the Government as well for some sort of subsidy.

CHAIRMAN - It is a big issue that one and it was an issue at the conference which we were just recently at, so that is why the members are so keenly interested in it.

Mrs JAMES - I notice that you have about 250 000 wooden poles and about 20 000 steel ones. Is there a move towards gradual replacement of the wooden ones, as they would be higher maintenance, one would think? I see you have many of those leaning over at quite a dangerous angle up the north east anyway, the Tasman Highway in particular.

Mr KIMBER - The issue of wooden poles compared with steel poles is a matter of price and cost and it is both the capital cost and the maintenance cost. It is certainly not an insignificant cost to the organisation and the option of replacing them certainly has been looked at as part of the exercise. I have it on advice that what we are doing is the most economical way in which we can do it. We are certainly under review. There is an extensive program of replacement and testing of poles.

Mrs JAMES - And towers too, I suppose.

Mr KIMBER - Towers are the responsibility of Transend, although we do contract services to Transend.

Mrs JAMES - Where there is demand for underground power you try to meet that too, I suppose. That would be quite expensive.

Mr DEVEREAUX - Comparatively.

CHAIRMAN - There are still a few more questions but we will have to wind up at about 12.30 p.m. as we have other commitments this afternoon. I will allow a few more questions.

Mr CHEEK - Just on what Mrs James was saying on the pole replacements, are you up to date with that program? I was told by a person who lives in Burnie that there are 1 600 poles there due for replacement that have not been replaced. Can I ask you to comment on that and also are you happy that your replacement program is right up to schedule?

Mr KIMBER - I understand that we are virtually up to date on it. There have been some instances where there have been pole failures, as a result of which we are conducting a significant review of that program and that is currently under way.

Mr CHEEK - Would that be the Burnie area that you are talking about?

Mr KIMBER - This is statewide.

Mr CHEEK - Is there any truth in the fact that there are 1 600 poles in Burnie that have not been replaced and should be or are due to be?

Mr KIMBER - I do not know of 1 600 poles that need to be replaced. There was a backlog at one stage in relation to some poles which identified as private poles, and you may have noticed some media releases concerning that as a result of which I understand we are up to date with our pole replacement process.

Mr CHEEK - If you could check on that and if there was, perhaps could you let the committee know if there is a problem in the Burnie area. I have had inquiries from there so I would appreciate that.

The other question, in your projections have you factored in a rate of growth for the Tasmanian economy in your submission and, if so, what rate of growth have you allowed?

Mr DEVEREAUX - Chairman, we have factored in a rate of growth which is reflected in the increased load forecasts that I referred to earlier. As to exactly what that percentage is though, Chairman, I cannot give you detail of that.

CHAIRMAN - You are the primary load forecasting authority then now, are you, rather than the Hydro-Electric Corporation?

Mr DEVEREAUX - My understanding is that the Office of Energy and Planning has a role in load forecasting and we would supply information to the office.

CHAIRMAN - And you would be the primary one out of the three entities that have disaggregated then?

Mr DEVEREAUX - Given the fact, Chairman, that we interface with all Tasmanian customers, that is a logical conclusion.

CHAIRMAN - Yes. I am sure that the committee is interested - and it runs off Bob's question - in any information you have in terms of load forecasting, where you see that we are at and where we are going in terms of load forecasting and particularly would include that element of growth, I guess - industrial growth or general growth.

Mr CHEEK - So your load forecasting is directly related to the overall rate of growth you see in the Tasmanian economy?

Mr DEVEREAUX - That would be an outcome, yes.

Mr CHEEK - You say you cannot recall what it was, your projections for the next three years or is it five years you have submitted?

Mr DEVEREAUX - Three.

Mr CHEEK - Can you tell us what it was -

Mr DEVEREAUX - No, I am sorry, Chairman, off the top of my head I cannot.

Mr CHEEK - Can you find out and let the committee know?

Mr DEVEREAUX - Yes, certainly.

Mr CHEEK - Thank you. The last one, Chairman - has the shareholders of your company asked you to achieve greater efficiencies?

Mr KIMBER - Not as directly as that. I would expect that every shareholder would expect that that is exactly what we do - directors have a responsibility to maximise the benefit to the shareholders.

Mr CHEEK - So the meeting with the shareholders has not said, 'Specifically we would like to see greater efficiencies in Aurora'. I realise that in your positions you are trying to achieve it but I just wonder whether you have had a direction from the shareholders?

Mr KIMBER - No, there has been no direction from the shareholders.

CHAIRMAN - Is there much shareholders' activity generally, other than at general meetings?

Mr KIMBER - In general terms, this company is run by a board of directors appointed by the shareholders to do their job and they are meant to get on with it with the management team, as distinct from a government department.

CHAIRMAN - I think we will have to wind up at this point. I think members have asked most of the questions. You would understand the matters of interest that we have and no doubt respond to those where you can. If there is any further matters our secretary will write to you outlining information that the committee seeks. We will then look at that with a view to seeing whether we need to perhaps request your attendance here again or not.

Mr KIMBER - We would be happy to provide any written responses that you need and I would trust that we will be able to satisfy your requirements with those responses.

CHAIRMAN - Thank you very much. We do appreciate your time and we do appreciate your openness and cooperation with this committee and we thank you very much for your attendance.

THE WITNESSES WITHDREW.

Mr BOB CUMBERLIDGE, CHAIRMAN, AND **Mr RICHARD BEVAN**, CHIEF EXECUTIVE OFFICER, TRANSEND NETWORKS, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIRMAN (Mr Schulze) **-** Thank you, gentlemen, for appearing before our committee. You are probably familiar with the Public Accounts Committee Act where we have a responsibility to look into many more things than we once had. We have a capacity now, as our act outlines, to look at all statutory authorities and our definition of 'statutory authority' in the act is very broad. At present the committee is particularly focusing on the capacity of the Hydro-Electric Corporation to pay its special dividend, but along with that of course there are a lot of other associated matters. We need to have a general look at the whole now disaggregated structure, the interrelationships between them, the sorts of dividends that your state-owned corporation might be required to pay, and what sort of deal you think the Regulator should give you, and those sorts of matters.

We have received your correspondence which points out your situation and believes that you should not be making any direct comment on that special dividend. That it is not in your court but we will certainly be interested in the matters that are. Would you be interested in making a short presentation to us about how you are now structured and how things have gone since disaggregation, and perhaps what your relationship is with the other GBE and the other corporation, or would you prefer us to just ask questions? A bit of an overview would assist us, I think.

Mr CUMBERLIDGE - Okay.

CHAIRMAN - If you would give your name and position first for the purpose of assisting Hansard.

Mr CUMBERLIDGE - My name is Bob Cumberlidge, I am chairman of Transend. I was appointed by the Government in June 1998. Just by way of background, I have been chairman of Forestry Tasmania since 1994, I am currently a director of SPC Ltd. I was formerly chairman of Gascorp and of Eastern Energy in Victoria, and before I reached my present mature age I was managing director of Petersville Slee Ltd.

Richard Bevan is alongside me. He is chief executive officer and he was also appointed in June 1998 in that role and is a director of the company. He was formerly a general manager in the Hydro.

We have four other directors: John Lord, a gentleman with a strong accounting background who works with KPMG in Launceston; Mark Kerslake, who is an officer of the Tasmanian Treasury; and very recently - in fact they have attended only one meeting - Mike Gray, who is a trade unionist and also serves on many other various committees; and Mr Ray Brown, who is a lawyer here in Hobart. As I say, those two gentlemen have been present at only one board meeting thus far.

