

UNEDITED TRANSCRIPT

THE PARLIAMENTARY STANDING COMMITTEE OF PUBLIC ACCOUNTS MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON MONDAY 15 MARCH 1999.

HEC SPECIAL DIVIDEND

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ANDREW REEVES, REGULATOR, WAS CALLED, MADE THE STATUTORY DECLARATION AND WAS EXAMINED.

CHAIRMAN (Mr Schulze) - I am sure by now, Mr Reeves, you understand the processes of our committee, having been with us before. We welcome you back and look forward to your contribution. As you would be aware, the committee is looking at the special dividend called for from the Hydro-Electric Corporation and their capacity to pay that. We have had the corporation here, as well as Aurora and Transend, because there is a nexus between them all, particularly in respect to your role, Sir, on that matter. So it was felt appropriate that we request your presence here so you can further inform the committee on how you deal with those groups and how the maximum tariff is set. You have been before our committee before although there has been, you would note, quite a few changes to the committee.

Perhaps you could give us a short overview of your role and how you operate and what weighting you give and what direction you come from in setting the maximum tariffs for those particular bodies. I think, in terms of previous evidence you have given this committee, it would seem there are two ends of the spectrum from which you can operate: you can look at what the prices ought to be, compared to other places or you can look at a reasonable return on investment, as indeed I understand they do in mainland jurisdictions. So perhaps, if you are comfortable with that, you could give us an overview of your role and how you are progressing in your sphere at the moment and then we will ask questions in the normal way.

Mr REEVES - I would be pleased to, Mr Chairman. Perhaps, first, if I put my role and functions in context. The Government Prices Oversight Committee received a requirement to investigate from Ron Cornish, the then Treasurer, in April 1998 to set maximum prices for monopoly services provided by the Hydro-Electric Corporation, as it then was. That requirement came to the Government Prices Oversight Commission with notice that the Government intended to introduce legislation which would transfer the responsibility for pricing from the prices oversight commission to the Regulator, from 1 July 1998. The requirement to investigate also foreshadowed the disaggregation of the Hydro-Electric Corporation and the creation of Transend for transmission network services and Aurora for distribution and retail services.

The new legislation took effect on 1 July 1998 and on that date too, the Commissioner of the Government Prices Oversight Commission also became the Regulator. So, wearing a different hat, I then took on the additional responsibilities of the electricity Regulator.

The commission, when it was first constituted, consisted of myself and Professor Tom Parry, who is chairman of the Independent Pricing and Regulatory Tribunal of New South Wales, who was the assistance commissioner. Professor Parry continues now as an associate regulator for the pricing investigation.

The original investigation was to have been concluded by the end of August 1998. That was subsequently extended to 1 January 1999, taking account of the forthcoming State election and we received that notice in July 1998. After the election and in early December the now Treasurer, Dr Crean, advised me that there would be a change to the requirement to investigate and I would be required to produce a final report in the latter half of 1999. We are now proceeding on the basis that we would submit a final report somewhere around the end of September this year.

The prices oversight commission released an issues paper in April 1998 and received a submission from the Hydro-Electric Corporation in May 1998 but with the caveat that the HEC was not really in a position to put a case, considering that the entity was shortly going to be disaggregated. Our plan now is to reissue an issues paper, probably in about late April or early May of this year, produce a draft report in about July and a final report in September, subject to the required timing for the investigation notified to me by government.

That is the current work that is going on. Mr Chairman, you also requested some comment on the approach that pricing regulators take to these affairs. If I then move on and outline the components of the task that we have been given and in broad terms how that task is to be approached.

We have been asked to separately price each of five monopoly services provided by the electricity entities. The services are: generation, provided by HEC; consistent control services, also provided by HEC; transmission services, provided by Transend; distribution services, provided by Aurora; and retail services, also provided by Aurora. The approach to each of these components differs, so I will go through them one by one. In regard to energy price, the commission - GPOC - in 1996 took the approach that energy price would be set by reference to a range of indicators. In assessing the energy price, which was ... to tariff customers - not the major industrials, but only to tariff customers - the commission would take account of interstate benchmarks of prices for wholesale energy. At that time we had information on the vesting contracts that had been put in place between generators and retailers in New South Wales and Victoria and those vesting contracts were of the order of 4 to 4.5 cents per kilowatt hour for medium-term electricity supply.

We also took account of the sum of the parts - that is, the impact that the energy price plus the costs of other components would have on final retail prices. And the third element of information we had were forecasts prepared by the HEC of what they saw as being the medium-term price of a pricing algorithm that they use for spot sales to large customers. That algorithm is referred to as the TEM - Tasmanian electricity market price. Taking account of those indicators, the commission assessed that a fair price for retail customers would be 4 cents per unit plus losses of about 10 per cent.

The alternative approach considered by the commission was to estimate a price which would give the HEC a commercial rate of return on the current replacement cost of their assets. On that basis the energy price would have been of the order of 7 to 8 cents per unit for wholesale energy. The commission considered that such a price would not be sustainable by the time it was transferred through to retail customers and, in effect, the commission considered that the value of HEC assets was less than the cost to replace those assets. That approach was consistent with the approach that the HEC had already adopted in valuation of assets in its annual accounts - that is, it was at that stage valuing the assets according to the earning potential of the assets. So there was nothing novel in what the commission was doing. It was in fact reflecting the practice of the HEC and it was also reflecting commercial reality. Notwithstanding what it might cost a body to build assets, their real worth is only driven by the revenue that they can generate over the life of the assets and if the market has turned against them they may well then have to write down the value of the assets or write down the value of the business.

In regard to transmission pricing, we adopted an approach at that time based on a draft of a national electricity code. The draft code which has now, with some amendments, been authorised by the Australian Competition and Consumer Commission and is now a live document, sets out a methodology for calculation of an allowable maximum annual revenue to be earned by transmission network owners. The approach in this case is more a cost-based approach and it consists of a number of components: one is the estimate of an allowable return on assets each year and the return on assets is calculated from an estimate of the asset value multiplied by the estimated cost of capital which takes account of particular risk characteristics of the entity. So that is the return-on-capital component.

There is also a return of capital depreciation and another component to take account of an efficient level of operating and maintenance expenditure. Added together those components then give a maximum allowable annual revenue. GPOC in 1996 followed that approach and I would expect that the Regulator, in the current investigation, would follow a very similar approach. There are a number of variables in there including asset value, cost of capital, asset lives and efficient level of O&M.

The assessment of distribution charges is very similar in mechanics to the estimation of the maximum allowable revenue for transmission networks in that it is also calculated by reference to asset values, cost of capital, asset lives and O&M. The other component is retail charges. These are sales and marketing expenses and customer services and they are assessed by looking at an efficient level of cost plus a retail margin to account for the business risks faced by the retailer. And the final element which I have left out is system control services which are currently provided by the HEC and charged out to each of the other entities according to the services that system control provides to keep the whole show on the road.

Mr Chairman, I hope that has been an adequate explanation at least of the process.

