



2009

Legislative Council

Government Businesses Scrutiny Committee 'A' 2008

Report with Minutes of Proceedings

Members of the Committee:

**Hon Ruth Forrest MLC
Hon Greg Hall MLC (Chair)
Hon Paul Harriss MLC
Hon Terry Martin MLC
Hon Jim Wilkinson MLC**

Introduction

What are Government Businesses?

Government Businesses comprise Government Business Enterprises (GBEs) and State-owned Companies SOC.

- GBEs are established under an Act of Parliament and operate within the framework of that Act and the overarching framework of the *Government Business Enterprises Act 1995*.
- SOC are established under an Act of Parliament and are incorporated under the *Corporations Act 2001* (Cth).

Both GBEs and SOC have special requirements beyond those of their competitors in the private sector and operate within a different framework. For example, in the private sector, the shareholders appoint a board of directors responsible for governance issues and return on capital. Publically listed companies face the discipline and regulatory requirements of the stock market and financial markets.

In the case of GBEs and SOC, the shareholders are Ministers of the Crown. The Ministers appoint the board and have a role in determining the strategic objectives of the business. They do not face the same discipline and regulatory requirements of the stock market and financial markets.

Why do we need to have scrutiny of Government Businesses?

The requirements for Government Business Enterprises to provide accurate, timely and market sensitive information to the ultimate owners of the business (the taxpayers of Tasmania) fall well short of the standards applicable to publicly listed companies, many of whom compete directly with these Government Businesses.

Australian Corporations Law requires an entity to notify a market operator if it has information that is not generally available and is information that a reasonable person would expect, if it were generally available, to have a material impact on the price or value of the securities of the entity¹.

The Australian Securities Exchange, the organisation responsible for jointly supervising Australia's listed corporate entities, also operates a continuous disclosure regime, requiring companies to provide immediate notification when a range of events occurs, including a change in the entity's financial forecast or expectation².

GBEs and SOC are not publically listed companies and as such are not subject to a duty of continuous disclosure. The public and their elected representatives in Parliament, who are not members of the Government, are often unaware of material changes in performance until the release of the entity's annual report. This can be tabled in Parliament up to 16 months after the start of the reporting period.

In the absence of a requirement to disclose material changes in performance throughout the reporting period, the Parliament has agreed to put in place a scrutiny regime which enables elected representatives as Members of Government Business Scrutiny Committees to ask questions and require answers by Ministers, Chairmen of the Board, CEOs and other

¹ Australian Institute of Company Directors, continuous disclosure requirements.

² ASX Listing Rules, Chapter 3.

managers of Government Businesses so as to ensure Government Businesses and their shareholders (Ministers) remain accountable to the Parliament.

The Role of the Legislative Council

The Legislative Council is one of the Houses of the Parliament of Tasmania. It is unique in Australia in that the majority of its fifteen Members are independent and not members of a political party. Unlike the House of Assembly where the Government maintain a majority of members and through party discipline controls the outcome of any vote in that chamber, the Government must obtain the support of at least some of the independent members of the Legislative Council to pass any of its measures.

One of the Legislative Council's roles as part of the legislature is to scrutinise the activities of Government and bring it to account for its actions. This is part of the Legislative Council's role as a House of Review. This review role consists of not only scrutinising and where necessary amending legislation but also reviewing all aspects of Government activity. This activity includes the operation of business for which the Government is a shareholder for and on behalf of the people of Tasmania. In many cases these Government businesses are supported by taxpayer funds.

Tension between Government Ownership and Commercial Practice.

In most cases Government businesses are required to operate on commercial principles in a competitive environment. This can lead to tension between, on one hand, the requirement for openness and transparency when these businesses are required by a Committee to answer questions or produce documents and, on the other hand, the need to maintain the confidentiality of certain commercially sensitive information the publication of which may result in a loss of a competitive advantage.

Committees of the Parliament have extensive powers to order the production of documents or the answering of questions by witnesses. A claim that a question cannot be answered or document provided because to do so would reveal commercially confidential material is not a valid reason to refuse to provide answers or documentation to a committee.

The limits on the Council's inquiry powers are largely self imposed. Self imposed restraints include the provision in Standing Orders of the Legislative Council that, at the request of only one Member of the committee, require evidence of a commercially sensitive or confidential nature to be taken in camera and not published unless a resolution to that effect is passed by the Council.³ This standing order balances the competing interests discussed above.

The procedure has been used on numerous occasions including most recently in the committee's current inquiry involving Aurora Pty Ltd. Aurora has provided commercially sensitive information to the committee after taking questions from committee members on notice.

Treasury Guidelines for Government Businesses

In October 2008 the Department of Treasury and Finance issued guidelines for Government Businesses. These guidelines consisted of:

- Governance Framework Guide
- Corporate Governance Principles;
- Guidelines for Assessing Board Performance;
- Board Appointments;
- Appointing the CEO as a Member of the Board;

³ SO 232.

- Director Induction, Education and Training;

The guidelines augment the existing governance framework provided by, relevant Government Business statutes, Treasurer's Instructions and, in the case of SOCs, their company constitution.

**Legislative Council
Government Businesses Scrutiny Committee 'A'**

MINUTES

Thursday 4 December 2008

Held in Committee Room no. 2, Parliament House, Hobart, at 8:50 am.

Members Present: Mr *Hall* (Chair), Mr *Wilkinson*, and Mr *Martin*.

1. Apologies

Ms *Forrest*. (granted leave of absence);

Mr *Harriss*.

2. Confirmation of Minutes

Deferred until next meeting.

3. Business Arising from Minutes

Deferred until next meeting.