We commenced trading on 1 July 1998. We own and operate the electricity transmission system in Tasmania and that of course is the link between the generators and the local distribution network. We do not distribute electricity to end-use consumers, in Tasmania that role is performed by Aurora and Aurora in fact at this stage is our only customer. Our assets comprise transmission lines and major substations. The split up that took place last year brings the Tasmanian electricity industry into line with most parts of Australia and most overseas countries. Most of these other areas have separate transmission companies with responsibilities very similar to Transend's and when Basslink is built it will link into our transmission system.

I will just finish, Chairman, by saying that our mission is to efficiently deliver a reliable and secure electricity transmission service to customers at a cost commensurate with appropriate and sustainable returns to our shareholder. I guess we can most effectively handle it by questions.

CHAIRMAN - Thank you for that, no doubt there will be quite a few. Perhaps in the first instance if you might speak to us briefly about your corporate structure and your direction of accountability and your relationship with the shareholder.

Mr CUMBERLIDGE - We are a Corporations Law company and at this stage at least the direction of the company is very much in the control of the board of directors. The first seven months have gone pretty well in line with the budgeted outcomes and we take no particular credit for that ourselves because the budgets were prepared by others. We are in fact at this stage marginally ahead of our budgeted profits and will certainly turn in the forecast profit for the full financial year.

The board meets every month and receives quite comprehensive papers from the executive which cover every aspect of our operations, both in a financial sense and an operating sense. We look at other things like safety, of course, and environmental aspects and focus a lot of attention on the forward planning of the needs of Transend. One of the important aspects of Transend's program ahead is a very heavy capital expenditure program of the order of $500 million over the next ten years. That at least is the forecast, although every individual project receives very close scrutiny, firstly by the executive and then by the board. We pull in whatever outside expert information we believe we need in order to form a judgment as to the appropriateness of that capital expenditure.

The simple facts are that Transend's assets are somewhat older and potentially less reliable than comparable assets elsewhere in Australia. I think the average age of our important plant and equipment is probably eight to ten years older than other equipment in the Australian industry and we do face this very extensive program to replace and, where appropriate, upgrade that equipment. Hence this $50 million approximately per annum capital expenditure program we have in front of us.

CHAIRMAN - You would have a corporate plan; you would have planning ahead two or three years in terms of forecasting profitability and future circumstance?

Mr CUMBERLIDGE - We do not have a formal plan at this stage but we are about to embark on a planning session which will produce that outcome. Our forward forecasts will really anticipate a weighted average cost of return on our asset base and any increase in the asset base, and that will dictate our revenue. Clearly we must also look to our cost structures; our cost structures are mostly external. We have only 48 employees and all of the services we need are by and large contracted in from others, in some cases from Aurora, in some cases from the Hydro and in many cases through external contractors. We have to of course make sure that they are delivered on a cost-effective basis.

Our auditor is the Auditor-General but we have an internal audit program which will look at the whole operation of the organisation. That is provided to us by KPMG.

CHAIRMAN - In your comments there you are talking about - it is a pretty old figure now, is it not - the $500 million on capital expenditure. You would be reviewing that, no doubt. You also talked about your costs being associated with your weighted cost of capital.

Mr CUMBERLIDGE - Yes.

CHAIRMAN - In saying that, and with that high level of capital expenditure to come, are you saying that costs of your operations are going to rise substantially?

Mr CUMBERLIDGE - No, I do not think they will rise all that significantly.

CHAIRMAN - What sort of debt do you have now that has a loading -

Mr CUMBERLIDGE - We have virtually nil debt at the moment. We were set up with nil debt. I think by the end of this year we will have about $16 million in debt, and I think our peak debt over the next five years will be of the order of $127 million, I think around that mark. That is as near as we can tell at this point in time. Our current level of assets is $365 million, I think.

Mr BEVAN - Subject to review.

Mr CUMBERLIDGE - That is subject to review, yes.

Mrs JAMES - What will happen to the leased money from the thermal station at Bell Bay?

Mr CUMBERLIDGE - The thermal station is not part of our organisation - generators.

Mrs JAMES - It was listed with the other power stations.

Mr CUMBERLIDGE - But power stations are not -

CHAIRMAN - Only substations.

Mrs JAMES - You are only the generators and -

Mr CUMBERLIDGE - We are only the transmission lines from the power stations.

CHAIRMAN - Only the transmission lines.

Mrs JAMES - I thought you said 'and the generators'.

Mr CUMBERLIDGE - No.

CHAIRMAN - And the substations.

Mr CUMBERLIDGE - Substations, yes.

Mrs JAMES - Right.

CHAIRMAN - Perhaps you could define for us your exact territory. Do you go down, for instance, to 22kv transmission lines or 11? What sort of sized substations and other substations with power stations are part of your deal too? Perhaps we could be clarified on that before we proceed.

Mr BEVAN - Okay. Our primary transmission voltages are 220 000 and 110 000 volts. Our transmission lines are basically the steel tower lines that you see marching across the countryside, not the wooden poles around the streets. Our business starts at the switchyard that is associated with any particular power station. The transformers at the power stations that raise the voltage to transmission levels are owned by the Hydro, not us. So we basically pick it up effectively at the fence of the power station substation. We then transport it to a number of major substations around the State - for example, Trevallyn, the Chappel Street substation, what you see at Sheffield and Liapootah. They are very large substations, not the green boxes - pad-mount substations - that you see around the streets that are owned by Aurora.

To answer your question, Mr Chairman, about 22kv assets, we do own the 22kv distribution circuit breakers that are part of our substations, and Aurora then basically take it. They own the cable out and then onto the wood pole lines around the streets.

CHAIRMAN - So a lot of these 22 000 volt transmission lines that are on large wooden poles that feed Mr Rattray's area and down to Strahan and so on are not under your jurisdiction?

Mr BEVAN - They are not Transend assets, no.

Mrs JAMES - How about the one to Comalco where they reticulate their own -

Mr BEVAN - Yes, we supply Comalco.

Mrs JAMES - To their substation.

Mr BEVAN - They actually take power at 220 000 volts. They actually own a major substation of their own, and then they transform from 220 000 volts to a number of voltage levels that they then reticulate around their site.

CHAIRMAN - Do members have any queries on the territory that -

Mr FLETCHER - Could I just get the base right, first of all.

CHAIRMAN - Yes.

Mr FLETCHER - I have made this conclusion. I am just asking you, for the record, to verify that. My conclusion is that Transend Networks Pty Ltd is a government-owned corporation that is monopolistic by nature; it receives a fee from its downstream customers - Aurora Energy Pty Ltd; the quantum of the fee is determined by the energy Regulator, and that profitability into the long-term future is very predictable.

Mr CUMBERLIDGE - That is a pretty accurate summary.

Mr FLETCHER - Is that an accurate summary?

Mr CUMBERLIDGE - Yes.

Mr FLETCHER - If that is an accurate summary, I am surprised that you have not done your forward projections at this stage, that really you are saying to us that you do not know where you are going, and there are a lot of predictable elements.

Mr CUMBERLIDGE - Perhaps I should clarify that. Forward projections were given to us at the time that we kicked off on 1 July last year. We have been watching the progress through this year to see how closely our performance aligned with the budgets we were given. We are now comfortable with that. We now have a working session coming up in April at which we will then project not our next year but for five years out.