CHAIRMAN - Yes, that has been most helpful, Mr Reeves. Before we go on to talk about more details, perhaps at this stage members might wish to ask some questions on what you have told us to date, if you are comfortable with that.

Mr REEVES - Sure.

Mr FLETCHER - Mr Chairman, I find Mr Reeves' dissertation learned and quite beyond me to understand and I am going to suggest that the witness be excused until such time as the *Hansard* transcript is available so that we might study this in greater depth and then be able to ask questions based on the information that is provided to us today. I am not questioning the content of what has been said, but it has been very technical by nature and if I were to sit here and pretend I understand exactly or feel confident about asking questions on the basis of what Mr Reeves has presented to us, I would be fooling myself and everyone else as well and I do not want to do that. Do you want a motion or does the committee want to debate that in camera, do you think?

CHAIRMAN - Well, we can do. I guess the ideal is to proceed as far as we can, getting all the information we can today from Mr Reeves, then digest it as you suggest and have Mr Reeves back for further analysis of that once we have taken it all on board. I think it would be a shame not to get all the information that we have then got to analyse before we release the witness.

Mr FLETCHER - I just want to point out that I wanted to ask questions but I need to fully understand a little more on that - well, I will never fully understand - but I want to understand more of where Mr Reeves is coming from and the implications of that before I ask further questions. My questioning would be superficial in the extreme to try to do it now. That is my point. But if you are saying you may well bring Mr Reeves back at a later time I will refrain and wait until the appropriate time.

CHAIRMAN - Yes. I think if we can get as much information from Mr Reeves as possible and then, as you suggest, give ourselves some digestion time for it and have Mr Reeves back at some later time, if the witness is comfortable with that process.

Mr REEVES - By all means. Mr Chairman, I would also be happy to brief the committee with the benefit of a white board and a worked example if that would be of assistance.

CHAIRMAN - On this occasion or future occasion?

Mr REEVES - Either.

CHAIRMAN - Perhaps we should endeavour to go as far as we can and then we will probably need the time Mr Fletcher suggests to digest the information so we can come back more properly prepared to ask appropriate questions, if the committee is comfortable with that. Did any other members have any questions at this point in relation to the process that Mr Reeves has outlined? This is a new committee of course, Mr Reeves. We have had a lot of information with, if you like, the previous committee but we of course again need to get up to speed on all these issues and the additional ones that have evolved since you were due to come before us previously.

Mr CHEEK - I just have a couple more, Mr Chairman. Mr Reeves, just so I have it straight about the alternative ways you were looking at finding a maximum price, you were saying, if I heard you correctly, that you were looking at a return on assets as one way, and also the other way was really taking into account the forecasts of the HEC and also the prices of interstate power utilities. Are you taking into account all those things, or are there two clear alternative strategies and you will pursue one of those?

Mr REEVES - The approach would vary depending on which component of activity we are pricing.

In regard to energy, the weight would be put on market indicators; in regard to network services, it would be more a cost-based approach, which is consistent with the approach taken by other regulators. The rationale is that network services are a monopoly service. There is the opportunity for network service owners to extract monopoly rents. Their prices should therefore be capped by regulation. However, in capping the prices, the regulators should ensure that the allowable returns are sufficient to maintain the assets and encourage the investment in the assets that is necessary to maintain a security of supply and delivery system.

Mr CHEEK - Even if that meant putting up prices significantly to give them a reasonable return on assets, which would have a huge impact on consumers. Which of the two alternatives would you look at there?

Mr REEVES - The network prices are in total a bit over half the total prices to customers. Transmission represents about 10 per cent in broad terms; distribution price is something of the order of 35 per cent of the total. So they are a significant component.

Mr CHEEK - And special consideration, such as the knowledge that the Hydro will have to pay a \$40 million special dividend, is that taken into account in your calculations?

Mr REEVES - Well, I have just outlined the approach in regard to the networks, which are Transend and Aurora assets. In regard to the energy component, which is the HEC component, as I said, we would put the weight on market indicators.

The Regulator is required by the legislation to consider the impact on pricing policies of taxes and dividends. The Regulator is also required to consider the financial viability of the enterprise.

Mr FLETCHER - I feel a little bit inferior -

Mr CHEEK - I think we all do.

Mr FLETCHER - in that I am not going to do justice to the situation. But the point you have made there challenges me to think about the issue a little bit more. The Regulator is so established that it can hold inquiries and make findings and have impact on both public and private sector businesses. Correct?

Mr REEVES - Yes.

Mr FLETCHER - You have just suggested to the committee that the Regulator must have regard to any demand that the owner makes upon the management in the way of dividend, and therefore you are entering into the relationship between the owner and the management in regard to the operations of a business and suggesting that is one of the considerations that you will have in setting the maximum wholesale price. That is correct?

Mr REEVES - That is correct, but I should put it in context. I would not like it to be interpreted that they are the only factors that the Regulator considers.

Mr FLETCHER - No, no, I am not suggesting that. But I find it, even in a monopolistic situation - well, particularly in a monopolistic situation - extremely difficult to accept that the Regulator is entering into the owner-management relationship with regard dividends, and that is going to be a factor to consider when establishing the price, because some owners may be rapacious and some may not.

Mr REEVES - You are quite right, Mr Fletcher. Perhaps if I can answer by, first of all, outlining some of the other factors required to be taken into account by the Regulator. These include the benchmark costs and prices of the service, by reference to interstate and international benchmarks. They also include the requirement to protect consumers from the exercise of any monopoly power, or market-dominant power. They also include the public interest. That is another element which we are required to consider.

In coming to a view on the balance of these factors, the Regulator is also guided by the objectives of the act under which he operates. The objectives that I have been given by the act are to promote competition and efficiency in the supply of electricity, and a further objective is to protect the interests of electricity consumers. Now that is a very clear objective of the act and provides the framework in which I have to do my work.

Certainly I am required to consider those range of factors, costs, prices, impact on pricing policies of taxes, the public interest, and the protection of the consumer from any monopoly pricing, and there is a matter of judgment as to the weight that is accorded that.

In regard to those factors that are particularly important to the Regulator, I guess the thing of fundamental importance is the relationship between the entity and its customers by virtue of the price. In looking at cost of capital, for example, we are looking there at fair returns to the owner, and the requirement of the regulation is to take account of the returns to the owner, including dividends.

So there are some issues that are above the line on which we put great weight. There are other issues below the line where we would put lesser weight, considering that they are more affairs between the owner and the enterprise itself. So while we are required to consider them - which I would do - by looking at cash flow forecasts of the entity, for example, they are not necessarily a compelling factor in a determination of the price.

Mr FLETCHER - Would you care to put on the record those factors which you believe are above the line as opposed to those you believe are below the line?

Mr REEVES - The factors that are above the line would be: revenues, efficient levels of cost, a rate of return on a fair asset value, and depreciation to take account of the use of the assets. Taxes would be another above-the-line item. The below-the-line item would be how the profits are then distributed to the shareholder or retained by the entity.

Mr FLETCHER - Do you think that where, say, one party is both the owner and the tax collector, that impacts upon your delineation?