4. Correspondence

Nil.

5. Publication of Transcripts

Resolved; That in accordance with Sessional Order No. 3 substituting for current Standing Order 200, the transcripts of today's proceedings will be published when available. (Mr *Hall*)

6. Government Business Scrutiny Hearing

Hansard recorded the proceedings.

Witnesses took their place at 9:00am.

TASMANIAN PUBLIC FINANCE CORPORATION (TASCORP)

The following witnesses appeared before the Committee:

Hon. Michael Aird MLC, Treasurer;
Mr Anton Voss, Senior Economic Adviser, Office of the Treasurer;
Mr Don Challen, Secretary, Department of Treasury and Finance and Chairman of the Board;
Mr John Hindmarsh, Chief Executive Officer;
Mr Bruce Rose, Senior Manager – Administration.

The Committee notes the following evidence in relation to TASCORP:

Overall Performance

- The 2007-08 year was a challenging one for TASCORP due to the sub-prime crisis in the United States which evolved into a full blown credit crisis in early 2008. This had a detrimental affect on TASCORP's Funds Management Business due to its exposure to the losses and volatilities of the equities market. This was despite a conservative approach to investing. TASCORP's borrowing and lending business was not affected by the credit squeeze and volatility of equity markets, making \$11.9 million of margin income.

Financial Position

- TASCORP suffered a \$1.9 million after tax operating loss. A downward revaluation of longer term fixed interest securities created unrealised losses of \$10.9 million.
- The short-term nature of TASCORP's investment portfolio, together with higher demand for TASCORP debt, produced a substantial increase in net margin income in 2007/08 (\$11.9 million).
- Since the end of the 2007-08 financial year, TASCORP has further reduced its exposure to longer dated securities, and tightened credit controls. Ongoing volatility in markets means the valuation of the portfolios are likely to change rapidly on a day to day basis, despite the conservative nature of both borrowings and loans.

Dividend Policy

- The provision for the payment of a \$3.5 million dividend to Government, and the loss of \$1.9 million for the year, reduced TASCORP's Retained Profits from \$12.0 million as at 30 June 2007 to \$6.7 million as at 30 June 2008.⁴ These payments were justified by witnesses on the current and historical level of retained earnings.⁵
- The Treasurer indicated that the dividend policy would be reviewed if the level of retained earnings could not sustain the dividend.⁶

Changes to Investment Portfolio

- TASCORP has continued a conservative investment strategy with a focus on the banking industry so as to spread risk. The decision to focus on banks commenced in February and March 2008 when it was clear that the markets were in serious disarray. This lead to a policy decision to spread risk widely and invest in organisations that

⁴ TASCORP Annual Report 2007-08, p.5.

⁵ Transcript of Evidence, 04/12/08, p.2.

⁶ *Ibid*, p.3.

had a minimal risk of instability or failure. The announcement, on 12 October 2008, by the Prime Minister of Australia relating to the wholesale funding guarantees to be provided to banks and approved deposit institutions further reduced risk to TASCORP investments in these areas.

- It is likely that TASCORP will maintain its very conservative policy until the market re-normalises when the distortions caused by the Commonwealth government's guarantee end.⁷

Market Distortion Caused by Commonwealth Guarantee

- The market distortions caused by the Commonwealth Government's guarantee of Banks and authorised deposit institutions has caused difficulties for TASCORP. This is because the wholesale funding of the banking system has made bank issued bonds more favourable than bonds issued by TASCORP and other entities not subject to the guarantee. This has resulted in the market for TASCORP issued securities to dry up.
- TASCORP's bond issues are one of its usual funding vehicles. As a consequence of it not being able to issue its bonds due to the market shift to banks, TASCORP is currently dependent on its shorter-term issuance, commercial paper and the domestic and the Euro-Commercial Paper market.⁸

Effective Capital Policy

- The effective capital employed in the year to 30 June 2008 was \$22.6 million. There was a loss after tax of \$1.89 million, so the return on the effective capital employed was -8.4 per cent. In the previous year the return on capital was +17.5 per cent.⁹
- TASCORP had reduced its effective capital from \$45 million to \$22 million. The payment of a dividend will further reduce TASCORP's effective capital. As a result of the volatility of the financial market a request was approved by the Treasurer, Hon Michael Aird MLC, to provide an additional \$5 million of capital in 2007-08. It is likely that a further request will be made of the Treasurer to increase working capital in the 2008-09 financial year.
- The optimum amount of effective capital held by TASCORP is part of its market risk policies. These policies, among other things, seek to contain TASCORP's potential exposure to market crises by setting aside sufficient capital to cover worst case scenarios. These policies have been found wanting in light of the unprecedented turmoil in financial markets. As a consequence market risk policies, including its effective capital policy, will be reviewed.¹⁰

Liquidity Policy

- The Committee was assured by witnesses that TASCORP has the necessary financial flexibility to move into other assets when opportunities arose. This was despite the existence of investments that, if sold, would crystallise unrealised losses. TASCORP explained that its strategy was to hold short-term assets and minimise longer term assets as these assets are more difficult to manage in terms of their call on effective capital. TASCORP could convert some of its short-term investments into those other opportunities simply by maturing short-term investments. It would not be forced to sell portfolio assets.¹¹

⁷ Transcript of Evidence, 04/12/08, pp.3-4.

⁸ *Ibid*, p.5.

⁹ *Ibid*, p.9.

¹⁰ TASCORP Annual Report, p.4.

¹¹ Transcript of Evidence, 04/12/08, p.10.