Mr FLETCHER - Okay. Through you, Mr Chairman, I wonder whether Mr Cumberlidge would then inform us of the projections with regard profit after tax for the next five years.

Mr CUMBERLIDGE - I do not have those figures here. The profit after tax this year will be $19 million; the forecast is $19 million. The variation is not great. I do not have the precise figures.

CHAIRMAN - Profit after tax.

Mr CUMBERLIDGE - Profit after tax. EBIT - earnings before interest and tax - will be about $33 million this year.

Mr CHEEK - Is that based on a revenue of about $66 million, which was the projected revenue for 1998-99?

Mr CUMBERLIDGE - Yes. The revenue is coming in almost exactly as projected. The difference at this stage is that our operating costs at the half-year are about $2 million lower than forecast, but we think that that will be adjusted to some extent in the balance of the year.

CHAIRMAN - That is about 2 per cent return on your asset value.

Mr CUMBERLIDGE - The EBIT return is more like 10 per cent return.

CHAIRMAN - Yes. Are you wanting to continue, Mr Fletcher?

Mr FLETCHER - Well, yes. I suppose I would ask a question of a prudent manager, do you foresee any factors in the near future that might vary, either positively or negatively, your assumptions with regard profitability?

Mr CUMBERLIDGE - We are in the hands of the Regulator and what the Regulator eventually determines to be the appropriate weighted average cost of capital will obviously bear upon our profitability. What the Regulator determines is appropriate capital expenditure will bear upon our profitability. As we look at the projects that we need to commit to, to maintain the reliability of the system, will be subject to the overview of the Regulator. Hopefully he will agree that those projects have been responsibly developed and he will allow us to get the appropriate rate of return on those projects. They are the only significant factors. Operating expenditure is always a variable, but I do not think it is a big bearing on our case.

Mr BEVAN - And it is also subject to the scrutiny of the Regulator.

Mr CUMBERLIDGE - Yes.

Mr FLETCHER - I am sure the information is available; it is just that I have not read it. What is your return on assets at the moment?

Mr CUMBERLIDGE - Our profits are based upon 8.5 per cent weighted average cost of capital - return on capital.

Mr FLETCHER - Do you consider that to be reasonable? Will you be mounting argument to the Regulator that he should vary that percentage?

Mr CUMBERLIDGE - We consider that to be reasonable. There has been discussion, not only here but elsewhere in Australia, about a lower weighted average cost of capital. But we would think the 8.5 per cent is reasonable and we would argue for that.

Mrs JAMES - You have the capacity for increased power demand, perhaps with a project such as the magnesite mine and so on, coming on stream. That would increase your profitability, provided you have the capacity to provide -

Mr CUMBERLIDGE - It would not necessarily increase our profitability. We have to ensure that we are able to service that increased demand. We have to make sure we have the assets in place for the specific demand. But again if the Regulator determines that 8.5 per cent weighted average cost of capital is appropriate then I guess the only increase will be if we have a substantially increased asset base.

Mrs JAMES - It depends what the deal is.

Mr CUMBERLIDGE - Well, no, it does not really depend on the deal for us because -

Mrs JAMES - No, but whoever makes the deal will have an effect on -

Mr CUMBERLIDGE - We are only paid for the transmission. We are not paid -

Mrs JAMES - Just the cost of -

Mr CUMBERLIDGE - We are paid effectively for the cost of our transmission.

Mrs JAMES - Right, thank you.

Mr CHEEK - You are going to spend $500 million over ten years, you think you will need to. How much have you spent in this financial year for capital expenditure?

Mr CUMBERLIDGE - It is lower than that average.

Mr BEVAN - The projected capital expenditure for this financial year is in the order of $54 million. Obviously the further out you plan, the more rubbery the numbers might be in terms of exactly knowing what or when we may spend the money is a bit less certain. But on average we would expect it to be around about $50 million a year over the next ten years. But it could be $40 million one year, $60 million the next. It could move around a bit.

CHAIRMAN - This $54 million, you are pretty confident about that figure?

Mr BEVAN - Very confident about that figure, yes.

Mr CHEEK - The $54 million you are spending this year and you have $33 million before tax in your profit.

Mr BEVAN - Yes.

Mr CHEEK - So your borrowings have gone towards your capital expenditure or is that for unfunded superannuation liabilities?

Mr BEVAN - The borrowings is primarily to fund the capital program.

Mr CHEEK - So you would not have a great - as far as superannuation goes, with a small work force that would not be a major problem for you.

Mr BEVAN - No.

Mr CUMBERLIDGE - It is not a big issue for us.

Mr CHEEK - The work force is roughly the same as it was with the start of this financial year?

Mr BEVAN - Roughly the same, yes.

Mr CUMBERLIDGE - It would not have varied by more than one or two people.

Mr BEVAN - And we would not expect to see our work force numbers moving dramatically in either direction. As the Chairman has explained, we really are a company that has been set up to manage the provision of service to operate our business using contractors. That is by design because the Regulator will be looking for us to be procuring service on a contestable basis wherever possible.

CHAIRMAN - Would there be much room for efficiency improvement when you are operating in that manner - 48 employees?

Mr BEVAN - We would always be looking for efficiency improvements but we certainly would not be in a situation where we would be saying we could, for example, pull 25 per cent of the operating costs out of the business. They are likely to be smaller percentages but we will look for cost savings wherever we can.

Mr CHEEK - Have the shareholders indicated to you what they expect to be paid in dividends in your after-tax profit?

Mr CUMBERLIDGE - The indication thus far is 50 per cent of after-tax profit.

Mr CHEEK - Have they met with you and told you that that is what they would be expecting?

Mr CUMBERLIDGE - No, we have had no direct discussions over it. That was the indication from the outset and we have heard no variation to that.

Mr CHEEK - The board of directors will have the final say on that, I take it?

Mr CUMBERLIDGE - The board of directors will certainly recommend a dividend but the shareholder has the power to instruct the board because that is in our articles of association.

Mr CHEEK - If there was to be a dispute between what the board recommend and what the Government was instructing, have you anything in train to deal with that?

Mr CUMBERLIDGE - No. The shareholder has the power to instruct the board.

Mr CHEEK - So you do not see any problem with that - that is it, you will obey their wishes?

CHAIRMAN - Up to 100 per cent of earnings for a dividend.

Mr CHEEK - Even if you did not consider it was prudent?

Mr CUMBERLIDGE - Well, I guess if a director did not consider it was prudent the director has a course of action he can take, does he not?

Mr CHEEK - Yes, he does.

Mr CUMBERLIDGE - But I do not anticipate a problem there. We have had no hint of it; we have had no hint of a different view. As you would probably be aware, in a commercial enterprise like this, 50 to 60 per cent of earnings after tax as a distribution for dividend is quite normal. At this stage indications are that we will be at 50 per cent and that leaves us some internally-generated earnings to contribute to the capital expenditure program and we have a depreciation cash flow of about $14 million and the balance will come from borrowings.

Mr CHEEK - What debt to equity ratio are you aiming for over this period of your capital expenditure?

Mr CUMBERLIDGE - Well, as I said, we have total assets of the order of $365 million. We see maximum borrowings of the order of $127 and that will go out to a peak and then decline on present projections.