Mr REEVES - The tax regime that the HEC operates under is a transparent tax equivalent regime. That is in regard to income tax and wholesale sales tax. The other tax which we have taken account of is the electricity consumption levy, which is one that is imposed through legislation and subject to parliamentary scrutiny.

CHAIRMAN - Following the same line but from a slightly different tack perhaps to get our minds clear on it, you mentioned how GPOC in 1996 had said that a commercial return on investment was not a significant factor as the wholesale price needed would be 7 or 8 cents a kilowatt hour to yield a commercial return on the written-down replacement cost of the assets. That was what was said at that time. That really means, of course, if it is not sustainable to charge that wholesale price - and you have suggested to us that a significantly lower figure is to be charged - does that not then cause a significant write-down in valuation on those assets. You can respond to that, but also I understood that perhaps regulators in other jurisdictions would be operating, or you would be operating in a similar fashion to those who I understand look to allow a reasonable return on asset value of, say, 7 per cent or something was the figure. Perhaps you could comment on that.

Mr REEVES - We need to keep clearly distinguished the treatment of generation assets from the treatment of network assets. In regard to the treatment of generation assets, yes there is implicit in the work that the commission has done a write-down of the value of HEC generation assets to below the cost of replacement of those assets and that valuation is already reflected in the annual reports of the HEC.

CHAIRMAN - So the latest report is a reflection of that. We will follow through a little later on the return of equity that is reasonable to expect then if that is the case.

Mr REEVES - Sorry, Mr Chairman, I have lost the questioning.

CHAIRMAN - Well, you have responded and said the assets have been written down so that a fair commercial return could be obtained. So perhaps if we do look at that balance sheet, the most recent one, it does show \$2 billion of equity based on, you suggest, a lower valuation than had been previously the case, would it be reasonable then to get a 7 per cent return on that equity of some \$2 billion?

Mr REEVES - Without having the figures in front of me, Mr Chairman, you have me at a disadvantage. But my impression is that the value of the equity quoted in the annual report already reflects the written-down value of the assets - that is, assets based on what is termed in the annual report the 'recoverable amount'.

CHAIRMAN - Yes, we accept that. So then as that is the written-down value that the equity is drawn from of the \$2 billion, it would be reasonable to expect then for the Hydro-Electric Corporation to get, I do not know, 6 or 7 per cent return on that equity?

Mr REEVES - Yes, in fact I think the figure is probably quoted in the notes to account and it would appear as the discount rate used by the HEC in assessing the recoverable amount valuation of the assets.

CHAIRMAN - So that return is before interest and tax?

Mr REEVES - Mr Chairman, perhaps these questions on the detail of the HEC Annual Report are best directed to the HEC. I refer to note 12 to the accounts where the HEC has quoted what they term 'replacement values' and the second table of 'recoverable amount values'.

CHAIRMAN - Yes.

Mr REEVES - And you are correct, Mr Chairman, that note also quotes a discount rate of 7.5 per cent nominal after tax.

CHAIRMAN - That is correct - page 49. You apparently then are focused on giving consideration to a reasonable return on the written-down asset value of the corporation in terms of your deliberations which, I understand, is a similar process to what regulators have used on the mainland.

Mr REEVES - Yes.

CHAIRMAN - Do you have a percentage in mind or that you work to?

Mr REEVES - Not in regard to generation because, as I have said, the principle determinant for generation advice is a market proxy or benchmarks with prices prevailing in other States. In that case, the value of the assets becomes the outcome - that is, first assess the price; secondly, assess a rate of return - the outcome is then the value of the assets which is the approach reflected in the HEC annual report. The regulators in other jurisdictions have not been challenged with assessing an energy price and if I may outline: the national market is now operating which means that generation prices are set each half hour according to generator bids for dispatch. Mr Chairman, this is a further very complicated area so I will try to gloss over it. But in effect generator prices are now set every half hour according to demand and generator bids. It is rather like a half-hourly auction.

The market participants also take longer-term positions - that is, they will hedge on the spot market and look for short and medium-term contracts. Those prices are market driven and outside the hands of the Regulator and that market pricing now refers to a large percentage of the customer base on the mainland - that is, certain classes of customers are now contestable customers.

The generators on the mainland have their revenues protected to some extent by vesting contracts that were set up by the New South Wales, Victorian, Queensland and South Australian governments respectively as these reforms were introduced. Those vesting contracts and the value of them were determined by governments rather than by regulators.

CHAIRMAN - As you are aware, this inquiry is looking at the capacity of the Hydro-Electric Corporation to be able to pay the special dividend although I guess, as far as the profit and loss statement is concerned, it is not separated there and I guess you would not be giving regard to what type of dividend or what it is called or whatever or how it is being paid but rather a reasonable return on the revalued asset. Would that be correct?

Mr REEVES - That is correct. The emphasis is on the price and the return rather than the distribution of the profits.

CHAIRMAN - Often the taxes paid to government have been lumped with the dividend paid to government in terms of some people have looked at that as what the Government is getting in respect to their asset. As I would see it, that is not an appropriate way of dealing with it. They are now corporatised in the private sector and so that is an operating expense essentially, the same as any other private operator would have, and so in your mind I would guess that any taxes or tax equivalents that are paid are outside your ambit of view and when you look at the dividend you would not be taking those matters into account, you would be looking at more return. Perhaps you could comment on some of those issues for us.

Mr REEVES - Yes, that is quite correct. The State Government receives tax equivalents from the HEC and from other government business enterprises and the purpose of the tax equivalent regime is to ensure that government businesses are operating in the same commercial environment as a private sector business. The difference is that a GBE, such as the Hydro, pays its income tax equivalents to the State Government rather than a private sector corporation which pays its income taxes to the Commonwealth Government. Other taxes, such as wholesale sales tax, similarly flow through but they are really State Government wearing its tax collector hat which it has borrowed from the Commonwealth, if you like.

The other role of the Government is one as owner. But that is really a separate identity to its identity as tax collector. So certainly, on the one hand, I regard the tax effect as being a part of the cost of doing business. The other issue of the distribution of dividends is much more the relationship between the owner and the enterprise and not one that has such an impact on price. I think the HEC has chosen in the past to bundle together all of its returns to State Government and to some extent that may be somewhat misleading.

CHAIRMAN - Thank you for clarifying that point. I think that has certainly misled some people and the public in some situations.

As far as the dividend itself is concerned, whether it is called special dividend or ordinary dividend or you combine the two, do you take any position or view in terms of what percentage that dividend should be in a commercial world today; which I think seemed to be the case with some of the mainland regulators where they allowed a certain return as a percentage, 7 per cent perhaps?

Mr REEVES - The regulators would look or may have occasion to look at a prudent dividend policy to assess the ongoing viability of the enterprise. That is one area where you would look at a model and run out the cash flows to see what the cash position of the entity is. But, as I say, it should be a prudent dividend policy and I would not expect any regulator to be influenced by the owner simply coming up and saying, 'We want to withdraw large buckets of money from the enterprise, so you should put our price up'. The regulator would say, 'That's not a factor that carries a lot of weight with me. I am rather more concerned about fair returns on aggregate rather than how much you choose to leave in the business or how much you choose to withdraw'.