- Despite a very conservative investment strategy, the sub-prime crises and ensuing instability in financial markets have made it difficult on occasion to trade even conservative investments. The current liquidity strategy is based on TASCORP holding a large portfolio of readily saleable assets against the possibility that it may not be able to borrow.¹² As a consequence of recent experiences in the financial markets, this liquidity policy will be reviewed by the Board.¹³

Business Opportunities

- TASCORP's client base is local governments, other Government Businesses and statutory authorities. In a falling interest rate market the Chairman of TASCORP agreed that there was an opportunity for additional business as capital expenditure projects which may have been marginal or unachievable under a higher interest rate environment became economically viable.
- The funding of new water and sewerage corporations which will require large capital infrastructure programs over the next decade and the Aurora Energy Tamar Valley power station being constructed at Bell Bay would be sources of new business.
- The Committee was assured by witnesses that the borrowings for the Aurora Energy Tamar Valley power station would result in a conservative debt to equity ratio and with a good revenue stream when on line and that this asset would become a attractive investment for potential purchases. There were no risks associated with the depreciation of the Australian dollar relative to other currencies as the borrowings had been fully hedged against these falls.¹⁴

Client Deposits

- TASCORP lost \$160 million of depositors' funds when it changed the pricing of on of its no-fees fixed interest products. As a consequence four investors withdrew funds and placed them with private sector fund managers. Despite these losses in deposits TASCORP advised that over half of its depositing clients increased their deposits with TASCORP in the 2007-08 financial year. The growth in total client deposits all but offset this \$160 million.¹⁵

Staff Numbers & Experience

- Despite two staff vacancies at the time of hearing the committee was assured that the number and experience of the current staff of TASCORP was adequate to enable TASCORP to undertake all of its business requirements in the current financial climate.¹⁶

10.00 am, Witnesses withdrew.

10.00 am, Hearing suspended.

Tabled Documents:

Nil.

¹² TASCORP Annual Report 2007-08, p.4.

¹³ Transcript of Evidence, 04/12/08, p.6.

¹⁴ *Ibid*, pp.16-17.

¹⁵ *Ibid*, pp.8-9.

¹⁶ *Ibid*, p.13.

Additional Information Requested:

Nil.

OBSERVATIONS/CONCLUSIONS

1. TASCORP is a well run Government Business with competent and experienced management and a conservative approach to investments.
2. TASCORP is a prudent and careful investor and as a consequence has not had the same exposure to the instability in financial markets caused by the Global Economic Crisis.
3. TASCORP experienced difficulties in its Funds Management Business due to its exposure to the losses and volatilities of the equities market. Its move to banks has reduced its exposure to the volatility in other investments.
4. The market distortions caused by the Commonwealth Government's guarantee of Banks and authorised deposit institutions has caused difficulties for TASCORP. This is because the wholesale funding of the banking system has made bank issued bonds more favourable than bonds issued by TASCORP and other entities not subject to the guarantee. This has resulted in the market for its investment products drying up.
5. TASCORP's capitalisation and liquidity policies are under review. There is a need for capitalisation to increase due to market volatility. Liquidity has been hampered by assets that have suffered paper losses which cannot be disposed of without crystallising these losses. There is a likely trend to even shorter term investments to improve liquidity and the capacity to take advantage of market opportunities when these arise.

11.00 am, Hearing resumed.

METRO TASMANIA PTY LTD

The following witnesses appeared before the Committee:

Hon. Graeme Sturges, Minister for Infrastructure
Mr Gary Hill, Head of Office, Minister for Infrastructure
Ms Angela Collis, Adviser to Minister for Infrastructure
Ms Sally Denny, Chairperson and Director, Metro Tasmania Pty Ltd
Mr Tony Sim, Chief Executive Officer, Metro Tasmania Pty Ltd
Ms Nicolle Brigg, Manager, Business Development, Metro Tasmania Pty Ltd
Ms Anita Robertson, Chief Financial Officer, Metro Tasmania Pty Ltd

The Committee notes the following evidence in relation to Metro Tasmania Pty Ltd:

Overall Performance

- Metro made a pre-tax loss of \$300,000 for 2007-08.¹⁷ Income rose by just short of \$2 million, but was more that offset by expenditure gains across the board including a significant increase in the price of fuel (20 percent).
- Administrative employee costs rose from \$2.16 million to \$2.60 million. Metro explained that this expenditure increase resulted from several factors including increased effort in service reviews, contract negotiations, the review by the Government Prices Oversight Commission (GPOC), surveillance camera installations, and the new smart-card ticketing system.¹⁸
- Metro forecast a loss in 2008-09.¹⁹

Financial Position

- Metro's financials appear sound. There is no debt, and no questionable items or entries that can be passed of as being due to changes in accounting standards.
- The major asset continues to be property, plant and equipment, with the bus fleet (which has been independently valued) constituting the bulk of the value.
- The annual report suggests further capital investment will be required²⁰, for new buses, route infrastructure, fare collection systems and support facilities.

Core Passenger Service Review

- The Minister advised the Committee that a Core Passenger Service Review had been undertaken which is forming a very key plank in an integrated strategic plan for public transport in Tasmania. Metro and it also recognises the need for alignment with the private sector.

¹⁷ After tax loss of \$259,000.

¹⁸ Transcript of Evidence 04/12/08, p.28.

¹⁹ *Ibid*, p.28.

²⁰ Metro Annual Report 2007-08, p 8.