Mr CHEEK - And your projections, you are saying for the next - I am sorry, I cannot remember what you said - over the next five years or four years from this year you have done those but you want to refine them -

Mr CUMBERLIDGE - Projections - correction.

Mr CHEEK - Projections - your forward estimates then over the next five years -

Mr CUMBERLIDGE - Of earnings?

Mr CHEEK - Of earnings.

Mr CUMBERLIDGE - The forward projections do not show a substantial drift in earnings at all. But they were not done by us, they were done before Transend came into operation.

Mr CHEEK - So you have not done a budget for next year?

Mr CUMBERLIDGE - That is on our immediate agenda now. We wanted to be sure that the operation, which is a brand new operation which was given to us, was soundly based. It appears to have been soundly based financially. We are almost spot-on, as I said before, with the forecasts we were given.

Mr CHEEK - How much experience in the electricity industry have the board members got or should I put it this way: are there any board members who have experience in the electricity industry?

Mr CUMBERLIDGE - I had eighteen months as the founder Chairman of Eastern Energy in Victoria, which is a distribution company like Aurora, and my role was to set the thing up on a basis that was ready for privatisation, which it was eventually privatised. Richard, of course, has had a long experience in the Hydro in the electricity industry.

Mr CHEEK - Is Richard a board member?

Mr CUMBERLIDGE - Yes. The other board members bring other commercial background to the board table and, as you would certainly realise, we are looking for a spread of expertise and experience on the board.

Mr CHEEK - So at the moment Aurora is your only customer -

Mr CUMBERLIDGE - Yes.

Mr CHEEK - and it will not really be until Basslink is built or until competition comes into the marketplace that you will have any other customers?

Mr CUMBERLIDGE - I do not think we will have any other customers in really, will we?

CHAIRMAN - You will never have competition that you can foresee?

Mr BEVAN - We will not have competition as a transmission business but we could have alternative customers, both upstream and downstream, if other generators came into the State and if other retailers decided to set up in Tasmania, and that obviously depends on the Government's timetable for introducing competition at the retail end.

CHAIRMAN - Are other companies restricted from establishing transmission networks?

Mr BEVAN - Technically, no, as I understand it; however I think it is highly unlikely that another company would be coming in and setting up a transmission business. There is the possibility for customers, for example, for a Comalco to build their own assets and operate them for their specific purposes, which in fact they do. An alternative would be for them to contract us to provide that service for them but we do not envisage that we would have direct competitors - that is, alternative sets of transmission lines marching around the State.

Mr CHEEK - So it will always be the Regulator setting the price and the only increase in profit we can get then is by efficiencies that you will make in the business.

Mr BEVAN - That is correct.

Mr CHEEK - And where will the efficiencies come from? You have not got a great deal of scope in payroll by the sound of it.

Mr CUMBERLIDGE - We have got, I guess, scope in looking at the contractual arrangements we have now for services which are, as I say, substantially provided by Aurora and Hydro. We would obviously look at those as we move out in time. We have a contractual relationship - what is the length of those contracts?

Mr BEVAN - They are nominally two-year contracts but they are reviewable after one year.

Mr CUMBERLIDGE - So we will start reviewing those contracts as soon as we are able. Whether or not there are better options available, we do not know, and the capital investment program, as it replaces the older and more expensive to maintain assets, will also show some productivity benefits. But, again, the Regulator will take that into account in determining what our profitability should be and therefore what our transmission use-of-service charge should be.

CHAIRMAN - Do you work with the Regulator at all in respect to assessing your capital expenditure requirements or does he do an independent evaluation there?

Mr CUMBERLIDGE - His valuation will be independent but we do work closely with the Regulator to discuss what we are doing.

CHAIRMAN - You would be making a submission, I take it then, to the Regulator in respect to his role in setting prices in the future?

Mr BEVAN - Yes, that is correct. In fact the Regulator is, at this point in time, initiating his review of pricing which will be effective from 1 January 2000 through to the end of December 2002 and we will be making a submission to his inquiry.

CHAIRMAN - The nature of your submission then would be based on a reasonable return on your asset base?

Mr BEVAN - That is correct. There are three aspects primarily that the Regulator will look at and one is what is the value of our asset base and he will have an opinion on that and so will we. He will have a view on what we ought to reasonably be expending for operations and maintenance purposes and he has in fact conducted an external benchmarking review on operation and maintenance costs of businesses such as ours. The third aspect is that the Regulator will be reviewing what we think we will be spending in the way of a capital program and he is in the process of setting up what is called the 'reliability and network planning panel' that has the specific role of reviewing capital expenditure that Transend may make to determine whether he thinks we should be allowed a return on that expenditure.

CHAIRMAN - Do you give any thought to a situation where the costs that are brought forward to the Regulator from the three components - that is, Aurora, yourselves and the Hydro-Electric Corporation - may be such that the price of energy may then be not competitive with mainland prices and the Regulator may have to use other criteria other than just satisfying your profit imperatives?

Mr BEVAN - Our submission to the Regulator will only consider the transmission components of the costs on that. The issues that you raise really are a matter for the Regulator to be determining in conjunction with Aurora and the Hydro.

CHAIRMAN - Do you have any concern that he might find the aggregate cost high to a point that he cannot allow you to have or any component - I can only speak about you, I suppose - you do not want to comment on the others - that he cannot allow you to get the return on assets that you are making claim to?

Mr BEVAN - We have no concerns at this stage that that situation would arise.

Mr CUMBERLIDGE - Clearly if that did arise then the security of the system becomes a question, so we have no reason to anticipate that that will be a problem.

CHAIRMAN - You said in that that he has little choice in terms of system security and risk management.

Mr CUMBERLIDGE - I think he has to make certain that we are performing efficiently. If he has any reservations about that then he will make that known. But if we are performing efficiently then we have to be given a sufficient return to enable us to maintain the integrity of the system.

CHAIRMAN - Have there been any efficiency gains that might have come about as a result of disaggregation?

Mr CUMBERLIDGE - It is early days, is it not - it is only about ten months. I think that certainly from the point of view of Transend - Richard could probably speak with more experience than me about that - but we are making small gains in Transend as we go along, there is no doubt about that. The people who make up Transend, I think, have done a first-class job in setting the thing up in the first ten months and all the time we see small gains. As to the other units - Aurora and Hydro - I cannot comment.

Mr BEVAN - I think certainly the objective of disaggregation or one of the objectives was to sharpen the focus of the components, the discreet components that made up the Hydro-Electric Corporation and there is absolutely no doubt that that has had a profound effect on us being able to concentrate just on the transmission aspects of the business without being perhaps distracted by other issues that we may not need to be looking at.

CHAIRMAN - So we are looking for that increased focus, as we have been told so often, to translate itself into efficiency improvements because you would probably still have similar administrative costs or maybe higher - you would not have the economy of scale, payroll and all those sort of things that might have existed before.

Mr BEVAN - I think some of those aspects we will actually do better; for example, a payroll system for 48 staff that are not on shift or are not on allowances, et cetera, is a very simple matter compared to what we were previously paying costs for.

CHAIRMAN - You might have been inappropriately loaded before.

Mr BEVAN - So it has actually given us the opportunity to move our business and move in systems that are appropriate for the size of the business in many cases with reduced costs.

Mr CHEEK - Does the fact that the average age, you are saying, of your infrastructure is eight to ten years older than counterparts on the mainland, does that affect the delivery of your service?

