Age
Wednesday 7/6/2006
Page: 12
Section: Business News
Region: Melbourne Circulation: 195,100
Type: Capital City Daily
Size: 352.74 sq.cms.
Published: MTWTFS-

Howard's snappy shuffle leaves Labor states, and Snowy Hydro, flat-footed

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ONE only has to look at the red ink in the NSW budget to recognise what a nasty but effective political ploy John Howard's decision to pull the plug on the $3 billion Snowy Hydro float last week was.

The deficit of $696 million — and underlying cash deficit of $4.6 billion — would have appeared far less reckless at what appears the peak of an economic cycle had NSW been able to get its hands on the lion's share of the float proceeds, probably not far short of $2 billion.

Howard cited the "overwhelming feeling in the community" as the pretext for the Commonwealth withdrawing from the sale, although the decision probably owed more to the unrest in his own government's back bench than to broader popular opinion. Howard won't abandon T3 or the Medibank Private privatisation because of any feeling in the community.

The Federal Government had nothing much to lose by walking away from the float. With a shareholding of only 13 per cent in the company, worth perhaps $400 million, a government awash with cash and anticipating torrents more from T3 and Medibank could afford to.

NSW, with a 58 per cent share of the proceeds, and Victoria (29 per cent) had already planned how to spend them. In the lead-up to elections in both Labor-governed states, Howard has landed a neat blow.

It would have been open to NSW, with or without Victoria, to go it alone by reverting to its Plan B — the float of its majority interest in Snowy Hydro. Presumably, NSW Premier Morris Iemma calculated the political risk of being seen to defy community feeling nine months out from an election (and with Alan Jones on the rampage) and decided the $2 billion wasn't worth the angst and political risk.

It is worth noting that the "community feeling" wasn't all opposed to the sale. About 200,000 Australians preregistered for the prospectus in only a fortnight. Given the full month that was planned for pre-registration, that number may well have topped 500,000 and the prospective proceeds would almost certainly have exceeded initial expectations. With the proposed restrictions on foreign ownership, the "iconic" scheme would have remained Australian-owned.

The abandonment of the sale doesn't remove the pressures — both fiscal and commercial — that led NSW to the decision to sell Snowy Hydro.

Despite some of the nonsense that was uttered in relation to the float — and which, unhappily, NSW did nothing to counter — the aborted privatisation had no adverse implications for ownership or control of the flows within the Snowy scheme. Those are controlled by NSW, with Snowy Hydro operating under a licence that dictates how the flows, including environmental flows, are managed. The privatisation had no implications for the water rights of other users. The governments could, had they wished, have imposed further controls on the company's management of the flows.

As my colleague, Alan Kohler, has noted, Snowy Hydro's business isn't primarily managing water, or even selling hydro-generated electricity. It is more of a financial institution, offering derivative products to energy retailers to insure themselves against spikes in prices.

It is, however, increasingly investing in non-scheme peak generation capacity — it owns one gas-fired plant in Victoria and is building another — as part of a strategy of diversifying its generating capacity away from the scheme and creating new opportunities for profitable trading and hedging of its own risk. It has also bought an

MEDIA MONITORS
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energy retailer as part of what is already a $500 million or so expansion plan that has been funded largely with debt. Snowy Hydro has close to $1 billion of borrowings.

As it has changed shape, Snowy Hydro's risk profile has been evolving and, had the privatisation proceeded, would

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have evolved further as it built its east coast peaking capacity and looked to capitalise on its generating capacity by building a retail presence.

Presumably it will now have to scale back its ambitions and/or the time frame in which they can be realised. Unless its three government shareholders amend the shareholders' agreement that governs its operations, it would appear unlikely the company would simply abandon the strategy.

That places NSW and Victoria — NSW in particular — in an awkward position. NSW taxpayers are effectively funding 58 per cent of the cost of Snowy Hydro's expansion — NSW's share equates to nearly $300 million so far — and therefore are financing the building of generation plants in Victoria.

Snowy Hydro has expressed interest in bidding for the Queensland energy retailers the Beattie Government has said it will sell. NSW and Victoria wouldn't be happy to see their funds/capital being deployed in Queensland. Snowy Hydro's operations and ambitions are increasingly less aligned with the government shareholdings and economic exposures.

As Snowy Hydro becomes an increasingly complicated enterprise and engages more ambitiously with the national energy market, the governments will be increasingly uncomfortable about their exposure to risk. NSW has particular, and painful, experience of derivative activity by government-owned energy companies.

Once they have their elections behind them, the new governments of NSW and Victoria (whoever they might be) will have to revisit Snowy Hydro's future and their role in its affairs, and perhaps commit a lot more time and effort into explaining the detail and merits of any fresh attempt at its privatisation — or else curtail its ambitions and its potential.

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