

Submission to the Parliamentary Standing Committee of Public Accounts – enquiry into the financial position and performance of government owned energy entities.

In responding to the committee's request for submissions, I will address your terms of reference as laid out, and hopefully add to the debate and knowledge about why these companies have indeed struggled.

Firstly the committee is entirely right by describing them as energy entities rather than energy companies. None of the three businesses operate as a company managed for profit, and in particular The Hydro Electric Corporation is extremely close to being considered as a national standout model of a sheltered workshop operation.

1. Financial positions of the entities:

1.1 Aurora Energy

Commencing with **Aurora Energy** which is now simply a sales company retailing electricity in a *monopoly* environment for tariff customers, and in a *competitive* environment for contract customers.

The previous Aurora Energy company although touted as a saleable item, when this was put to the market, realised no bids as the company was unable to convince the private sector that it had any value.

This is still the case that the company has no or little realisable value.

For its size and function, with 171 employees the company appears to be substantially overstaffed by 30%, when compared and contrasted to private sector companies in the same field.

This is not unusual for Tasmanian public sector entities which have no profit imperative or functional shareholder control. It is normal for the 2 of the 3 energy entities owned by Tasmania.

This is the problem with the Tasmanian Energy Entities, in that they are all significantly overstaffed as a result of amalgamations of failed functions, and as well the management teams are all grossly overdone.

Aurora Energy's operating revenue will continue to fall (notwithstanding the Directors views) at an underlying rate of 2.7% compound, as it represents the future reduction in use of the distributed electricity network as more a more solar PV installations occur and as more a more LED lighting installations are undertaken.

This is the **national rate of the reduction** of use of network supplied electrical energy.

Tasmania is not immune and current energy security difficulties will see an acceleration of alternative energy inputs.

For example I refer the committee to the replacement of streetlights by the City of Hobart with LED fittings that will reduce maintenance and operating costs by 90%. These funds will no longer be paid to Aurora Energy. These savings by the City of Hobart and that of the City of Glenorchy represent more than 5% of the total energy costs of those Councils which is not an insignificant sum.

Based on the balance sheet this Entity has very little in the way of reserves, and it's current and noncurrent liabilities essentially equal its assets if intangibles, deferred tax and inventories are offset against those assets.

In other words **the company has no real value.**

Aurora Energy will need to transform its operations and become proactive in the sales of energy, rather than *hiding behind* the regulated tariff customer base, of which the cash flows are structurally diminishing.

Secondly it will also need to reduce its staffing, and become substantially more efficient if it is to generate returns on investment that fully justify to the people of Tasmania, the risking their capital by continuing to own this energy entity.

At present staffing levels it represents a nice comfortable sheltered workshop, and is not a profit driven customer focussed organisation.

This is one component of government that could be readily sold, amalgamated, or transferred on a deferred payment basis to some large energy retailer in Australia where the advantages of scale can be applied to reducing costs to the consumer.

There is no apparent justification presently based on the balance sheet for the retention of this entity.

2.2 Tasnetworks Pty Ltd.

This entity is the original Transend Networks Pty Ltd Company that received from Aurora Energy Pty Ltd the low voltage network assets of that company, along with a huge chunk of debt from the Hydro Electric Corporation.

The best run of the 3 energy entities, it is relatively lean and mean, but did get stuck with all of Aurora Energy's IT division staff and a large HR department – Ex Aurora, that now struggles for something to do.

The IT division has over 100 people, doing what? We should ask.

Perhaps the committee might ask them to provide a list of all the projects and the costs of these projects with both internal and external contractor staffing presently being worked on. It also might care to ask the entity for a value analysis of each of these projects, contrasted against revenue opportunities.

In other words are they value for money and are they necessary?

If this expenditure of public money is unnecessary, it could and should be terminated immediately.

We should not be funding with taxpayers funds, functions that are entirely not needed.