Review into Urban Transport in Tasmania

- The Government has committed \$280,000 to a review of Urban transport in Tasmania. This will look at all aspects of transport, including light rail, ferry services and in particular the rail corridor from the northern suburbs of Hobart into Hobart.²¹

Greater Hobart Travel Household Survey

- This study involves a travel pattern study of approximately 2,500 people in the Greater Hobart area. The initial data has confirmed the changed nature of journeys being undertaken prior to or on the way back from work or other engagements.
- The study will be completed in June or July 2009 and will provide sound data to assist Metro in determining the appropriateness of the routes and the times buses run, and the size of feeder buses.²²

Government subsidy to Public Transport

- The Minister advised that Government contributes approximately \$63 million to the public transport system in Tasmania and some \$27.4 million of that goes towards Metro.

Possible Sale of New Norfolk Service

- Metro operates several urban fringe contracts which are contracted services on the same terms as private bus operators. The service provided by Metro in New Norfolk is one such contract service.²³
- The contracts for these services include service standards. These standards and other contract terms are set by the DIER not by Metro. Metro witnesses explained that the sale of one of its urban fringe services such as New Norfolk to a private operator would not affect the service provided. This is because the service standards and other contractual terms that applied to Metro under its contract with DIER would also apply to the new operator when the contract is sold.²⁴
- Metro is able to sell these contracts to another operator by resolution of the Metro Board.²⁵
- The Chair of the Metro Board advised the committee that there had been some 'discussions' with an interested party but no contract for sale had at that time been entered into.²⁶ The Minister described these negotiations as 'early discussions' and "...commercial matters that are under initial discussion".²⁷ He said:

*Metro, as the current holder of the contract, are saying that they are in the very early stages of deliberation with regard to whether or not that fits with their core business arrangements or whether or not it might be better placed being sold to a private operator. The Government is not - and I stress not - looking at any variation to that contract.*²⁸

21 Transcript of Evidence 04/12/08, p.4.

22 *Ibid*, p.16.

23 *Ibid*, p.6.

24 *Ibid*, p.6.

25 *Ibid*, p.5.

26 *Ibid*, p.4.

27 *Ibid*, p.4-5.

28 *Ibid*, p.6.

- The Minister explained that because the contract that applied to Metro regarding this route was not being repealed or varied, there would be no need to consult with the New Norfolk community during negotiations for the sale.²⁹ He said:

I am not quite sure why we would need to consult with the people of New Norfolk. You might explain to me why we would want to do that. If in fact the service was - and I am not suggesting it is, I want to make that quite clear - going to change in a significant way yes, then there would be a need to talk with the community, but if it was just a sale of the business and it was a seamless sale and the service continued as it is currently running, I would not see that there would be a need. If there is any potential negative impact on the community then certainly it would be appropriate to engage in discussion at an appropriate level, possibly through local council, but that is certainly not being contemplated.³⁰

- When asked by the Committee whether he could guarantee that there would be no diminution of the current Metro service at New Norfolk if the route was sold, the Minister maintained his view that the Government was not contemplating varying the existing contract.
- The Committee notes that the Metro Board resolved to sell the New Norfolk route to a private bus operator at its Board meeting on 9 December 2009, some five days after the hearing. This resolution followed from:
 - a. An informal approach from the private bus operator on 22 September 2008 to canvas Metro's possible interest in a sale of the New Norfolk route; and
 - b. A without prejudice offer from the private bus operator on 15 October 2008 for the purchase of the New Norfolk route.³¹

Patronage

- Overall urban patronage was reported to be a fall of 0.3 per cent over the year. The overwhelming majority of users continue to be children/students and adult concession passengers, with the level of patronage scarcely different from that of a decade ago. This was despite population increases and a significant increase in fuel prices.
- Metro explained that three factors impacted on the patronage figures. Firstly the reduced number of free pass tickets issued. Secondly the demographic changes in Tasmania that account for a reduction in numbers of its primary user group – students.³² Thirdly, a malfunction in the ageing ticketing system for a period of three months in Hobart led to a two percent under reporting of patronage.³³ This also impacted on Metro's revenues as these passengers travelled for free. It was acknowledged by Metro that fuel prices did have an impact on patronage but many other factors were also in play.

²⁹ Transcript of Evidence 04/12/08, p.6.

³⁰ *Ibid*, p.5.

³¹ Letter dated 13 March 2009 from Graeme Sturges MP, Minister for Infrastructure, to the Chair.

³² There was a 4.2 per cent decline in student/child travellers. These constitute about 40 per cent of Metro's total patronage.

³³ Transcript of Evidence 04/12/08, p.11.

- The Minister advised that marketing and promoting public transport was one of the factors that would encourage increased patronage. However, Metro management stated that the direct marketing budget for Metro was only \$150,000 per annum.³⁴
- The Chief Executive Officer explained that, rather than spending money on promoting Metro services directly, it had focussed in the last two or three years on doing things so that the public see that services are safer, more reliable et cetera. The newer air-conditioned and disabled access buses, security cameras and the introduction of a new ticketing system were cited as factors contributing to improvements in Metro's service.³⁵
- The Minister advised that infrastructure changes would also contribute to encouraging increased patronage and cited the dedicated bus lane on the Southern Outlet in Hobart and other changes to give priority to buses which would make public transport more attractive.
- Some of the drivers to be used by Metro for increasing patronage are:
 1. Regular timetabling where buses leave on the hour or half hour ('clock-face departures');
 2. Simplified timetables;
 3. More regular services at peak times so as to attract full fare passengers;
 4. More direct routes;
 5. Value for money and flexibility in ticketing;
 6. Advertising on its buses the more efficient carbon footprint of bus transport compared to cars – 'One Bus Equals 42 Cars'.
- There was an acknowledgement by Metro management that typical journeys had changed with economic and lifestyle changes. For example, many women work and need to drop children at childcare and may have several journeys before travelling to or from work for which bus transport was not a practical option. Metro's focus to grow its patronage is on full fare paying passengers.³⁶

Smart Card Ticketing System

- The existing ticketing system is over 20 years old and is suffering from reliability issues.
- The new smart card ticketing system will be introduced in stages starting with in Burnie at the end of January beginning of February 2009 and then in Hobart towards the end of March and then in Launceston in April 2009.³⁷
- The new ticketing system will have significant benefits over the previous system including the capacity to pre-purchase via the internet and improvements in data collection and reliability and integration with private carriers.