CHAIRMAN - So in that sense, in looking at this current profit and loss statement and balance sheet, we see a \$2 billion equity in terms of the corporation and a provision of dividend that is made up of several elements, although this profit and loss statement just shows it as one as \$57 million. That would not then be seen as a particularly excessive dividend as a return on that \$2 billion of equity. Do you focus on that sort of circumstance?

Mr REEVES - In regard to the energy pricing, our focus would be on a fair price for the energy rather than the fair returns on the value of the assets. Given that the HEC has written down the value of the assets, then the returns that it currently gets on equity would be very close to commercial returns.

CHAIRMAN - I guess that, by definition, should be. But, as you are intimating, it is not necessarily that criteria. You would be strongly pressured I guess, would you, for the prices to be competitive when

you look at rates in other jurisdictions in Australia?

Mr REEVES - That is quite right. We do take account of electricity prices in other States to get a feeling for fair prices in Tasmania. Now that is not to say that Tasmanian prices should be the same as elsewhere because Tasmania has different cost structures to elsewhere. Nevertheless, the owners of generation assets in other States have also taken quite a hit on the value of their assets by virtue of the over-investment during the 1980s. They certainly could not sell the set of generators that they now have for anything like their total replacement cost because of the surplus capacity. A similar situation emerges in Tasmania.

CHAIRMAN - So, in taking that into account, you may well be driving the asset value of the Hydro-Electric Corporation lower if you are giving consideration to mainland prices, if you like, that they were highly competitive compared to Tasmanian prices, it could well be the return on asset here is diminished and accordingly the asset needs to be further devalued. Would that be valid?

Mr REEVES - I really could not comment. I do not know what energy prices or what prices are implicit in the HECs valuation of assets. That detail is not disclosed in the annual report.

CHAIRMAN - Do members have any questions on those particular issues?

Mrs JAMES - Mr Reeves, I was wondering what would happen in the event of a dispute between the Hydro or either one of the other entities on the valuation of assets. They seem to be presenting the view that they would be looking to impressing you that their assets were worth more than they have been previously acknowledged to be.

Mr REEVES - The asset valuation is a very important component, particularly for the network. To inform us we have commissioned an independent valuation of Transend and Aurora assets. The consultants we have used have used a methodology consistent with that used in other States so that we have some comparability and that is one important stake in the ground for the asset valuation. That is not to say that that is the definitive answer on asset valuation.

Mrs JAMES - It is still negotiable to an extent then.

Mr REEVES - There is still an exercise of regulatory judgment, or even judgment by the owners, on the appropriate asset valuation.

Mrs JAMES - There was a disagreement in Victoria, was there not, which had to be resolved.

Mr REEVES - Yes. The principal disagreement in Victoria - are you referring to Victorian gas last year - towards the end of last year?

Mrs JAMES - That was my understanding but I am not too up with it.

Mr REEVES - The principal debate there was in regard to the allowable return on assets rather than the asset valuation itself. But I might add -

Mrs JAMES - They are interlocked, I suppose.

Mr REEVES - Yes, there is a certain circularity.

Mrs JAMES - If a similar situation arose here - you seem to have an immense amount of power - in the event of an ongoing dispute what would happen?

Mr REEVES - All my work is exposed to scrutiny.

Mrs JAMES - By Parliament.

Mr REEVES - By the public. I think another factor that I have put weight on are the reports that we produce and leaving a trail for people to follow, so see how we have reached our conclusions. That has now been codified and the code now requires me to leave a trail, whereas previously there was a simple requirement for transparency.

Mrs JAMES - But your decision would prevail?

Mr REEVES - Yes.

Mr CHEEK - You say 'we' but it is you and you alone who make the final decision on the pricing?

Mr REEVES - No, I say 'we' -

Mr CHEEK - Your team.

Mr CHAIRMAN - 'We' the regulators.

Mr REEVES - Yes. Strictly speaking it would be myself and Professor Parry as the associate regulator. I do tend to use 'we' speaking of my office and the support of my staff.

Mr CHEEK - But it is you. You are the sole arbiter; you are the only judge at the end of the day on what pricing is finally established?

Mr REEVES - Yes.

Mr KEN BACON - Can I go back and get one point clarified? The draft national electricity code, which has now been established, was it correct that I understood you said that that has the power to set acceptable levels of return to non-competitive ...

Mr REEVES - That is right. The code sets out the pricing arrangements for the transmission network in detail, and there is a detailed methodology there.

Mr KEN BACON - So given that there is not a lot of competition in the areas we are talking about, would your market indicators and criteria that you assess the price on be the same if there were more competition?

Mr REEVES - Yes. The networks are priced according to a fairly rigorous methodology because they are monopoly services. If there was competition for supply of network services then there would not be the need for regulation. The characteristics of the network are that it is really not efficient to have two networks running side by side doing the same thing.

Mr RATTRAY - I am pretty interested, Mr Reeves, after having the HEC chairman in and explaining the situation in regard to the dividend and so on that the Government are requiring, and with the devaluation of the asset overall of the generation facility. I understand that there may not be any further money committed to paying off the debt. How does that affect you in making your decisions? They have been paying off quite a bit of debt over the last few years, I think - \$250 million or something like that. Does that come into the role at the end of the day? What does it do to the whole system and your outcome of determining what is a fair price all round? Also you have made emphasis of the consumer being pretty important. What will that do, say, at the end of this ten-year period that we are talking about?

Mr REEVES - I will be asking the HEC for ten-year financial forecasts so we can see what the cash position is and the cash needs of the entity for replacement of assets out to the future, and also look at their debt-reduction strategy. That is more a business decision than a regulatory decision.

Mr RATTRAY - I appreciate that.

Mr REEVES - If that analysis was throwing up some major anomalies and concerns, I guess we would go back then and start to examine whether that was an appropriate business strategy.

CHAIRMAN - Surely your determination has a bearing on the rate of repayment of debt?

Mr REEVES - Yes, it does. It is one of the factors. The other factors are the allocation of debt between HEC, Transend and Aurora - which the owner made on disaggregation - and the other factor which you are referring to, which is the dividend policy.

Mr KEN BACON - So really there is some type of safety-net control there in the long term to ensure that it is going to happen?

Mr REEVES - No. I am not -

Mr KEN BACON - Well, when you said, in answer to Mr Rattray's question, that if some great anomaly turned up in the long-term project or business strategy, what you are saying is you would reassess it. That to me is a safety net; that they are not going to run into trouble.

Mr REEVES - Well, we would certainly look at it, yes, and we may well comment on it.

CHAIRMAN - This committee, Mr Reeves, has been talking to Aurora and Transend, as well as the Hydro-Electric Corporation. While the prime issue we are looking at is the capacity of the corporation to pay its dividend - aggregated, I guess - the committee would be interested to hear from you perhaps on interactions that might exist between those three entities.

