**Energex: A Sustainable Future?**

Current practises disallow for Energex’s sustainable future as the increasing high electricity prices show consumers seeking alternate ways of accessing power. Within Energex itself, there lies a culture that impedes good governance of the distribution network with overinvestment, data manipulation and a public sector mentality directly contributing to south-east Queenslander’s consumer financial struggles.

Unless the Australian Energy Regulator (AER), provides a more commercial ‘slap of reality’ for the distributor, and the foresight to go through the Energex submission with the mentality of a razor gang, dismissing what isn’t required, Energex in its current form is unlikely to remain but instead become a technologically outdated white elephant as consumers look elsewhere for cheaper alternatives.

**Overinvestment – Gold-plating the Network**

The distribution network costs of Energex remain a substantial proportion of south-east Queenslander’s electricity bills and the increase in household power prices can be primarily attributed to investments in the distribution networks.

Within commercial business, a capital overinvestment during a business cycle usually has a flow on effect of an ‘underinvestment’ during the following business cycle. This allows the underutilised investment to become financially viable. Hence, there is no incentive to overinvest as the commercial reality of ensuring an appropriate return on investment precludes such wastage of unproductive resources. Within Energex, as a distribution network, there is automatically an incentive to overinvest as under the current regulatory framework, significant financial gains can be obtained without risk of penalty or business closure.

These are not new or controversial statements. The Productivity Commission in its 2013 Electricity Network Regulatory Frameworks Report wrote “Average electricity prices have risen by 70 per cent in real terms from June 2007 to December 2012. Spiralling network costs in most states are the main contributor to these increases, partly driven by inefficiencies in the industry and flaws in the regulatory environment”. While Ross Garnaut wrote in his 2011 climate change review *Transforming the Electricity Sector* that “there is a prima facie case that weaknesses in the regulatory framework have led to overinvestment in networks and unnecessarily high prices for consumers”.

The Courier Mail reported on October 6, 2014 that a Pacific Paradise substation, partially constructed at a cost of $6.5 million, eight years after planning began is still not connected to anything due to incorrect electricity demand forecasting but that consumers in all likelihood have already paid for this expense in their power bills.

Under the ENCAP Review in 2011, Energex itself identified a range of capital savings totalling almost $870 million that could be achieved in the 2010 – 2015 regulatory period while then CFO Darren Busine confirmed to the 2012 Select Committee on Electricity prices that Energex had reduced its capital expenditure within that regulatory period by $850 million.

This unwarranted capital expenditure, which would have increased household bills further, was able to be slashed without any ill-effects to the networks safety, efficiency or reliability. This figure in part was due to over-zealous security standards but was also in part Energex’s inability to forecast demand correctly. With Energex’s demand forecasting posing such future financial risk to consumers, the AER should question the efficacy of the current required capital expenditure lest the same cycle of overspend continue into the 2015 – 2020 regulatory period.

**Overstaffed, Underutilised**

Energex staffing levels based on my observations are excessive for its actual needs. Walking around the building saw row upon row of employees spending large amounts of their day engrossed in personal activities while the inefficient dissemination of information means employees often spend large parts of their days in unproductive meetings.

Employees are hired to do roles that became redundant in commercial organisations a decade prior and any attempts to modernise, streamline the workforce seem to be a very touchy subject due to labour constraints. Treasury departments often look at work-place efficiencies but all attempts by me to discuss cost-less technological changes that would affect a personnel and cost reduction were quashed so Treasury wouldn’t upset other departments.

Energex staff are provided exceedingly generous income and benefits compared to commercial standards for the same roles. This in itself contributes to an inefficient workplace as once people are in jobs that provide pay and benefits well in excess of market conditions, employees are more likely to ‘cling to jobs like limpets to wet rocks’. With the current employment conditions, Energex employees can only be made voluntarily redundant, unlike the conditions imposed upon other Queensland government funded programs.

Excessive staff costs directly contribute to consumers household electricity burden and Energex management should be held responsible for these additional operational costs. If Energex management are not able to cull the unwarranted labour, that could be easily reduced without impacting on the safety, efficiency and reliability of the network then the AER needs to provide incentive by decreasing Energex’s operational expenses.

**Costly Processes**

Energex internal procurement processes compared to commercial enterprises increase the cost to consumers by at least $50 million per year by my calculations when I was working as the Energex Treasury Analyst.

Energex current methodology of hedging its exposures would work exceedingly well with a skilled team but the mismanagement I witnessed within departments instead directly contributes to additional power costs.

Appropriate risk management techniques mitigate a company’s risk to foreign exchange and commodity movements and good Treasury / Procurement teams can often provide multi-million dollars in savings.