Security Issues

- Metro currently have a fleet of 213 buses. 130 of these are fitted with cameras. It is expected that by the end of January 2009 all buses will be fitted with video systems.³⁸ Metro are of the view that the cameras provide some deterrence value and offer some benefits for driver and passenger safety and reduce the incidence of vandalism. There

³⁴ Transcript of Evidence 04/12/08, p.12.

³⁵ *Ibid.*

³⁶ *Ibid*, pp.20-21.

³⁷ *Ibid*, p.15.

³⁸ *Ibid*, p.24.

is also the important perception of security that surveillance cameras bring and the benefits for post incident law enforcement.

- Metro have trialled safety screens for drivers but these have a negative impact on customer service and driver comfort.
- Metro have in place codes of conduct for students and for general adult patronage.
- Four police officers stationed in Hobart assist with policing of buses and education of drivers. This arrangement has recently been extended for a further three years to 2010. Metro also receives assistance from Launceston police but not in the contracted manner that exists in Hobart.³⁹
- Anti social behaviour in the Ravenswood area of Launceston has been controlled through engagement of the local community and police enforcement.⁴⁰

Negotiation of New Contract and Service Standards

- Metro are currently in negotiations with DIER for a new services contract. This contract is expected to have a five year term and five year extension option.
- The existing contract has service standards that Metro must strive to achieve. These include the frequency of services effectively by days of the week and times of day depending upon the demographics of the area.⁴¹

Capital Expenditure and Bus Replacement Program

- Metro has commenced delivery of 20 Euro 5 buses. There have been some teething problems with these buses in respect to their power output which are being worked through with the supplier.
- Metro has sufficient cash in 2008-09 to fund its capital program of bus acquisition. The renegotiation of the current service contract with Government which will be for five years with a five year extension option will make it easier to raise capital in the event that there are insufficient funds in 2010-11.
- The benchmark for bus replacement in the Metro fleet is 12 years. Currently the turnover is at 14 years. The ongoing replacement program is seeing the replacement of about 10 buses per year and, over time, the benchmark will be attained.⁴²

Alternative Fuels

- Metro is exploring the use of alternative fuels to maintain low emissions but also to ensure sustainability of supplies and price. Metro has conducted trials with biodiesel and is currently negotiating with a local supplier. Metro intends to introduce a 20 percent biodiesel mix with standard mineral diesel for its entire fleet.
- Modelling has shown that Compressed Natural Gas buses offer no environmental, financial or other advantages over current fuels when used in Euro 5 buses.⁴³

1.00 pm, Witnesses withdrew.

Tabled Documents:

Nil.

³⁹ Transcript of Evidence 04/12/08, p. 24.

⁴⁰ *Ibid*, p. 30.

⁴¹ *Ibid*, p. 21.

⁴² *Ibid*, p. 26.

⁴³ *Ibid*, p.27.

Additional Information Requested:⁴⁴

1. What are the timetable, routes, patronage and service level requirements for the current private contractor service from Richmond to Hobart and what differences are there in timetabling routes, patronage and service level requirements between this service and the previous service provided by Metro?
2. What are the timetable, routes, patronage and service level requirements for the current Metro services to from New Norfolk to Hobart?
3. What is the breakdown of actual marketing expenses incurred by Metro Tasmania Pty Ltd? (See Notes on the Financial Statements, page 19 Annual Report, Expenses, (c) Administration and General – Other Expenses)
4. In each of the last five financial years:
 - (a) what have been the direct marketing expenses for Metro;
 - (b) what marketing initiatives have been conducted; and
 - (c) provide an estimate of staff costs associated with each of these marketing initiatives.
5. What have been the amounts of Government subsidies provided to Metro in each of the following financial years:
 - 2007-08
 - 2006-07
 - 2005-06
 - 2004-05
 - 2003-04
 - 2002-03
 - 2001-02

OBSERVATIONS/CONCLUSIONS

1. Despite increases in fuel prices for motorists, total patronage of Metro Tasmania services declined in 2007-08.
2. Metro has a small direct marketing budget and its focus in attracting increased patronage is on service improvements, including the installation of security cameras, more modern air conditioned disabled accessible buses and a new ticket system that will integrate with private operators. To date these measures have not resulted in an increase in total patronage in an environment where high fuel prices would have expected a move towards public transport.
3. Demographic changes are having a negative impact on Metro's patronage with numbers in its primary user group of students declining. This will require Metro to target other user groups so as to increase patronage.

⁴⁴ The Committee also subsequently requested information from the Minister in relation to the sale of the New Norfolk contract by Metro to a private bus operator.