In terms of any of your determinations, could effects on Aurora and Transend reflect back into the corporation itself and its financial circumstances, or are they dealt with as separate entities? Some might say this committee need not bother looking at Transend and Aurora in relation to its inquiry into the capacity of the Hydro-Electric Corporation to pay the dividends that the Government expect of it.

Mr REEVES - Certainly I am treating them as five separate functions carried out by three separate businesses, so I consider the HEC as a stand-alone activity. The network services again are really stand-alone activities and should not have any bearing back on the HEC - except for one element which I understand is in the arrangements which came from disaggregation and the treatment of revenues from the major industrial customers. That would be one area, but I do not know how material that would be. I think the committee has probably already been advised that the HEC -

CHAIRMAN - Of how that is dealt with.

Mr REEVES - Yes.

CHAIRMAN - We have had some witnesses speak to us on that, yes. So other than that, you do not see any other nexus between those groups and the ability or otherwise of the corporation to pay the Government dividends?

Mr REEVES - No, not off the top of the head, Mr Chairman.

CHAIRMAN - In terms of your processing, I think you did give us some indication of what time scale you were working to. When would you be expecting to make your first determination?

Mr REEVES - We will be producing a draft report, I expect, by end July 1999 before a final at the end of September. We would then take public submissions on the draft report and the draft determination.

CHAIRMAN - I see. So in the interim, of course, the entities are operating under the old structure in terms of their tariffing?

Mr REEVES - That is right. The tariffs are set by the tariff order which was established in 1996. So tariff prices are set until 31 December 1999.

Mrs JAMES - No indexation?

Mr REEVES - Yes. They are adjusted each year according to a formula that was also set down in 1996. In broad terms, residential tariffs are adjusted by CPI, and business tariffs have been adjusted on average with a reduction in real terms of 5 per cent. So they are multiplied by the CPI then minus 5 per cent. That is an average.

CHAIRMAN - So would it be fair to say that you have a balancing act to do, on one hand, in looking at return on equity as a reasonable commercial percentage and, on the other hand, looking at the commercial rates of power in other jurisdictions and trying to reach a compromise between those?

Mr REEVES - Yes. It is certainly a balance between the interests of customers and a fairness of returns for the businesses themselves.

CHAIRMAN - In terms of maintaining some sort of comparative rates between Tasmania and the mainland, I guess, do you take into account the possible connection between Tasmania and the mainland ultimately drawing those tariffs together on a pure, competitive commercial basis anyway?

Mr REEVES - I take that into account, that is certainly another indicator. I would not expect, though, that the interconnector would be operating during the term of effect of our next determination, depending on how long that determination runs for of course, but I think the current plan is for interconnection in the second half of 2002 or thereabouts. The other difficulty is to define the circumstances under which the interconnector would operate. As the committee is aware, the Government through the Basslink Development Board is seeking proposals from a number of proponents. There are a variety of ways in which the interconnector could operate and the terms of operation of the interconnect could have an impact on the energy price. So while it would certainly help my work if we could be definitive or if someone could be definitive and tell us what the costs of interconnection would be, but that is not likely to be the case.

CHAIRMAN - In terms of these two different parameters that drive you towards a determination, is there a big gap between the two - I might be asking a hard question - in other words, in setting a tariff to give a reasonable commercial return looking at equity and commercial rate of return, is that far away from the figure that you would arrive at by using the other method of being competitive with mainland prices?

Mr REEVES - Well, in broad terms, Tasmanian prices are now comparable with interstate prices. In some sectors the Tasmanian prices are above the charges that comparable customers will be seeing in some other jurisdictions, it varies of course. New South Wales has quite competitive prices for tariff customers and for business customers, Victoria less so at the other end of the range. On the main, Tasmania sits at the upper end of the range but we are not the highest. Now there are some areas where Tasmanian prices are rather higher than those in other jurisdictions for the comparable set of customers. That is changing over time as a result of the 1996 investigation. Business tariffs, for example, have been coming down and for the very small business customers came down quite dramatically. There is still some room to go in that quarter.

But, I guess, Mr Chairman, to try to address your question as to the balance, Tasmanian prices are not completely out of kilter with those paid by customers in other States and, on the other hand, the HEC returns also seem to be, well adequate.

CHAIRMAN - So the balancing act you have, Sir, is not perhaps quite as difficult as it might have looked two or three years ago in terms of disparity.

Mr REEVES - This work was done three years and our view at that time was that the business sector was paying considerably more than we felt was a fair return. As a result of that work, the commission recommended changes to tariffs which have now delivered, on average, a 15 per cent reduction for business customers.

Mr CHEEK - How much farther do you think we need to go in that area to make us completely competitive with other States as far as the business sector goes? Do you think we have got much farther to go before you can say that we are competitive?

Mr REEVES - The work last time came to the view that business tariffs, on average, were about 20 to 25 per cent above what we thought were a fair reference tariff. We reasoned that a four to five year transition would be reasonable and hence 5 per cent per annum. The comparison of Tasmanian prices with mainland prices is actually included in the HEC submission to the investigation last year and some graphs there across a range of customer classes demonstrate where business and residential customers line up with mainland customers. Unfortunately, one also needs to be paddling pretty vigorously just to keep your position in the field because there are downward pressures on electricity prices in other States as well.

Mr CHEEK - Would it be fair to say then that we are 5 to 10 per cent behind the rest of Australia in business costs or 5 to 10 per cent higher than the rest of Australia in business costs at this particular time?

Mr REEVES - No, I think we need to be careful in the generalisations. There are some sectors where Tasmanian prices are above the rates charged in New South Wales for example but less than those charged in Victoria. The sectors that I guess I am concerned about are those where Tasmanian businesses are competing head-on with comparable interstate enterprises and this tends to be in the sort of the larger manufacturing and the food processing, et cetera, where Tasmanian firms are head-on with Victorian firms. In those areas, the larger and medium-size manufacturing, the Tasmanian prices really are not too far out of kilter with the comparisons in the other States. As I say, the information is in the HEC submission to the commission and it is certainly well worth having a look at just to get a feel for where we stand.

The other caveat to put on that is that that is a tariff comparison. As competition has been introduced in the other States the prices have come down so fewer customers are now on the tariffs. But, even making allowance for the difference between tariff and customers enjoying the benefits of competition, Tasmanian prices do not seem to be too far out of the show for those larger customers.

CHAIRMAN - And there is still some room to go in terms of this readjusting the commercial tariff that you were instrumental in taking -

Mr REEVES - Yes, that was certainly a view in 1996 that the three years at 5 per cent would not bring tariffs down to what we thought were more appropriate levels and that is being reviewed as part of the

current investigation.

CHAIRMAN - So at this point you are not too far away from eliminating what might have been considered by some as cross-subsidy.

Mr REEVES - That is right. We are not too far away from the target that we set two and a half years ago. Let me say, for the very small business customers there would have been price savings of the order of 25 to 30 per cent for a large number of customers. I was actually surprised at the number of small commercial enterprises that operate small offices, for example, and electricity might not be a significant component of their total price but they have enjoyed significant savings in their hydro bills.

CHAIRMAN - We thank you for that.