The huge amount of debt in this company needs to be repaid, and with falling Cash flows due to less electricity being transmitted, the capacity of the company into the future to make the debt payments may diminish.

Thus early and substantive cuts to unnecessary functions such as a huge IT staff inherited from Aurora Energy, where they ran projects that cost tens of millions of dollars and generated nothing, is probably something that should be energetically explored.

The balance of Tasnetworks appears to be somewhat understaffed.

2.3 The Hydro Electric Corporation.

The recent failure to provide energy security to the people of Tasmania by Hydro Tasmania essentially sums up the way the Hydro Electric Corporation has been a substantial management failure over the past five years.

From the annual report, the Board of the entity appears quite proud of this catastrophic management failure.

The Mercury opinion pieces written by Mr Davey over recent weeks appear to be more disinformation than reality.

To say that there has been a return on investment over the past five years ignores the reality of last year without a carbon tax, where the Hydro electric Corporation essentially had an operating cash flow of \$26 million.

This is against total net equity of \$2.06bn being a return of 0.1% of net equity.

So the people of Tasmania have as a result of \$205m of cash transferred from Tasnetworks to Hydro Tasmania an entity (Hydro Tasmania) that produces a cash return on investment of 0.1% and drives the state very close to a total energy disaster.

Brilliant Management outcome!

This entity has an equity position that is quite fluid, as it includes high level prospects of further write-downs on assets that cannot produce energy at the same levels as in the past, as water in those storages, has been spent.

Remember that under the accounting rules these write downs have to be expensed to the profit and loss account.

Based on these figures it would be highly unlikely that without the renewable energy certificates to boost its bottom line, and with its current increased borrowing costs to meet the energy security failures of 2016, the Hydro Electric Corporation will make a profit for some time.

The Treasurer of the State of Tasmania thinks this is the case, having written off the prospect of any returns from this entity for years to come with the state budget.

In other words **shareholder returns** for capital investments of thousands of millions of dollars, **will be nil. This is a public disgrace.**

Furthermore the Hydro Electric Corporation has the capacity from the Tasmanian public finance Corporation to borrow a further \$229 million on top of the already borrowed \$826 million. With falling liquidity at an annual rate of about 2.5% which is lost generation, with no capacity to export power, or trade in the market, the actual capacity to raise revenue is very very limited.

In fact it would be quite understandable if the capital expenditure budget of some \$100 million which is necessary to keep the Hydro Electric Corporation assets functional, needs to be borrowed in full.

There is no explanation from this entity of how it is going to fund its capital expenditure, the continuing need to run non-renewable generation which obviously will be the case for next summer, the costs of the Basslink facility fee and the Macquarie swap deal.

If these explanations were given without spin and went to the truth of the matters, then there may be some capacity to believe the statements from the entity now being made.

However when discussing the valuation of the assets, the entity can't quite get to the meat of the matter, which is that they will have to write down the asset values as there is no water in the dams.

This leads to the decision to write off the Tamar Valley Power Station in full thus destroying \$234 million of Tasmanian taxpayer wealth, and transferring the debt elsewhere, in order to receive the cash.

Now with the need to keep the Tamar Valley Power Station operating for some foreseeable future, and as a long-term standby energy security facility, would not this asset value now be written back onto the balance sheet? Any future thought of selling this asset is now quite remote.

The contribution of \$205 million coming from Tasnetworks by way of a purchase of the loan held against the Tamar Valley Power Station was blown almost immediately in providing \$118.5 million dividend to the government, and the rest used for capital expenditure *that could not be funded* from cash flow.

This was in a good year, where the annual report was all sweetness and light and spin.

So there was neither cash flow to continue managing the future high quality of the assets, or it had been spent on a range of spurious internal projects none of which contributed to cash flow or revenue for the entity in any shape or form.

If this was the case that I'm sure it will be a headline upfront in the Hydro Tasmania annual report.