4. The global economic downturn will result in a reduction in Commonwealth and State revenues, including the State's share of GST revenue. There is a real prospect that Metro will not be able to rely on an increase in public subsidy.
5. A focus on evidence based decision making is pleasing. The Core Passenger Review, the Greater Hobart Travel Household Survey, Urban Transport Study, demographic information and direct surveys of passengers and reviews conducted by Metro provide valuable data upon which to plan routes and make other decisions contributing to the effective and efficient running of public transport in Tasmania. They also provide data that can be used to determine whether or not the standard of service is improving and benchmarks are being attained.
6. Although the Minister insisted that there was an integrated strategic plan for public transport in Tasmania, he could not provide any detail of this plan to the Committee other than the reviews and studies referred to above.
7. The negotiations for the sale by Metro to a private bus operator of its contract to provide a service at New Norfolk was described by the Ministers as being at the stage of "early discussions" and "commercial matters that are under initial discussion." Metro had received a formal offer to purchase the contract from a private operator on 15 October 2008. The Metro Board resolved to sell the contract on 9 December 2008; some five days after the Committee's hearing.
8. The bulk of Metro's revenue comes from Government service contracts. Its operating loss is small in the context of its overall budget and there is no debt. With fuel prices falling and administrative costs likely to fall with the completion of several projects, it would seem likely Metro will be able to post a better result during the 2008-09 financial year, unless patronage levels continue to fall.
9. Metro Tasmanian needs to work closely with private sector operators and DIER to ensure continuity of services for the travelling public, particularly in circumstances where previous Metro routes have been privatised and are operated by private bus companies.

1.00 pm, Hearing suspended.

2.01 pm, Hearing resumed.

AURORA ENERGY PTY LTD

The following witnesses appeared before the Committee:

Mr David Llewellyn, Minister for Energy and Resources
Nick Wright, Adviser to Minister for Energy and Resources
Mr John Hasker, Chairman, Aurora Energy Pty Ltd
Dr Peter Davis, Chief Executive Officer, Aurora Energy Pty Ltd
Mr Scott Adams, General Manager, Retail, Aurora Energy Pty Ltd
Mr John Devereaux, General Manager, Network, Aurora Energy Pty Ltd
Mr Adrian Wild, Group Manager, Government Relations, Aurora Energy Pty Ltd
Mr Martin Wallace, General Manager, Strategy and Corporate Affairs, Aurora Energy Pty Ltd
Mr Thomas Gribble, Finance, Aurora Energy Pty Ltd

The Committee notes the following evidence in relation to Aurora Energy Pty Ltd:

Overall Performance

- Aurora Energy Pty Ltd ('Aurora') had a drop in net operating profit to \$27.2 million from \$32.5 million in the previous year.⁴⁵ Aurora generated \$903 million in revenue in 2007-08 compared with \$814 million in 2006-07. This provided a 9.7 percent return on investment compared with 12.3 percent in 2006-07. A significant increase in sales, driven by higher receipts from business customers was largely offset by higher wholesale energy costs.
- The dividend paid to Government was \$9.9 million compared with \$10.7 million in 2006-07.

Reliance on Hydro Tasmania

- It is difficult to comment on Aurora's performance in isolation and without considering the challenges facing Hydro Tasmania. Aurora remains Hydro Tasmania's biggest customer, and the pressures faced by the generator flow through to Aurora.
- Hydro storage inflows continued to trend below average, with the revised 9,000 gigawatt hour target based on the last ten years' average.⁴⁶ Despite low storage levels by Hydro Tasmania and reduced projections for generating capacity, the Minister stated that Government was taking every contingency into account and was confident that in the next five years generated supply would meet demand.⁴⁷
- The Minister cited projects that would result in increased generation capacity. These were:
 1. Geothermal generation possibilities;
 2. Utilisation of old thermal generation units at Bell Bay;

⁴⁵ Aurora Annual Report 2007-08, p.80.

⁴⁶ Down from 9,500 gigawatts.

⁴⁷ Transcript of Evidence, p.4.

3. Standby and combined-cycle turbine plant coming online in the middle of next year (Tamar Valley Power Station);
4. increased importation of electricity over Basslink; and
5. increased generation from existing Hydro resources via a storage-building program and small hydro electricity projects.

Financial Position

- Debt on balance date was a manageable \$550 million which is modest compared to some private sector competitors. Debt levels may rise in future years as capital works, and the cost of the Tamar Valley Power Station are funded.

Higher Wholesale Electricity Costs

- One significant factor contributing to Aurora's drop in net operating profit, despite an 11 percent increase in revenue was the higher wholesale cost of electricity. Locally generated supply could not meet demand and as a result Tasmania's electricity supply had to be supplemented by imported electricity via the Basslink cable. There was a net import over Basslink of 2300GWh in 2007-08 compared with 1400GWh in 2006-07.⁴⁸ This represents a 64 percent increase in the need for imported power.
- In addition to the desire to guarantee electricity supplies to Tasmania, a significant argument to join the NEM was the economic benefits this would bring in enabling the exporting of power from Tasmania to mainland States connected to the NEM in times of high demand. This benefit has yet to materialize.

Major Employer

- Aurora is a major employer in Tasmania with 1160 staff including 79 trainees and apprentices. There has been an increase of 34 in the total workforce since 2006-07.
- The contribution to the community is much wider including a wages bill of almost \$80 million and more than \$93 million in contracts let to suppliers and service providers.⁴⁹

Diversification

- Aurora sees itself as an energy company not just an electricity company.⁵⁰ It competes in a national market against much larger players. The need to find ways to make Aurora competitive to achieve economies of scope and scale is the philosophy behind its move to diversify into other areas.⁵¹

Aurora Gas Pty Ltd

- Aurora's move into the gas retail market is a logical fit for its business. It already has sales people, call centres and computer systems so it is only a marginal incremental cost for it to be able to offer gas retail to the Tasmanian public.⁵²
- Aurora's major competitors, AGL, True Energy and Origin, are dual retailers of electricity and gas and are active in trying to tie up their customers to get their

⁴⁸ Aurora Annual Report 2007-08, p.4.