Mr BEVAN - It potentially will if we do not pay close attention to maintaining those assets in reasonable condition and, as the Chairman has already explained, replace them in good time.

Mr CHEEK - Has it affected it yet though, the power of delivery?

Mr BEVAN - We have had some experiences in recent years where the age of our assets has caught up with us. The most recent probably was the significant outage in Launceston in late June last year where we had the whole of Launceston off primarily for about three hours on a very cold, wet wintry night and the assets that led to that failure are in the process of being replaced right now with the work that is going on at the Trevallyn substation.

Mr CHEEK - That is where some of the $54 million is going to.

Mr BEVAN - Exactly.

Mr CHEEK - Is that all of it or where else are you spending money?

Mr BEVAN - We have a number of major projects under way at the moment. We are building a new transmission line which links Liapootah in the south to Palmerston substation in the north and that project will be completed in April. We have the work going on at Trevallyn, stage 1 of which will be completed in June this year, and we have a major substation about to be commenced with commissioning at Hadspen just south of Launceston which will alleviate a significant number of bottlenecks that we have had in getting bulk electricity into the Launceston and north-east area of Tasmania.

Mr CHEEK - Where do you see the other areas of immediate concern or potential trouble spots, have you identified those?

Mr BEVAN - Yes. We have a comprehensive risk management review of all of our assets. A couple of examples are bringing an enhanced supply into West Hobart substation which is currently owned by Aurora because of its voltage level and it services a significant part of the Hobart CBD, and we are in a situation there where the assets are old and also the capacity is reaching the stage where we need to do something about that.

Mr CHEEK - What sort of cost will that be?

Mr BEVAN - That will be of the order of about $30 million, I think.

Mr CHEEK - Any others?

Mr BEVAN - There is an upgrade on the books for the Devonport area, which was announced by the Hydro some years ago, and that is of the order of $9 million. There is some work going on at lower levels right around the State. Eventually we will need to build a 220kv substation at Lindisfarne and connect that to the southern 220kv system via a transmission line that will go via New Norfolk to Liapootah to give us a second 220kv injection point into the Hobart and southern Tasmanian area. So there is an ongoing program along with lots of rats and mice, you might say, in replacing individual asset components at substations all around the State.

Mr CHEEK - How do Transend's charges compare to other electricity transmission utilities on the mainland? Do you do benchmarking?

Mr BEVAN - We do benchmark ourselves, but we benchmark ourselves not only on prices but also on our operating costs. We participated two years ago in an international benchmarking study along with eighteen other companies from around the world and Australia and in many areas we came out quite reasonably, in some areas we came out not so well and that quite clearly are the areas that we are focussing on in improving our performance.

Mr CHEEK - And what are they?

Mr BEVAN - It was primarily in the protection and control assets which are the assets that monitor the performance of the system and operate the switch gear when we need to do so. There are really two levels of assets: there is what we call the primary assets, which are the wires and the transformers and the switches; and then the secondary assets, which are the protection and control of equipment that actually look at what is going on and monitor the system and tell pieces of equipment to operate in a certain way depending on the circumstances.

Mr CHEEK - How do our charges compare with mainland utilities?

Mr BEVAN - I do not have those figures with me at hand but I can tell you that the relative level of the transmission price in what a domestic customers sees, for example, is around about 10 per cent. So an average residential consumer might be paying 8 or 9 cents a kilowatt hour and about 1 cent of that is associated with supporting the transmission business.

CHAIRMAN - Who pays for the energy losses in the system?

Mr BEVAN - The energy losses are effectively paid for by the retailer, so they are added. Ultimately the customer is going to pay; it is a matter at which end of the equation you wish to add the loss costs in.

CHAIRMAN - It is not in your area?

Mr BEVAN - No.

CHAIRMAN - So the fact you deliver a little bit less than you receive is not to your cost and that would be in the order 2 or 3 per cent, would it?

Mr BEVAN - Yes, between 4 and 5 per cent, but that is quite clearly something that the Regulator will also be looking at from a benchmark point of view to give him a view as to whether our assets are operating efficiently enough or whether we ought to be putting in bigger capacity to reduce the loss factors in our lines.

Mr FLETCHER - I am going to revisit to some degree the questions that Mr Cheek has asked but I will not be looking for the technical detail that he has sought. I think you would reaffirm that in establishing Transend it was structured to be debt free in recognition of the ageing nature of your fixed asset base and now you are going to embark on a program of borrowing to upgrade that asset base. Will that upgrade be a charge against long-term borrowings and fixed assets or will you choose to charge the upgrade as an expensive transacting business?

Mr CUMBERLIDGE - I am not quite sure what you mean.

Mr FLETCHER - As a result of the upgrade I want to know whether you will write it off as an expense of maintenance of an existing asset or whether you will lift your valuation of your fixed assets because they are now in much better shape.

Mr CUMBERLIDGE - I guess in some minor cases where equipment is upgraded it might be so minor as to be an expense but they will be very small assets. The significant capital investment will go onto our balance sheet and it will be reflected in our revenues at the level of the weighted average cost of that capital that the Regulator is prepared to approve.

Mr FLETCHER - Yes. So if you borrow, to keep a simple sum, $54 million, $54 million is going to be long-term debt and $54 million is going to be fixed asset, increase in value of fixed assets.

Mr CUMBERLIDGE - Yes.

Mr FLETCHER - So you are going to get an increased return on that basis. You are going to get your weighted average on that increased asset cost.

Mr CUMBERLIDGE - Yes. Richard just mentioned that our costs represent around 10 per cent of the average cost of supply to retail customers. We see our costs perhaps increasing by 10 per cent over time because of this capital investment program. But when I say 'our costs', we see the actual direct costs of that capital investment program adding 10 per cent but that would be offset by productivity savings to a large degree.

Mr FLETCHER - A player in the private market, and there are so many variations I will try to keep it simple, but a player in the private market might choose to maximise the expense component to minimise tax. That is not a consideration for Transend?

Mr CUMBERLIDGE - Well, I guess we will be looking within the accounting regime for the most tax effective approach on every occasion but I do not think there is a lot of scope for us there.

Mr FLETCHER - Would you agree with that, Richard?

Mr BEVAN - Yes, I do not think there is -

Mr FLETCHER - But you do see it as a legitimate exercise.

Mr BEVAN - Quite clearly, as Jim has mentioned, the Regulator is setting the regime by which we can earn our revenue through the weighted average cost of capital and if we were to try and expense our capital costs quicker then that would have to impact on the weighted average cost of capital which is being set externally. So we are really in a situation where we have not got too much room to move in terms of writing things off.

Mr FLETCHER - Yes, but you would choose to maximise it within those parameters of accounting standards and prudent management.

Mr BEVAN - Prudent business practice would say that you would be looking for any opportunities you have.

Mr CUMBERLIDGE - We would seek to maximise the returns of Transend and within the normal accounting standards.

Mr FLETCHER - There is an interesting anomaly here in that your tax collector and your shareholders are one and the same party.

Mr CUMBERLIDGE - Yes.

CHAIRMAN - And the more capital you spend the better off you are in terms of the criteria used by the Regulator until you determine your return.

Mr CUMBERLIDGE - Well, not really, because the capital is costing us money and he is only going to recognise the cost of that money in our revenues. There will only be a marginal difference between the external cost of that money and the weighted average cost of capital that he will recognise.

Mr FLETCHER - I wanted to ask a relatively short series of questions, I accept that.