Without some full and frank accounting of what the \$86.5 million of capital funds was spent on in relation to capital works at an itemised level, the people of Tasmania will never know, whether they have been dudded for another series of IT projects that came to nothing, or whether the cash was actually spent on repairing Hydro generation infrastructure.

The committee may care to ask for a detailed breakdown of the capital expenditure program item by item of amounts greater than \$100,000 over the past five years. This should provide some illumination as to what has been happening.

I recall here the \$65 million IT project for a new billing system for Aurora Energy that seems to have quietly disappeared. The Hydro asset management program seems to be another great idea that got out of control. These entities appear to waste huge amounts of money for software that generates no real outcome or is quietly forgotten.

The committee might be able to find out where each dollar has been spent and this would be then be able to be reported by the PAC to the people of Tasmania.

This entity Hydro Tasmania loves to compare itself to other companies in the energy market.

The committee should benchmark this entity against the Snowy Mountains Corporation, a company generating hydropower at an equivalent generation size to Hydro Tasmania, albeit having purchased substantial generating assets elsewhere in Australia.

Compare the financial outcomes of the Snowy Hydro to Hydro Tasmania as Generators.

The committee should specifically examine the 2014-2015 Snowy Hydro financial report and compare it to the performance of Hydro Tasmania. One entity made a profit of \$210m and the other entity made a profit of \$26m.

Summary:

The Hydro Electric Corporation appears to have been very poorly managed, and has been moved away from its primary management focus of energy security for the people of Tasmania.

It is considerably overstaffed when compared to other equivalent generators, and has more IT staff than engineers. It has an immense management team that has generated two years of disastrous results that are without peer.

I note that the entity is not run by a qualified engineer. It is apparent that this must now be a primary prerequisite for the position of Board Chairman and a mandatory qualification for the CEO.

This would be one way of establishing energy security as a core function rather than trading the system to way beyond its limits.

To run out of water is evidential of management failure and not a weather event.

Protection of the people of Tasmania is the primary duty of the entity, and all other issues follow.

2. Factors currently impacting the financial performance of the energy entities:

Factor 1: Lack of restructuring of the entities to meet the changing energy sales environment.

This factor that is the *least understood* but is the most important, especially for the Hydro Electric Corporation which is poorest performing asset owned by the Tasmanian people.

Hydro Tasmania presently has a staffing structure representing the 1990's when energy use was rising, and there was no real pressure in meeting internal budget outcomes, and indeed internal budgets are not really adhered to.

This entity has not met any revenue targets in the past 5 years that would on independent assessment, be seen as having generated a sound business result.

The costs of operating this entity is excessive, the management team is bloated and clearly under-performs – albeit in terms of spin doctors it is average, and this leads to complacency.

Now that the generating sales are falling in real terms at 2.5% per annum, and this is a national trend that will probably accelerate, there have been no changes to the 1990's Hydro Tasmania.

The Hydro is an engineering company and is presently run as a trading company.

Disaster in terms of energy security has been the result.

It would be better for the existing management team to be wholly replaced and an engineering focus re-established by having both the Board Chairman and CEO as qualified power engineers.

After all the Hydro is a generating company and this is where it needs to focus.

The danger in not undertaking this full replacement of the management teams will be for an increasing risk to the investment of the Tasmanian people in this entity which is in business terms out of control.

Nice pictures of staff in the trading room recently are very cute, but given there is no trading into the NEM possible without Basslink, the trading function is totally irrelevant, especially when part of the generating load will be fossil fuel based for some time to come. Why does this entity push this type of PR hype to mislead the people of Tasmania?

In any case trading water that does not exist is not going to be a key corporate focus, and certainly if the Government allows Hydro Tasmania to do anything other than re-build storages in the next 18 months, we will all be wholly surprised.

So in essence an overburdened company loaded with non engineering staff, which produce no revenue, are the key issues facing this entity, which needs an early and orderly transition down to staffing levels that are able to be funded, and a complete new management team.