⁴⁹ Transcript of Evidence, p.2.

⁵⁰ *Ibid*, p.10.

⁵¹ *Ibid*, p.10.

⁵² *Ibid*, 04/12/08, p.6.

combined business.⁵³ Aurora needs to do the same to remain competitive in the energy market.

- Aurora's and its competitor's capacity to capture business in Tasmania is dependent upon the extent of the roll-out of the gas pipeline infrastructure. This is undertaken by Power Co, which owns and operates the gas distribution network. It also has a retail competitor to Aurora in Option One

Tamar Valley Power Station

- Aurora Energy Tamar Valley Power (AETV) has purchased Babcock and Brown's interest in this power station project.
- The ownership of a wholesale energy supply business provides upstream risk management for Aurora's retail business and is consistent with its diversification strategy.
- When the power station comes on line in 2009, Aurora will be both a generator and supplier of electricity in the National Energy Market. This raises interesting issues as it will be both a purchaser of Hydro Tasmania power and a competitor on the supply side.
- The purchase and completion of the AETV facility will take significant capital and the Committee was assured that, other than the possible need for additional equipment outside of the contract, the cost had been sufficiently hedged against movements in the Australian dollar.⁵⁴
- Although the A subsidiary of Aurora will complete the station, indications are the plant will be sold within five years, hopefully when the global financial crisis has ended and asset values recover.

Optic Fibre Network

- In December 2007, Aurora was selected as the Tasmanian Government's strategic partner to commercialise the on-island optical fibre network (TasGovNet). This optic fibre network was laid concurrently with the installation of gas pipe lines and connects Hobart, Launceston, Burnie and Devonport to George Town.⁵⁵
- City Spring (the owners of Basslink) and Aurora will compete with Telstra and each other in delivering high speed broadband services across Bass Strait and within Tasmania.⁵⁶
- Aurora intends to integrate the optic fibre network with its own optical fibre links and will also link with Basslink optical fibre. On-island services are expected to be operational in March 2009.
- Aurora has committed \$6 million for spending on optical fibre in 2008-09.
- The strategy as to how Aurora will commercially compete with Telstra, and capital cost over the next three years will depend to a significant extent on the outcome of the Commonwealth Government's National Broadband Network process.⁵⁷

⁵³ Transcript of Evidence, 04/12/08, p.10.

⁵⁴ *Ibid*, p.7.

⁵⁵ Letter dated 18/12/08 from Minister for Energy and Resources to Committee.

⁵⁶ *Ibid*.

⁵⁷ *Ibid*.

Staffing

- Aurora is confident that it has sufficient staffing capacity to be able to effectively manage the diverse range of activities it is now branching into.⁵⁸

No Plans to Sell Diversified Assets

- The Minister assured the Committee that there were no plans to sell any of Aurora's diversified entities⁵⁹.

Full Retail Contestability and Increased Competition

- Following Tasmania's entry to the National Electricity Market (NEM) on 29 May 2005, Aurora faced competition for the first time.
- Currently, five retailers are licenced to operate in Tasmania. Aurora now faces competition from ERM Power Retail, Integral Energy, Country Energy and TRUenergy. Other market participants could conceivably be added to the list in coming years.
- Contestability is being phased in, as shown in the following table:

Date	No. of customers	Type of customer
1 July 2006	19	Mineral processors/heavy industry (20 GWh)
1 July 2007	46	Food processing/large offices (4 GWh)
1 July 2008	330	Supermarkets, workshops etc (0.75 GWh)
1 July 2009	1,375	Fast food, service stations (0.15 GWh)
1 July 2010	261,481	Residential and small business (\leq 0.15 GWh)

- Contestability means the customer will be able to choose their electricity retailer. The phase-in commenced with the largest consumers first and will progressively encompass all industry and commercial electricity consumers. Before 2010 the State Government committed to undertake a public benefit test to decide whether competition should also encompass residential users of electricity.⁶⁰
- The Government issued terms of reference to the Tasmanian Energy Regulator to undertake this public benefit test. The draft report detailing the Regulator's findings was released for consultation in May 2008 and a final report has been submitted to government for consideration.⁶¹
- Mainland States have full contestability so Aurora currently has an advantage in this market. Can sell into those markets but has it 'patch' protected in Tasmania. However, Aurora's focus on the mainland is on the larger business customers which generate larger revenues, not residential users.⁶²

Mainland Expansion

- Aurora has achieved market penetration in New South Wales, Victoria, Queensland and the ACT. In South Australia Aurora not only has industrial customers, but pay-as-you-go domestic customers. In Tasmania, Aurora has been very successful in

⁵⁸ Transcript of Evidence, 4/12/08, p.8.

⁵⁹ *Ibid*, p.10 (Minister Llewellyn).

⁶⁰ *Ibid*, p.11.

⁶¹ *Ibid*, p.11.

⁶² *Ibid*, p.13.

rolling out our pay-as-you-go meters with some 50 000 Tasmanian customers taking advantage of being able to manage their energy consumption.⁶³

Capital Expenditure

- At the last regulatory price reset, the Regulator accepted Aurora's submission that it needed to upgrade its ageing infrastructure and approved a program of \$588 million in capital investment and some \$300 million in operating investment. This has been funded by the Regulator's agreement to increase electricity prices which have already begun to be implemented.

