The Director  
General Purpose Standing Committee No. 1  
Parliament House  
Macquarie Street  
Sydney NSW 2000

Re: INQUIRY INTO THE GENTRADER TRANSACTIONS

Attached are documents we prepared on the issue of the NSW electricity privatisation which address the Committee’s third and fourth Terms of Reference. They are also relevant to the second Term of Reference since it appears that eight directors of state-owned electricity agencies resigned their positions because they believed that the consideration offered in these transactions was inadequate.

These papers show that the State’s electricity assets and businesses – apart from providing an essential service to the people of New South Wales – were highly profitable and generated significant annual returns to the State Budget. Moreover they indicate that publicly-owned electricity agencies were, if retained, capable of funding significant on-going investment in infrastructure from their operating cash flows.

The most recent paper, which was circulated to many members of Parliament including the Premier, was prepared just after the State Budget was brought down in June 2010. It should be noted that the analysis contained therein was:

- before a further improvement in the State’s economy with its concomitant positive impact on the State’s finances; and

- before the State could benefit fully from the huge electricity price increases which appear to have been imposed in order to ‘fatten the cow before sale’ – that is, in order to make the assets even more attractive to purchasers who will be the main beneficiaries of the increases. In this connection we note that IPART (while nominally an ‘independent’ agency) is required by sub-sections 15(1)(g) and 15(1)(h) of the IPART Act to have regard to the wishes of government.

At the very least, we urge the Committee to focus on what can be learned from recent experience with these transactions, so that mistakes are not repeated – and possibly, so that further transactions do not proceed without greater Parliamentary scrutiny.
In particular it is suggested that the Committee seeks evidence (from central agencies, those consultants contracted to negotiate the sale, and from directors of the electricity agencies concerned) regarding the sale price of these assets (or elements of government businesses) as compared with their ‘retention value’.

We note that the Premier has conceded that government agencies have calculated a ‘retention value’. However she has declined to release relevant documents before transactions were completed. As some transactions have now been completed it would be appropriate for the Committee to seek copies of relevant documentation, so that they can be subject to careful analysis and assessed as to their validity. If it is claimed that some transactions are still in process, then possibly documents can be provided that at least detail the matters that were considered in the analysis of sale versus retention values, and the choice of any discount rates used to assess the present value of alternative options.

In this connection, any analysis of ‘sale versus retention value’ (and ‘the value obtained for NSW taxpayers’) will have to consider such matters as:

- the financial impact of government subsidies for the ‘inputs’ to coal-fired power stations;
- the basis upon which transfer prices payable by private-sector retailers for access to ‘poles and wires’ were established;
- the prospective profitability of the retained ‘poles and wires’ businesses, and how that compares with the profitability of those business segments when operated by government agencies before the transactions;
- an analysis of what risks were transferred to the private sector and what risks will be borne by government as a consequence of the alleged ‘reform’.

The role of the Auditor-General

Much has been made of a forthcoming review of the sale transactions by the NSW Auditor-General. We believe that the Auditor-General has failed to ensure that the Parliament was adequately informed about the financial aspects of these transactions before they occurred.

Moreover, we have little confidence that the Auditor-General will provide a fully independent and comprehensive report on these transactions. That view is based on the fact that he is compromised by the stance he has previously taken on this issue. For example, despite on-going community concerns about proposals to sell off the electricity retailers and other businesses, and government responses that it proposed to retain Transgrid and other electricity distribution infrastructure, the Auditor-General has failed to ensure that government electricity businesses reported on the contributions of the ‘poles and wires’ segments of these businesses, or to provide commentary on this omission even though the information is highly
relevant to any Parliamentary scrutiny of the merits of selling-off or retaining multi-billion dollar businesses. In contrast, listed public companies and other ‘reporting entities’ are required to report on the profitability of business segments.

Further, a year or so ago during an interview with Deborah Cameron on ABC Radio 702, before the Legislative Council was due to consider a bill dealing with the electricity privatisations, the Auditor-General announced that he proposed to restrict any review his office would undertake to a review only of the Government’s ‘strategy’ for selling these assets and not address whether or not the transactions were a good deal for the State – this was before Parliament had even considered legislation relating to the privatisation proposals. We also note that the Auditor-General’s 2010 report on the profitability of government-owned electricity agencies gave prominence to the ‘after tax’ profitability of these agencies when in fact such taxes (and other guarantee charges) are actually paid to the NSW Government. A more relevant indicator would have been the rate of return earned on these businesses, before NSW State taxes and charges. As the accompanying papers note, these returns have been of the order of 24% per annum (even after applying public sector accounting practices – private sector firms would have recorded an ever higher rate of return).

On the basis of the positions he has taken in the past on this matter, it may be that the Auditor-General will (wrongly) take the view that he is bound to avoid commenting on the adequacy of the sale consideration in the transactions being considered by the Committee, as acceptance of those prices was a matter of ‘government policy’.

However the Auditor-General has not shrunk from criticising certain activities (such as expenditure associated with the now postponed Metro project) as ‘waste’ – even though much of that expenditure could be regarded as reflecting government policy to secure a corridor for future public transport initiatives. Whatever the merits of his criticisms of the Metro project, the financial impact of the Gentrader Transactions seems likely to involve far greater financial costs to the taxpayer if publicly-owned assets were sold for a song. That is a more fundamental form of ‘waste’, and the sums involved are greater. Moreover, by failing to ensure that members of Parliament have been provided with relevant financial information the Auditor-General appears to have, by omission, endorsed the sale of businesses that have provided a basic service to citizens of NSW – as well as a very good financial return to the Budget. In that respect, arguably he has already ‘crossed the line’ by endorsing a contentious ‘policy’ that was unambiguously rejected by the 2008 State Conference of the political party currently in office in NSW (and which polling suggested was opposed by 80% or more of the community).

In that context, the Committee’s work is of great significance.

We are happy to appear as witnesses with or without the benefit of Parliamentary privilege. Indeed, our experience suggests that the Parliamentary privilege is likely to be of little interest to those who are prepared to comment on public sector financial issues on the basis of
evidence and analysis. On the other hand, privilege may afford protection to those MPs who are so sensitive to criticism of their policies that they are prone to attack critics rather than engage in reasoned debate about financial issues.

Yours sincerely

Prof Bob Walker

Dr Betty Con Walker