CHAIRMAN - If it is a line of questioning follow through on it and then Mrs James will follow you.

Mr FLETCHER - Well, it is to do with the asset and the capacity of the asset that we have now - the capacity of your fixed asset. You claimed previously that the impact of Basslink would have no effect on your business at all because you are receiving a return of the asset. I conclude from that that your system has latent capacity, unused capacity, and that you could transmit a lot more energy without spending much more in the way of capital. Is that a fact?

Mr BEVAN - No, that is not quite the case. The spare capacity, if you like, around the system varies depending on where you are in the system, and depending on how much capacity Basslink has - which has yet to be determined - then that would obviously impact on how much and what the impact on our transmission system is likely to be. One of the issues in relation to Basslink is that the landing point is quite clearly going to be somewhere in the north of the State, most possibly George Town, where a significant portion of our load is through customers like Comalco, Temco, et cetera.

So the impact of Basslink on the rest of the system may not be all that significant in terms of a load scenario. It may have an impact in terms of a generation scenario if Tasmania were exporting through Basslink and, for example, we wished to transport power for hydro from, for example, Lake Gordon up through the Central Highlands to get it over Basslink into Victoria and the mainland.

Mr CUMBERLIDGE - We will have some capital expenditure associated with the connection to Basslink, but we do not know what that is yet.

Mr FLETCHER - So your earlier statement is factual that the advent of Basslink will have no real impact upon your profitability. If you are required to service that, you will have to invest more capital to provide that service.

Mr BEVAN - It will not have an impact on profitability, it may have an impact on what we need to do to service it. They are two very different issues.

Mr CHEEK - What about the introduction of gas? What effect do you think that will have?

Mr BEVAN - Probably very little, on the basis that our costs are recovered across the transmission customer base. Unless we had significant customers walking away from using electricity, which would leave us with what are dubbed 'stranded assets' which would then need to be reviewed by the Regulator, we would not see that the introduction of gas would have a significant impact on the profitability of our business.

Mrs JAMES - If the Regulator does insist on increased income from your assets, I take it one of the things you would have to do was increase your price to Aurora. That would downstream to them and they would have to pass it on to their consumers, would they not?

Mr BEVAN - We do not set the prices, the Regulator has a responsibility to set the price as well.

Mrs JAMES - No, but you have to raise the money.

Mr BEVAN - The issue would be that if the Regulator was not to allow us what we believed to be an acceptable return to fund our capital program, it would mean that we would be in fact borrowing more money.

Mrs JAMES - You cannot go on doing that.

Mr BEVAN - We are not in a position where we can increase prices arbitrarily to our downstream customers.

Mrs JAMES - You would also limit your borrowings too.

Mr BEVAN - No. The issue of borrowings is a matter for the board of the company to manage.

Mrs JAMES - Aurora made some mention that it was quite critical what the Regulator decided as to their viability. The same would apply to Transend, would it not?

Mr CUMBERLIDGE - Yes. They are talking there about the rate of return that he will allow on assets, and obviously that goes to your viability. As I think I said earlier, if there is an insufficient rate of return allowed then that goes to our ability then to continue to provide a reliable system.

Mrs JAMES - What would happen if that happened?

Mr CUMBERLIDGE - I think he would be a very foolish regulator to put this State in that position, and I do not think that will happen. It has not happened elsewhere.

Mrs JAMES - There is the matter of human judgment too.

Mr CUMBERLIDGE - Well, yes. There was a case fairly recently with the Victorian Regulator about twelve months ago where he came up with a ruling on weighted average cost of capital which caused some howls of anguish around the industry. He subsequently amended that ruling when the industry came back to him very strongly and said that at that level they would be unable to maintain what they saw as necessary capital investment programs. That was in Victoria and all of those entities now are privatised, but he had to respond to that.

Mrs JAMES - Thank you for outlining that. I had just vaguely heard something about it but I was not clear about it.

CHAIRMAN - Out of that it seems that in the Regulator allowing you to set charges, you are not charging for the amount of units per kilometre transmitted, you have an overall charge, do you? In other words, if there was a reduced flow of power through your system as a result of, say, an industry downturn, or the reverse where suddenly there is an increase of flow through your system, are you paid according to those changes?

Mr BEVAN - There are three components to the way the prices are set. One is effectively a fixed component and that equates to 50 per cent of our revenue, so that 50 per cent we will earn regardless of the amount of electricity carried. Of the other two components one relates to demand, what is the demand placed by particular customers on the system, and that is worked out at each nodal point on the system. The third element which is also struck on a demand basis pays for what are called 'system services' which are the infrastructure costs to run things like system control to operate the system, which you need to have regardless of whether there is a lot of energy passing through it or not. In summary, 50 per cent of our revenue is impacted to some degree by variation in load and 50 per cent is not.

CHAIRMAN - With a given system, say as it exists today, if the load dropped 10 per cent, I would suggest your costs would hardly change, would they?

Mr BEVAN - That is true.

CHAIRMAN - Or vice-versa.

Mr BEVAN - Yes. The Tasmanian Electricity Code, in the event of material change in circumstances - say, for example, a very significant customer walked away from Tasmania and the load changed dramatically - does allow the Regulator to reopen the books, so to speak, to recalculate the revenue charged to ensure that we remain a viable business. But it is a matter of judgment as to what constitutes a material change.

CHAIRMAN - Would that not suggest the basis formula is not structured correctly?

Mr BEVAN - There are a number of national reviews going on at the moment looking at exactly this issue. One review has been conducted by the ACCC which is looking at how the revenue is determined; another review is being conducted by NECA, which is the National Electricity Code Administrator, and that is looking at the method by which the revenue that is being determined is then turned into prices for the various customers. So there are a number of questions hanging over both the revenue determination and the pricing determination in the national forum. The Tasmanian code is a mirror to a large extent of the national electricity code, and we fully expect the Tasmanian Regulator to be taking close notice of what these national reviews determine.

CHAIRMAN - If Tasmania was indeed selling power to the mainland via Basslink, would you deem that power to be, say, coming from Strathgordon and taking the longest route through your system or would you be considering it came from the closest station or a combination of two?

Mr BEVAN - The pricing is actually determined on what is called a 'nodal basis' where the costs are determined at each node in the system. The whole basis of the code is to send pricing signals especially to generators so that if you are generating from a long way away you would expect him to be paying the penalty for that as opposed to someone who is generating close at hand.

CHAIRMAN - And that takes into account the transmission line losses too, does it, by dealing with it on that basis?

Mr BEVAN - Yes, that is correct.

Mr CHEEK - What about your major industrials like Comalco? There is 10 per cent of the average cost of supply to the retail market, but what is the average cost for the big industrial users?

Mr BEVAN - The cost for the industrial users in fact are proportionately higher because they are taking the energy straight out of our system and they are not picking up any distribution cost.

Mr CHEEK - But there is no discount for them at all in what you charge -

Mr BEVAN - No. In fact the percentage transmission component for someone like Comalco is in fact higher than the respective transmission component for a domestic customer.

Mr CHEEK - So what sort of percentage would that be? It would have to be a fair bit higher, I realise, because of the end cost.

Mr BEVAN - Yes. In some cases it is up around - for example, for the major industrials 25 per cent of their charges could be transmission.

Mr CHEEK - While we are on costs, what sort of interest rate have you factored in for the money you have borrowed? The money you have borrowed is $16 million so far, I think you said. What sort of interest rate did you get that at?