Mrs JAMES - Seeing there is considerable volatility in the mainland States with, I think, Victoria accusing New South Wales of having their prices too low and South Australia saying they will take power from elsewhere other than South Australia and all this sort of thing, do you consult with the other regulators? I think it is what has been called 'slow capital' invested in the Victorian power stations in that the owners are willing or they were willing to sit back and take the lower prices for a time but now they are looking to up their prices. I suppose they are trying to impress the Regulator that that should be so. But how will this all bottom out as you are pretty reliant on mainland prices to some extent? With that volatility I wonder where that leaves Tasmania, particularly with Basslink?

Mr REEVES - Well, you have raised a number of points there.

Mrs JAMES - I hope I have not confused you.

Mr REEVES - No, but pull me up if I have not addressed them all.

One of the factors is the views of the Regulators in other States. We do talk to each other.

Mrs JAMES - But not formally.

Mr REEVES - No, we do formally, as well as informally. We have a regulator's forum which consists of all of the State regulators, plus the ACCC, and we have some common work groups established under the Regulators Forum looking at such issues as cost of capital, for example, and benchmarking of efficiency and levels of service for customers. I am also an associate commissioner of the ACCC on the energy division, together with my colleagues in Victoria and New South Wales and Queensland - Queensland does not take an active role. So through that role I also get exposure to the ACCC consideration of gas and electricity issues that come before it and my colleagues in New South Wales

and Victoria also share their papers and research with us.

Mrs JAMES - It is a wide field to cover.

Mr REEVES - It is, but I think there is certainly goodwill between the regulators, recognising we are working in a national industry and it is highly desirable that there is some consistency in approach between regulators in various jurisdictions and with the national regulator. We would also not like to see a situation of regulator shopping -

Mrs JAMES - Crossing the border to get a better deal, you mean?

Mr REEVES - Yes. There is a lot of shared benefit in research and each of the regulators are quite strong-minded individuals and different characters and they bring different perspectives to the issue. So I am sure we all benefit by having this diversity of views too on best regulatory approach. It is a new field for Australia; we can be informed by UK and US experience, but those experiences also have to be applicable in the Australian context.

Mrs JAMES - Thank you very much; that was interesting.

CHAIRMAN - Following on from that, Mr Reeves, in Victoria particularly we received evidence some time back that there was a surplus and over-capacity there and because of that prices were below real long-term commercial rates. Do you study those matters and take those into account when you are making determinations for price tariffs in this State?

Mr REEVES - Yes. You cannot just look at prevailing prices on the mainland and immediately transfer them and say that is what the price ought to be in Tasmania because that would completely ignore the Tasmanian situation. Victoria and New South Wales prices, the spot prices, have been very low particularly twelve months or so ago as a result of the over-capacity. They have been edging up but the spot market, average prices, are still well below the prices that would be needed by a large new entrant in generation. They are averaging somewhere around \$20 per megawatt hour - that is, two cents per unit - that is an average taken over say the last twelve months - these are very broad figures I might add - compared to the cost of a new entrant, which would be some \$35 or so per megawatt hour.

CHAIRMAN - Significantly more. So you do give consideration to that in making your determinations here?

Mr REEVES - We certainly look at where we think prices are going and recognise that short-term spot prices are a result of significant over-capacity in the market, over capacity that will be taken out over time either by increasing demand or by closure of some power stations.

Mrs JAMES - We do not have that luxury of excess power.

Mr REEVES - Certainly not to the extent of the mainland.

CHAIRMAN - In terms of the special dividend that is being required of the Hydro-Electric Corporation in addition to the normal dividend, do you actually consciously look at that and give regard to that in terms of return on equity or is that not visible to you in your role?

Mr REEVES - No, I tend to look at it at the higher level, as a total return on equity. As I say, my regulations require me to consider the dividends so I cannot be blind to it.

CHAIRMAN - So you would look at it as the aggregate rather than necessarily looking at the dividend declared plus the special dividend. You would look at the \$57 million, or whatever it is, and look at that as against equity and return, as we talked about earlier in the financial report.

Mr REEVES - I think the more important figure is the return on equity rather than the dividend payments.

CHAIRMAN - Yes.

Mr FLETCHER - I think the point Mr Reeves made at an earlier time that he looks at what a prudent dividend should be on an investment of that quantum.

Mr REEVES - In effect, yes. Perhaps to be more precise, an appropriate rate of return on assets is the guiding light and we then, perhaps as a secondary test, look at dividends and the financial viability of the enterprise.

CHAIRMAN - In commercial terms, do you make that comparison before interest and tax or after?

Mr REEVES - We are speaking in regard to the HEC?

CHAIRMAN - Yes.

Mr REEVES - In regard to the HEC we would look at all the indicators, certainly earnings before interest and tax as well as after-tax profits.

Mr FLETCHER - I would like to take Mr Reeves back. I still want to explore the basis of valuation of the HECs assets. I accept that the valuation in the books of account is a matter for the HEC and not a matter for the Regulator, but the valuation is of some concern to you if the asset value is a component in determining the equity and you are somewhere in your process looking to give the corporation a fair and reasonable return on equity. That is where I am trying to come from. As I have been listening I have been trying to determine where each piece of the puzzle fits into place because I cannot help getting away from the feeling that there is a circular equation here somewhere, that we are going round and round and round and the Regulator is setting a return which the HEC is capitalising and which the Regulator is taking into account when setting his return. So I do not clearly see the independence of the Regulator from the valuations, which seems to be an important factor. It might be - you could brief me at another time on this which might help rather than try to explain in this sort of forum and taking the time of other people.

If I could take you back. You did say to me previously that there were a number of criteria that you used to establish the wholesale price. Some of these were above the line and some were below the line. The matters above the line, I think - and you might add to them - were community interest; the need to maintain a competitive neutrality, I guess; tax and other burdens that might be imposed upon the corporation; and there was a fourth which I do not remember. Then below the line were the relationship between the owner and the management or the owner and the corporation and the dividends or return on equity and the viability of the business for the long-term sustainability of the owners interests were important matters but they were secondary matters compared with the first three. Am I correct in concluding that that is pretty much right?

Mr REEVES - In effect, yes.

Mr FLETCHER - Did I miss anything from above the line?

Mr REEVES - There were probably a few. I know I rattled through fairly quickly and it was probably not comprehensive.

Mr FLETCHER - I see.

Mr REEVES - The above-the-line items would be the return on assets, plus depreciation, plus operating and maintenance costs, plus taxes.

Mr FLETCHER - In your role as Regulator, are you at all interested in the process the corporation uses to value its assets?

Mr REEVES - Yes, I am because I would be conscious of any gaps between the corporation's asset value and the Regulator's valuation of asset.

Mr FLETCHER - Am I right in concluding that you have a valuation of the corporation's assets prepared independently of the corporation?

Mr REEVES - Again, we should distinguish between energy and network services.

Mr FLETCHER - I am dealing only with the Hydro-Electric Corporation now; only the energy generator.

Mr REEVES - Right. With regard to the HEC, I would not be seeking an independent value of assets because the market value of the assets is so far short of the replacement cost it really would not be worth getting another view on the replacement cost of assets.