Complaints

- Aggregate complaints increased in relation to billing which Aurora believes was directly related to the impact of higher pricing. Aurora has placed the Ombudsman's phone number on the bills to encourage customers who are unhappy with its performance to give them very clear access to an independent party.
- Aurora acknowledged that there was a need to improve its systems in relation to Electrical Work Requests due to complaints relating to perceived delays by clients in the connection of electricity to new homes and businesses. Some delays were caused by the scale of its capital program⁶⁴ and prioritising between works for this program and customer generated work.⁶⁵
- Rural areas were identified as presenting some challenges in relation to the reliability of loads and the impact of brief interruptions in supply on computerised systems for irrigation controllers and dairying. Aurora has a targeted reliability improvement program directed at rural areas which is aimed at addressing electricity supply to those communities over the next four years.⁶⁶ The Minister suggested that these customers install an interrupted power supply.⁶⁷

3.38 pm, Hearing suspended.

3.55 pm, Hearing resumed.

Hon Don Wing MLC was granted leave by the Chair to participate in the proceedings.

3.55 pm, Mr *Wing* took his seat.

4.13 pm, Mr *Wilkinson* resumed his seat.

4.13 pm, Mr *Wing* withdrew.

5.05 pm, Witnesses withdrew.

Tabled Documents:

Nil.

⁶³ Transcript of Evidence, 4/12/08, p.8.

⁶⁴ Capital expenditure of \$134 million in 2007-08. Approved future program totalling \$588 million.

⁶⁵ Transcript of Evidence, p.45.

⁶⁶ *Ibid*, p.46.

⁶⁷ *Ibid*, p.46.

Additional Information Requested:

1. What is Aurora's mainland market revenue on a State by State basis?

The committee agreed to accept this evidence on a confidential basis.

2. What is the strategy for commercialising the optic fibre network, estimated capital cost and how will the implementation of it be funded?
3. What has been the performance of Aurora Gas Pty Ltd in the gas retail market in Tasmania and on the mainland States over the last five years?

The committee agreed to accept this evidence on a confidential basis.

4. Provide a list of sponsored entities without the associated dollar amounts for each sponsored entity but a total sponsorship cost. (This was indicated to be in the vicinity of \$600,000)

OBSERVATIONS/CONCLUSIONS

1. Aurora sales have increased but higher wholesale costs of energy have resulted in a drop in net operating profit compared with the previous financial year.
2. Aurora's current reliability on Hydro Tasmania as its main wholesale electricity supplier, a reduction in rainfall and likely reduced generation capacity from Hydro sources will put pressure on electricity pricing with higher prices likely to become the norm. The need to import more power over Basslink to meet demand and competition pressures if full retail contestability becomes a reality in 2010 will present significant cost challenges to Aurora.
3. It is pleasing to see energy generation sources being developed or plans to expand existing generation capacity. The Minister has assured the Committee that generation capacity will be sufficient to meet demand at least for the next five years with Basslink and Hydro Tasmania looking to increase output, wind generation at Mussel Roe Bay, gas generated power at Bell Bay and the Tamar Valley Power Station currently under construction.
4. The Minister cited geothermal generation as a likely addition to alternative power sources particularly as it has base-load power generation capacity. However, it is likely to be many years before commercial generation from geothermal sources become a reality in Tasmania, if at all.
5. Full retail contestability will present challenges to Aurora. The market is becoming more competitive. Aurora has lost some large business customers but is presently protected from competition in the domestic residential and small business electricity market in Tasmania whereas mainland States are subject to full retail contestability. Although full retail contestability is subject to Government approval, Aurora is positioning itself for its likely introduction in 2010 through an aggressive advertising campaign, including sponsorship of Aurora Stadium,⁶⁸ and increasing market awareness of its brand through sponsorship of community events.

⁶⁸ Aurora Energy Annual Report, p 57

6. Aurora has diversified into electricity production as a consequence of its ownership of the Tamar Valley Power Station. The completion of this power station by its wholly owned subsidiary, AETV, will provide considerable benefits to Aurora's business. The acquisition provides upstream risk management for Aurora's retail business. However, becoming an electricity generator may cause some commercial friction between Aurora and its main wholesale energy supplier, Hydro Tasmania with which it will be in direct competition.
7. Aurora had diversified into businesses that it believes offer synergies with its core business as an energy company. Gas retailing is a natural fit with its existing electricity business and aligns with the electricity and gas products offered by its direct competitors.
8. Moving into telecommunications is a giant step for a relatively small company. Through its agreement with Basslink optical fibre, Aurora will become a major competitor to Telstra, a company with a massive asset base and income flow. Aurora may be hampered in this highly competitive market by its incapacity to raise equity in the same manner as publically listed companies. As long as it remains in Government hands, Aurora will continue to be reliant on Government to ensure its balance sheet is structured in a way that enables it to undertake future capital programs.
9. The Minister assured the Committee that there were no plans to sell any of Aurora's diversified entities.
10. Capital expenditure on infrastructure programs continues to increase, funded in part through electricity price increases approved by the Energy Regulator. Debt levels may rise due to the need to complete major infrastructure projects like the Tamar Valley Power Station.
11. Aurora is a good corporate citizen with a commitment to the Tasmanian community. It is a significant employer and sponsor of community events. Sponsorship is a key support strategy for Aurora's branding and market recognition in readiness for full retail contestability.
12. Complaints have increased due to increased electricity prices required by the need for significant increase in expenditure on infrastructure, and due to supply issues in rural and more remote areas.

7. General Business

Discussion ensued in relation to the format for the committee's report to the House.

Ordered; That the Secretary provide a draft report for consideration of the committee by early 2009 (Mr Hall).

8. Adjournment

The Committee adjourned at 5.50 pm until a date and time to be fixed by the Chair.

DATE 2/4/09

CONFIRMED



CHAIR

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