Mr CUMBERLIDGE - We are required to borrow through Tascorp and quite frankly I am not sure what the current rate is there. Again, that is in our articles.

Mr BEVAN - We had no alternative other than to borrow through Tascorp, so we would be getting the same rates that they are achieving.

Mr CHEEK - What sort of borrowings would they be? How long? Ten years?

Mr BEVAN - At the moment our borrowings, given the current interest rate situation and also given the low level of borrowings that we have for this year, we are basically on the short-term market. That is something that the board will be reviewing on a regular basis, in line with our Treasury policy.

Mr CHEEK - How much competition is there with the transmission utilities in a place like Victoria?

Mr CUMBERLIDGE - There is not.

Mr CHEEK - There is no competition at all.

Mr BEVAN - There is only one transmission company.

Mr CHEEK - Only one transmission. So in every State in Australia there is only one.

Mr CUMBERLIDGE - Yes. In fact at one stage in Victoria the transmission entity was not going to be privatised because it was seen as a natural monopoly, but in fact it was eventually privatised, but it is still regulated.

CHAIRMAN - Are you interested in getting involved in Basslink in terms of equity in that project?

Mr CUMBERLIDGE - No, I think that is outside our mandate. We are involved in collaboration to facilitate the connection of Basslink but in terms of actually being involved in Basslink per se, no.

CHAIRMAN - But you would see it as just part of the energy transmission system of high voltage.

Mr BEVAN - It depends. There are two ways that Basslink could be put in place: one is as a transmission element, what is called a regulated asset with a predetermined revenue based on how much the asset cost -

CHAIRMAN - The same as your current operation?

Mr BEVAN - The same as our assets currently are. The alternative is what is called a non-regulated or an entrepreneurial link where, even though it is a piece of cable across the Strait, it effectively would be an energy trader where the operator could buy power from the Hydro, for example, ship it through the cable and sell it onto Victorian markets. So it actually becomes a market participant. So while both scenarios - they are only a piece of cable - it is a very different business. And that has not been determined; that has actually been left up to the proponents as part of the Basslink submissions to make their own judgment on that.

CHAIRMAN - Do you have any views on that; how that could best be set up? That would have some effect on new operations, I guess, at the end of the day.

Mr BEVAN - Not really; on the basis that we do not believe - we will not be owning Basslink. Someone else will be owning and operating it so, as we have said before, the impact on the profitability of our business from Basslink will not change significantly.

Mrs JAMES - Wouldn't they be competing with them in some areas?

Mr BEVAN - No, because actually they will be attached to our system. But, no, they are not a direct competitor.

CHAIRMAN - They would be a competitor to the Hydro-Electric Corporation?

Mr BEVAN - It could well be. If it was set up as an entrepreneurial link, yes, it would effectively be a competitor to generators in both Tasmanian and mainland Australia.

CHAIRMAN - That could have an indirect effect on your operation?

Mr BEVAN - Yes, it could have an indirect effect to some extent, but not a material extent.

Mr CUMBERLIDGE - I do not think it would have a significant financial effect. Obviously if there was a scope to change some of our operations to accommodate the Basslink structure, but in terms of financial implications, no, I do not think there is any significant financial implication for us.

Mrs JAMES - You would become part of the pool?

Mr CUMBERLIDGE - Part of the pool?

Mrs JAMES - The pooling of the various power.

Mr BEVAN - The pool is a market structure and we basically provide an electricity-carrying service to enable the pool to operate. We are effectively a trucking company that transports electricity. We do not actually own the electricity on the truck.

CHAIRMAN - I noted some time back there was a problem with a power outage up in the highlands and most of the outage time was involved in getting someone to come and close a switch from a fair distance away because there had been a change in who could operate the switch. It seemed to me that the power station operators could once, whereas now - say, the HEC corporation was operating them - this is rather a switch structure rather than at a power station - whereas now it is Transend's responsibility. There did seem to be a problem arise in relation to that. Would you comment on that?

Mr BEVAN - This is Derwent Bridge?

CHAIRMAN - Yes.

Mr BEVAN - There is a number of issues. One was we had some problems with birds and animals getting on the assets and causing the power to go, and that is something we have addressed. The other issue was, who should attend the fault. There are obviously different skill levels with different service providers and we had the situation where the first person who was responding to that fault did not have the skill level to do what they may have needed to do to actually reconnect. We have now rectified that as well by making sure that the appropriate person is called in the first instance rather than being a subsequent call-out.

CHAIRMAN - To get the right skilled person in in the first instance might mean calling a person from further away so the delay is in getting him to the site rather than waiting for someone to come and close the switch.

Mr BEVAN - The situation we had was that the first call-out would have been a linesman who has the ability to do some things but not to do a substation operation, as it required in this particular case. So the linesman would go to Derwent Bridge, he would find that he had a problem that he could not rectify and he would then have to call someone else. We have now changed the regime where the right person gets called along with the linesman regardless.

CHAIRMAN - Will more of the linesmen be upgraded: ticketed or trained to be able to do closures to a greater degree?

Mr BEVAN - There is a balance there in how far you can train up individuals to be able to do everything; a super operator who could do everything. So there is a judgment there as to what is the appropriate level to train people to, depending on what sort of circumstances they may confront.

CHAIRMAN - Previously I understand that there might have been trained people who could close that switch who were closer to hand but are now part of the Hydro-Electric Corporation. This might have been some downside, if you like, in respect to disaggregation.

Mr BEVAN - Perhaps to a minor extent, but we believe we can use smarter technology to get around the issue of who the operative might be or where they may come from.

CHAIRMAN - The amount of outages on the system, what has been the trend in terms of outages over the last four or five years? You are saying you have older equipment, older assets, and that would suggest you would have a greater number of outages or greater number of outage time than other systems around the countryside.

Mr BEVAN - The measure that is used is called 'unserved system energy', which is a measure of how much energy the system could not deliver because something has gone wrong. For example, last year our unserved energy level was around about 30 what is called a system minute, which is the equivalent capacity if the whole system was off for one minute. Other mainland authorities are down around five. This year we are currently sitting and would expect to come in around about somewhere between 15 and 20. So we are getting better but we still have a considerable amount of distance to go to reach what would be regarded as an internationally acceptable benchmark. Quite clearly some of the climatic conditions we have to deal with here and the terrain we go over makes that a difficult challenge as well as the issue of the age of the assets.

CHAIRMAN - Is it equipment failures or as a result of inappropriate control equipment operation?

Mr BEVAN - The unserved system energy count includes anything, regardless of whether it is an operator error or an asset that has failed or a possum in a switch yard or a lightning strike. So some of those things are very controllable by us; for example things related to transformer maintenance. Some of those things are not quite so controllable by us, like the lightning storm last night; we have not got a lot of control over that. Tractors pulling towers down on the north-west coast is a good example of an event that was uncontrollable from our perspective but in fact cost us 10 system minutes. Of the 15 system minutes we have had off this year, 10 of those were attributable to that one particular incident where we had the whole north-west coast off for about eight hours.

Mrs JAMES - Are you involved with other countries in any way; providing expertise?

Mr BEVAN - Not directly, although we have a very close alliance with the other transmission utilities around Australia and the world in fact through things like the benchmarking study. I suppose the beauty of our business is that because we are not a direct competitor, other companies are very happy to share information with us and vice versa, as opposed to being a situation where direct competitors might say, 'Well, I'm not prepared to share that information with you because that is my competitive advantage'. So it is quite a different business from that perspective and a very close-knit technical community with swapping information right around the world.