Mr FLETCHER - So you accept totally that the capitalisation of the future cash flows is the only way really to value the assets of the HEC?

Mr REEVES - That is the method that is required by the accounting standard and endorsed by the Auditor-General.

Mr FLETCHER - Okay. So now we have a valuation and in establishing the maximum wholesale price that is to be recommended by you, a return on that asset valuation is one of the components to be taken into consideration when you are determining the price?

Mr REEVES - No, I would work from the other end - determine the price. That then sets the revenue stream for the HEC. The HEC would then adopt its own discount rate in its accounts and would then itself work out the asset value for its books.

Mr FLETCHER - I see.

Mr REEVES - So in that case asset value is an outcome rather than an input.

Mr FLETCHER - Yes.

CHAIRMAN - From your determination.

Mr REEVES - Yes.

Mr FLETCHER - It may well be a reasonably volatile figure; it may change on a regular basis, depending on the cash flows - on the net present value of the flows using the discount rate.

Mr REEVES - Yes. This has been the subject of some discussion on the mainland as being the impact on the generation sector of the national market. Wholesale energy prices are quite volatile and the generation companies are going to find their values bumping up and down according to the state of the market, in much the same way as the shares in mining companies bump up and down. But again it is important to distinguish between the characteristics of the generation sector versus the characteristics of the network sector. In a network the revenues are much more stable and hence the value of the companies is much more stable.

Mrs JAMES - And you said the maximum price?

Mr REEVES - Yes.

Mr FLETCHER - This inquiry is really about making a judgment as to whether the Hydro-Electric Corporation can pay tax equivalents, then 100 per cent of its after-tax profits by way of dividend, and then \$40 million per year for the next ten years out of cash reserves or depreciation cash flow surpluses - not cash surpluses, non-cash expense surpluses - on a sustainable basis without putting at risk the corporation, I guess. It seems to me that you really do not have a role to play in making that judgment.

Mr REEVES - No, that is correct. I do not think that would be my role.

Mrs JAMES - You could see from what you learn from all your inquiries whether those amounts to be taken are sustainable though.

Mr REEVES - I could. I probably would not look out much beyond the ten years. As I say, it is a secondary issue and to a large extent is driven - let me rephrase that. It is not one of the primary inputs to our work.

Mr FLETCHER - Well, you seem to have confused me here a little because you did say it is not a matter about which you would make a judgment; it is not in your domain to make a judgment about such matters, and therefore I could reasonably conclude that it is not a matter that you would take into consideration when you are establishing the maximum wholesale price?

Mr REEVES - I am required by my legislation to consider it - which I cannot avoid - but there is a question of judgment as to the weight that is put on it.

Mr FLETCHER - But you are also required to sustain to a degree - I am not sure what the degree is, what the weight is - the viability of the business?

Mr REEVES - Yes, I am.

Mr FLETCHER - And if the owners are making a demand of substance, you would need to take that into consideration and give the business a capacity to continue to be viable knowing that there is a special dividend being levied upon it.

Mr REEVES - Not necessarily. Let us take an extreme case for illustration, rather than the one before us. If we had an extreme case where the owner decided to take out its reserves in the entity and circumstances changed, the entity then got on tough times and found that it could not maintain its assets or whatever and came rushing back to the regulator wanting more money, the regulator could well say, 'I'm sorry; the decisions that you took at that time - the decisions taken by your owners at that time - were not prudent business decisions. There are benchmarks for dividend payouts. Directors have responsibilities.' There are all sorts of other safeguards involved. It should not really be for the community to be carrying the cost if the owners had been imprudent. That is in the extreme.

Mr FLETCHER - You do not think paying a \$40 million a year dividend out of reserves, bearing in mind that those reserves are not going to be added to by cash surpluses or by operating profits in the future because 100 per cent of the operating profits are going in dividends, so there is going to be no cash growth in the reserves. The reserves to this time have been created by a very strong depreciation or writing down of the asset in this last year, I think, further by almost \$300 million, which are established as a fund set aside for further Hydro generation at the time of the Commonwealth King-Anthony subsidy - which was held in abeyance pending the development of the next Hydro scheme. There is \$20 million or \$30 million also in an oil account which fires Bell Bay, I guess, at some stage. So a very, very substantial part of the reserves there at the moment are fragile by nature and may well change with changes in valuation in the future. Do you not see that \$40 million a year being an extreme case?

Mr REEVES - I really have not done the analysis to see whether it is extreme or not. I am aware that the HEC has advised the committee of its view, the substance of that view being that the special dividend does not raise concerns about the ongoing viability of the business.

Mr FLETCHER - Okay.

Mr RATTRAY - Mr Chairman, perhaps I can ask Mr Reeves, you have commented quite a deal on the Victoria-New South Wales circumstance. In getting a price across a board or some comparable price, considering that Tasmania is a very small player in the field - we only have a few people, we only have a small island - what emphasis is placed on the drawbacks or the disadvantages, I suppose, in being

such a small area - in being able to maintain a reasonable return to the HEC, and also the fact that the price that comes out the end to the consumer - certainly the domestic consumer - because of the major players involved in a certain percentage of power in the State. What sort of a role does that play in the smallness of our State in coming to these decisions?

Mr REEVES - The size has a number of impacts. One, Transend and Aurora cannot achieve the economies of scale of the larger corporations in other States, so that is a significant factor, which then means that their efficient levels of costs are probably above the efficient levels of cost that the larger companies can achieve - those with the much bigger customer base.

In regard to customer prices, while I am required to act in the interests of the electricity consumer, there are limits to things that are reasonable for the Regulator to take into account. So I certainly look at the benchmark electricity prices, for example, as one input, so prices are an input as well as Aurora and Transend costs. But there are other factors about being a smaller State which are probably not within my scope to be taking into account.

Mr RATTRAY - Perhaps at the end of the day that will not help the situation either because we do not seem to be having expansion that many of the other bigger States of course are having in the volume of work - the requirement of power to generate new industries and things. That seems to me to be a problem here within the State in being able to do all the things that we think we would like to do, and you being the Regulator is certainly one of them very much to the fore in giving us a reasonable supply to a small number of people.

Mr REEVES - Yes, sadly that seems to be the position - that Tasmania does not have any further low-cost generation options available to it in contrast to other States with substantial coal reserves, substantial economies of scale, substantial gas.

Mr RATTRAY - Thank you, Mr Reeves.

Mrs JAMES - With Comalco taking about 25 per cent of the State's power and other major bulk consumers, it must have a very substantial effect on the price setting for the rest of us. How do you view this? What part of that does this fit into your deliberations?

Mr REEVES - I have not allowed the supply for the major industrials to impact on the prices paid by retail customers. Earlier in this afternoon's discussion the Chairman was referring to the returns to the HEC and whether they were fair commercial returns. The returns to the HEC are a combination of revenues from retail customers as well as revenues from major industrial customers and perhaps one of the factors for the valuation of HEC assets is the price paid by major industrial customers, the average price paid. But, as I say, when the commission did its work last time it assessed that the maximum wholesale price for retail customers could fairly be set at about 4 cents per unit.