Factor 2: The lack of Oversight and control by the Boards of Management.

The present Boards of Management of the 3 Energy entities appear not to be able to operate effectively within the confines of the present GBE Act. This act confines the boards to in effect being a ministerial directed committee, and empowers the management team to have a far greater level of authority and would be the case with the normal company and board operating under the Corporations Act.

An amendment of the Government Business Enterprises Act 1995 is now urgently required, in order for there to be Chief Financial Officers of each entity, whose appointment would require confirmation by the Public Accounts Committee of the Parliament, that would report quarterly to the Parliamentary Accounts Committee.

Thus the oversight would be direct to the Parliamentary accounts committee, and thus provide a level of review presently not found.

For example, the board may wish to terminate certain staff within the entity, but that may be impossible as the relevant minister may not agree, and thus the investment of the people of Tasmania is put further at risk, due to political interference in the operation of Government Business Enterprises.

There is nothing abnormal about each Government Business Enterprise having a Chief Financial Officer appointed and confirmed by the Parliament, who is required by legislation to report to the public accounts committee of the Parliament each quarter as to the financial outcomes of the Crown Corporation involved. Such a reporting system was put in place by Sen John Glenn of the U.S. Senate and is called the CFP Act for all government business enterprises in the United States government, and this system works very well.

It provides very necessary checks and balances presently not in place here.

People may argue that the Boards of these entities undertake this function now, and so if that is the case, why do we have massive energy security problems, worthless companies, and huge debts loaded into state owned business enterprises, that have diminishing markets.

3. Any Strategies currently being implemented by the energy entities to address their current and future performance:

There is very little sign of any actions being taken, apart from TasNetworks, to ready their current businesses for future performance in a changing market.

Apart from TasNetworks who are still trying to digest the excess staff imposed on them by government with the transfer of the previous Aurora energy low-voltage network, TasNetworks being the most progressive and foremost of the three entities, and the one that is managed the best.

I see no signs that the Hydro Electric Corporation has done anything to address their current and future performance needs and strategies.

Not only has the present trading strategy been an abject and monumental failure, but the whole idea that Hydro Tasmania is some sort of scale player in the National energy market is ludicrous.

At the absolute best we are talking 400 MW of export capacity, into a market that presently has 4700 MW of spare capacity on a daily basis. This surplus is growing.

It would be better for Hydro Tasmania, to start shortening up all of its existing internal overstaffed and overdone structure, and get back to basics driven by engineering needs not trading needs.

There was I recall under the previous Chief Executive officer, a program to renew the technology in each of the Hydro electric generating stations, which in some instances are now composed of 45 years of technology. This renewal and updating process apparently had key performance upgrades of some 6 to 8% of increased energy generation efficiency. Perhaps it is time to refocus efforts on basic engineering outcomes.

These are not sexy or the stuff of spin doctors, but they do at the end of the day provide for increasing energy security.

4. Past and current Government's energy security policies and management including risk management strategies and plans.

This is a question the committee will spend some time on, because there is apparently a huge lack of any energy security policy, apart from the statement that “we will not sell Hydro Tasmania”.

It seems that previous governments and this present government actually believed that Hydro Tasmania was looking after the store.

They actually believed that Hydro Tasmania was managed properly, considered risk issues adequately, and had a conservative policy of water use in the large storage systems in order to manage energy security risk.

When Hydro Tasmania was found to be still exporting energy in December 2015, when the water level crisis in the dams was very real, this was fundamental proof that no adequate risk management strategy was in place, and even it appears the Hydro Tasmania Board of Management Risk Committee was it seems, totally ignored.

To ignore a Board of Management Risk Committee asking a fundamental question, and then providing it with an answer that proved to be fallacious, is evidence of the Hydro Tasmania management team being out of control.

I am sure government does now not have the same view, as it had prior to this energy crisis.