Mr FLETCHER - With regard to the main thrust of why we are here. We are here because we have been given a charter by the Parliament to consider whether the Hydro-Electric Corporation has the capacity to pay a $40 million special dividend on a sustainable basis year after year after year. I have reached the conclusion that the factor driving that is the Budget imperative, that the government-of-the-day has a need to generate revenue and that special dividend is an important component of it. I think the special dividend, the quantum of the special dividend, is determined by the capacity of the other energy utilities, or players in the energy field, to produce their dividends and guarantees and tax equivalents according to their future projections. The questions I have asked today suggest to me that Transend has a sustainable business; that its forward projections in the relatively short term of operation are being met; that your business is predictable and you feel very confident that you are going to be able to sustain your business at that projected level into the long-term future. It is a sound business. Is that a fair conclusion?

Mr CUMBERLIDGE - That is a fair conclusion. There will always be some, I guess, tension between ourselves and the Regulator but it is up to us to satisfy the Regulator that we are doing the job properly; and in turn it is up to him to be responsible in his responses to us. If those things happen, yes, we have a sound and predictable business going forward.

Mr FLETCHER - Now whilst the government-of-the-day has indicated to Aurora Energy that they expect guarantees and tax equivalents and 50 per cent of the profit after tax as a dividend, that same indication has not been given to Transend at this time.

Mr CUMBERLIDGE - It was given at the outset that that was the expectation. We have had no further discussion about it since then and we have no reason to expect that it has changed.

Mr FLETCHER - But your board has an expectation that you will pay 50 per cent of your profit after tax in dividends to the Consolidated Fund?

Mr CUMBERLIDGE - Yes.

Mr FLETCHER - And you have a capacity to meet that?

Mr CUMBERLIDGE - Yes.

Mr FLETCHER - Both now and into the longer-term future?

Mr CUMBERLIDGE - Yes.

CHAIRMAN - So the Government has a knowledge of that, which I guess they will factor into the Budget that they are putting together now.

Mr CUMBERLIDGE - Yes. The Government has asked us for a half-yearly report, which we are about to give them. That will show our performance for the first six months and we will confirm that we are on track to produce that outcome.

Mr BEVAN - And the Government has our longer-term projections as they currently stand, notwithstanding the chairman's comment that the board of Transend itself is yet to embark on the process of closely scrutinising those longer-term projections that we have put together as part of the disaggregation process.

Mr CHEEK - Can I ask what each board member is paid, what sort of remuneration? And the chairman?

Mr CUMBERLIDGE - Is that a question we should answer here? I am looking for the Chairman's theory.

CHAIRMAN - I do not think it is unreasonable. Normally in corporations there is disclosure of those things in their annual reports, so I would not see it as a problem unless you have one with it.

Mr CUMBERLIDGE - No, okay. The individual directors are paid $30 000 a year and the chairman is paid $60 000.

Mr CHEEK - Who set those remunerations - the shareholders?

Mr CUMBERLIDGE - The Government of the day when Transend was set up. And I might just say that those fees are exactly in line with the Victorian fees.

Mr CHEEK - Just on that point, can you make available to the committee the benchmarking you have done with the other States so we can compare the costs, and also what I asked earlier about the fees charged by the other mainland transmission utilities and how they compare with Tasmania? You said you had them but you could not remember what the difference was.

Mr CUMBERLIDGE - We have some benchmarking. Benchmarking information - and I am not trying to stall you off here - is difficult in some areas to get an example apples for apples comparison but we could provide to the committee an estimate -

Mr CHEEK - Straight out costs and charges.

Mr CUMBERLIDGE - I do not know how much of that is commercially available from the other companies, to be honest, but we could put together a review of where we think we stand in the scheme of things. We may not be able to name individual companies but in terms of a scatter matrix or something we maybe able to put something together for you.

Mr CHEEK - Thank you.

Mr RATTRAY - Seeing that we have had a transition period now of about nine months, since July last year, it does appear from the outside that the transition between the three different entities has gone pretty well. There was some concern at the time how it would all work from the HEC to Transend to Aurora and it seems as if it is working pretty well. Have you any comments you would like to make in regard to that period of time and how you expect it to continue on?

Mr CUMBERLIDGE - From Transend's perspective, I think it has gone remarkably well. There is scope for breakdowns in communication and other problems to appear but they do not seem to have appeared. Richard observed before that the fact that the Transend people have been able to focus very clearly on their role as being beneficial and certainly from the perspective of the board I think it has gone remarkably well.

Mr RATTRAY - Do you have any meetings between the three groups at any particular time to discuss the direction of each individual one or whether you might change anything?

Mr CUMBERLIDGE - The board does not but the executive, I think, do.

Mr BEVAN - There is obviously a number of operational meetings that occur because we are all in the one industry. The other meeting that still occurs on a monthly basis is what is called the CEO Steering Committee, which was set up at disaggregation. I meet with the CEO of the Hydro and Aurora once a month. It was set up just to keep a high level overview of how the disaggregation was occurring and to make sure that the loose ends that were still around at 1 July were in fact tidied up as we have moved through. And that steering committee has just about run its course, I think. It has served its purpose and it will probably, within the next few months, be winding itself out of existence.

Mr RATTRAY - The other thing is perhaps if in the future we get the other major industries or something that comes onto line, are we in a reasonable position to be able to service that with what power we have in the State? Say, for argument sake, we had a 20 per cent increase in power needs in, say, twelve months' time, are we in a position to be able to handle that?

Mr BEVAN - In terms of generation capacity that is a question you would have to ask the Hydro. In terms of our ability from a transmission owner to provide that capacity depends very much on where the load occurred; for example, with things like the proposed magnesite processing in the George Town area, we believe we can satisfy their requirements. If someone was to want 200 megawatts at Queenstown - and I know it would please the Chairman greatly - it would mean significant expenditure for us to boost the system in that particular area, so it is very much horses for courses.

Mr RATTRAY - Wherever you might be.

Mr BEVAN - Yes.

Mrs JAMES - There was an energy committee - and I think it was within the old TDR, Dan Norton was on it - do you still have that set up with major projects?

Mr BEVAN - That is not one that Transend participates in.

Mrs JAMES - State development or -

Mr BEVAN - That is not a committee we have participation in, however I do meet on a regular basis with people such as the Regulator, the TDR and a number of other parties to make sure we keep our finger on the pulse about what might be coming over the horizon.

Mr CUMBERLIDGE - But with respect to major projects like magnesite and the Basslink, we have a direct input to those projects ourselves.

Mrs JAMES - That would be rather necessary.

Mr CUMBERLIDGE - Well, it was not always like that but it is now.

CHAIRMAN - Thank you very much, gentlemen, for appearing before our committee and cooperating with us as you have done. You have taken on board, I understand, a few of the requests for information and you can deal with our secretary on that and she will correspond further if there is anything else we do require in the way of information. If we do need you again of course we will make that request but I think most of our requests can be satisfied by the other way. Thank you again very much for attending.

Mr BEVAN - With your permission, Mr Chairman, we do have a little brochure that describes our business, if you are happy for me to give each of the members of the panel a copy of.

CHAIRMAN - More than happy.

THE WITNESSES WITHDREW.