We also commented in the final report that people would inevitably draw a comparison between that price and the prices paid by major industrials.

Mrs JAMES - Which people are not told.

Mr REEVES - Yes, and would then claim there is a cross-subsidy here.

Mrs JAMES - Do you know what they are?

Mr REEVES - Not at the moment, no. I think the HEC has stopped publishing MI revenues in its annual report as a class. I think it publishes a broader class of customer now and I have not tried to reanalyse it. But we did make the point in our 1996 report, and my views have certainly not changed, that the impact of internationally competitive prices paid by major industrial customers is carried by the owners through reduced profits rather than by retail customers.

Mrs JAMES - And that is in your 1996 report.

Mr REEVES - That is in our 1996 report and I will keep repeating it whenever I am asked to do so.

Mrs JAMES - Thank you, I will read it.

The proposed Duke Energy taking on the Bell Bay plant, will that be part of your jurisdiction?

Mr REEVES - Probably not, in that I would be looking at the fair price for retail customers rather than the aggregate of HEC costs. The introduction of a new generator in the State could be an important factor for pricing -

Mrs JAMES - The excess power which could come from it.

Mr REEVES - Yes, but it might not be a material amount and the other thing, too, is the work that I am doing for this investigation is looking forward probably about three years, which would be about the time that I understand it is planned for the Duke-Crest proposal to come to fruition.

CHAIRMAN - Getting back to that other point Mrs James was making, you indicated that if, for instance, the tariffs to bulk consumers was indeed subeconomic that that would not have an impact on the price being paid for energy from other classes of consumer, so that would mean of course then that the return on equity or whatever the dividend to the owner would be thereby reduced, would it not be

necessary then for you to be able to determine whether bulk consumer tariffs were subeconomic or not?

Mr REEVES - Again, I think the important thing is that the retail customers are not carrying the load themselves.

CHAIRMAN - So to ensure that you would have to satisfy yourself there is not a cross-subsidy in that arrangement.

Mr REEVES - Yes.

CHAIRMAN - And to satisfy yourself of that you would have to know the full details of the bulk supply contracts, tariffs and costings.

Mr REEVES - It would probably be sufficient that we understood the aggregate.

CHAIRMAN - Yes. You did make the point that that is not clearly spelt out as it used to be in annual reports, but you would get that information?

Mr REEVES - I could requisition that information, yes.

CHAIRMAN - So you would have a need in fact to do that?

Mr REEVES - Yes, as part of our work I will be looking for the revenues from particular classes of customers and want to reconcile that against the revenues that the HEC quotes in its annual report.

Mrs JAMES - Would you be identifying who is paying the cross-subsidisation?

Mr REEVES - Well, the cross-subsidies -

Mrs JAMES - The Government taking less out or -

Mr REEVES - I think that is the point. Trying to define cross-subsidies is a very difficult position from an economist's perspective and I think that the real point is that the owner is ultimately carrying the impact of the internationally competitive prices rather than the retail customer.

Mrs JAMES - The industries are not supposed to allow that to happen or the Government is not supposed to subsidise.

CHAIRMAN - So that means you have a significant role in ensuring that.

Mr REEVES - Yes. I would be quite determined that retail customers will not carry any impact.

CHAIRMAN - So accordingly, as you said earlier, it is necessary then for you to be totally au fait with what bulk consumers are paying and what the real costs of supply are?

Mr REEVES - Yes. Even the allocation of cost becomes a difficult issue.

CHAIRMAN - But an essential one to your role.

Mr REEVES - Yes. In regard to transmission pricing, for example, there is a methodology which ascribes shares of costs to points at which customers connect to the grid, whether those customers are major industrial customers or whether they are Aurora which in turn supplies the retail customers. So there are methodologies about transparent approaches that attribute costs to particular customers.

CHAIRMAN - So in fact a hypothetical situation, if bulk consumers were indeed getting a favourable treatment, you would have to ensure that the return on equity to the corporation indeed reduced rather than having any of that carried by the other classes of consumer.

Mr REEVES - That is right.

Mrs JAMES - It did not impact on them, that was really the point of my question initially with a bit of help from my friends, thank you very much.

CHAIRMAN - I think it is an important point to have talked about for a while. Do members have any other questions of Mr Reeves?

Mr FLETCHER - I have one other, Mr Chairman, or perhaps two. Mr Reeves, do you know of any other energy generator in Australia that would be required to pay 100 per cent of its after-tax profits in dividends, plus \$40 million per year in special dividends on top of that again? Would there be another one?

Mr REEVES - I really do not know.

Mr FLETCHER - But you do study the industry performance Australia-wide, you do meet regularly with other regulators to consider the industry from a national perspective so you can make judgment about the Tasmanian scene. Surely you would know the sorts of tax burdens and dividends that other energy generators in the private and public sector would be paying. That would be part of your operations, would it not?

Mr REEVES - We tend to focus on the prices rather than the dividend policies of the owners, so it is not something that we have covered in conversation, neither is it material that I have had any occasion to research. But the information will be available through the annual reports of the State-owned entities in New South Wales with some difficulty to get access to the annual reports of the privately-owned generators in Victoria

Mr FLETCHER - Would not the regulators in those States have that information available to them?

Mr REEVES - Not necessarily because the generation market, as I say - the regulators are more concerned now with how the market operates than setting a price for the outputs in regard to generation. I guess the feeling is that the market should determine the price and the market will shake out the inefficient performers. Owners will make their own views about what they require in dividend policies. It is not something that the regulators now are so concerned about. That is in the generation sector.

Mr FLETCHER - When Tasmania links to Basslink, presumably at some time in the future, does your position become redundant with regard regulation of the generation industry?

Mr REEVES - That would depend on the terms in which Tasmania participates in the national market and the terms under which Basslink operates. Under some scenarios, yes I will become redundant in regard to the HEC and in regard to Transend.

CHAIRMAN - Once they move into a real competitive market would Basslink be big enough to totally do that, as projected?

Mr REEVES - I think that is a very interesting question, Mr Chairman, and one that would be addressed by the Australian Competition and Consumer Commission when it considers arrangements for Tasmania's participation in the NEM.

CHAIRMAN - Are there any further questions from the committee?

Mr RATTRAY - No, I think it has been pretty informative. I knew nothing about it but I have been listening with great interest today and I appreciate what Mr Reeves has been able to tell us and explain how he comes to the final figure that the consumer is using. Then I think it is up to the HEC and their chairman and directors how they manage it and how the Government take the dividends out of it. I am very appreciative of the opportunity to be here.

CHAIRMAN - Thank you very much, Mr Reeves, for your presence here. You have given us quite a bit to digest. As intimated earlier by Mr Fletcher, it may well be that we seek your presence here again to further educate us as we go down the path on this particular term of reference that we are looking at. We appreciate your support to this committee and your clarity of view and your presentation here today to us and I guess we can say we look forward to seeing you again some time.

Mr REEVES - Thank you, Mr Chairman.

THE WITNESS WITHDREW.