Therefore the question of energy security within Tasmania has probably never been addressed in global terms to government. The present government has no published energy policy position.

There have been various stages of advisings in the annual reports specifically by TasNetworks, as to the risk factors on the high voltage network if certain links were not upgraded and certain transformers not renewed, these assets being at the end of their useful life.

I can find little evidence of any risk management or energy security issues having been identified in Hydro Tasmania's annual report.

There has not been to the author's knowledge any global strategic analysis of Tasmania's energy security needs, its long-term generation and distribution needs, especially in the face of photovoltaic cells, LED lighting technology, and TESLA battery wall systems.

Perhaps this should be a consideration going forward, in view of the present uncertainty.

The committee should also note that these TESLA battery wall systems are being packaged and sold together with network connections and PV cell systems by energy companies in mainland Australia. This is the new norm.

Of course this can't be done here as we have three separate energy entities welded into silos that have little in common and do not consider themselves anything but competitors.

5. Past and current Government's and Government owned energy entities energy mix policy decisions and challenges.

The past and present government decisions are essentially the same, when it comes to energy policy, in that they obviate their responsibilities, as they consider it to be background noise and not part of the body politic.

The only thing the energy companies are essentially good for, is providing profits to the public purse, and in some cases this has been done to the absolute detriment of the balance sheet of the entity, or has been an acquiescence by the Board of Management of the entity to such actions determined by government.

A long history of featherbedding, over staffing, budgets being in essence out of control, and operating in a monopoly guaranteed outcome environment, has inbuilt to these energy entities a sense of "self entitlement" and self-direction without reference to government.

If these entities had to report as any normal public company would have to report publicly to the shareholders, then the entities today would be completely different.

For example it would be a challenge to explain to the Tasmanian taxpayers why \$65 million was wasted on the Aurora Energy billing system, or various internal Hydro IT projects which got out of control by tens of millions of dollars.

Lastly it would be very difficult to explain why energy security is not considered at all, when scarce water was being pushed through turbines and sold to the National energy market, at a point in December 2015 when alarm bells were already ringing.

Policy decisions such as the Hydro Tasmania trading policy are bereft of any portfolio minister or board of management guidance.

No sane Government Minister or Board of Management would bet the future of Tasmania on the prospect of an early finish to an El Niño weather event.

6. 6. Any other matter incidental thereto.

1.1 Amalgamation of energy sales companies

Question – why do the people of Tasmania have to own two separate energy sales companies?

The committee will note that presently Hydro Tasmania holds up as a beacon of wonderment, the energy sales company called Millennium in Melbourne.

Notwithstanding a recent spanking and a large fine, by the ACCC, for advertising renewable energy, a question should be raised in strategic terms, as to why this company does not simply absorb Aurora energy in Tasmania, and operate competitively in the marketplace here.

If this company is such a brilliant operation, then if it absorbs Aurora energy, and that company operates much more effectively and profitably, then the people of Tasmania will be better off.

There might be whole bunch of managers and some staff let go, and this also means that the board of Aurora energy would be amalgamated with the board of Millennium, but savings would accrue and profits would increase.

There is no real reason this could not occur effective immediately.

1.2 Creation of a new Tasmanian Energy Security Act

To mandate that there will always be a first up focus on energy security for Tasmania, it is recommended that the committee consider a small three-page act, entitled the Tasmanian Energy Security act of 2016.

This act would have as its legislated primary function of each energy entity, and their successors, the need to provide for the energy security of the people of Tasmania.

The Act would require each entity to publish energy security plans on an annual basis to Parliament, and also to publish these on their website and in their annual report.

Lastly the act would require the Chairman of each entity's Board of Management to appear before the Public Accounts Committee annually, for a short hearing as to the adequacies of their entity's energy security plan for Tasmania.

To conclude I am happy to attend the committee if and when it conducts hearings.

Mervin C Reed FAICD FChFP AAFA JP
Chartered Financial Adviser

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