At Energex, the concept that they should be able to quantify the values of commodities and foreign exchange used was disregarded with the viewpoint that it wasn’t feasible as they didn’t know what contracts would be taken up. This is in direct contradiction with other multi-nationals and large corporations that undertake a detailed and quantified understanding of their capital expenditure exposures in order to better mitigate the risk of price fluctuations.

The incompetence that I witnessed at Energex using their hedging methodology was incredible. One person’s mathematical wanderings that were supposed to show the minimum, maximum effect of a contract was the equivalence of gibberish with made up numbers inserted into formulas but due to the mentality within the company, a task that has a direct impact on the cost of electricity to consumers has no scrutiny.

Another time, I spent many hours trying to explain to senior people within the procurement and finance departments at Energex that just because a country is within Europe, does not mean it uses the euro. On one multi-million dollar contract, Energex took a position against the euro which it had no currency exposure to while not hedging against its currency exposure to the Norwegian krone. These types of incompetency’s are a contributing factor to the upward spiral of electricity prices.

The continual ineptitude and the unconcerned attitude to mitigate against adverse movements in foreign exchange and commodities is one driven by a culture that in effect has no accountability or transparency. Energex operational expenditures should be decreased in order to provide an incentive for management to stop sloppy, expensive habits that would not be tolerated in a commercial environment.

**Management Board Dichotomy**

The inherent conflict between board and management “Agency Theory” is noticeable at Energex. Agency costs have arisen within Energex as management objectives deviate from best interests of the shareholder.

One personal example is in regards to the Board documentation required for procurement contracts over a certain multi-million dollar value. The Treasury Analyst is required to financially evaluate the efficacy of the contract and write commentary that is included in an overall ‘Board Pack’ outlining their mathematical evaluation. This pack is then provided to the Energex Board for sign-off.

On at least one occasion, my Board financial analysis and commentary was removed from the Board pack and substitute wording inserted.

My financial analysis and commentary, which found that the contract was not commercially beneficial to Energex, was substituted for wording that agreed with the financial viability of the procurement contract.

After the Board sign-off was achieved, I found out what had occurred and raised this issue with a number of senior management within Energex. The senior management response was blasé. I found no action was taken to inform the Board and no concern over this practise was shown. This culture of lack of concernedness for public funds can only be exorcised via an increase in accountability and transparency and a reduction in the availability of excess funds to use in such a wanton fashion.

**Conflicting Objectives: Excess Profits vs Sustainability**

The Productivity Report itself stated that “State-owned network businesses have conflicting objectives, which reduce their efficiency and undermine the effectiveness of incentive regulation”.

These conflicting objectives undermine the long term stability of Energex, as a corporation’s mandate is to create profit for shareholders but Energex’s company charter is to provide an essential service of electrical distribution to south-east Queenslander’s.

Internally, I saw confusion over what Energex’s role actually was. The most vocal conviction that I was witness to was ‘Energex was there to provide profit to its shareholders and social policy wasn’t Energex’s business, but rather the Queensland Government’s’. While I am also aware that other areas of Energex thought high electricity prices were an issue that the company should be helping to address.

As a monopoly, Energex is well-placed to provide these services at a reasonable rate to customers. However, once prices move beyond what consumers deem to be a fair market price, simple economic theory teaches us that substitution is likely to occur.

Currently, more and more Queenslanders are utilising solar panels to reduce their electricity bills which is a substitute product. Although technological advances in this field are still in infancy, the higher the electricity prices, the higher the likelihood of advancements in battery and other technology’s as the financial pay-off becomes viable.

Infrastructure white elephants have occurred in recent Australian history, with the Telstra copper network being a prime example of how technological change has made a distribution network of once great value into an aging infrastructure burden.

The AER has the ability to ensure Energex’s longer-term sustainability by ensuring that capital expenditure actually reflects what is required, and via cost-effective delivery, rather than the token gesture Energex has made to cost cutting in its submission.

**The Flow-On Effect**

Electricity usage is now enmeshed within our lives. Not only does it have a financial impact on households but also in businesses and not-for profit organisations. Although corporations make a significant proportion of Australia’s GDP, it is our small businesses that employee the vast majority of Australians and are least likely to be able to continually absorb excessive power price increases.

The increase in power prices has also affected one of Queensland’s primary economic drivers, the agricultural sector, with an alliance of agricultural bodies uniting to protest ‘soaring electricity prices’ (fairpowerprices.com).

With Queensland’s rural sector becoming financially stressed over the significant power price rises, simple logic dictates that this will inevitably lead to increased prices for Queensland households. With cost of living increases for consumers that had over 8,000 small customer disconnections due to non-payment in the September Quarter 2014, according to the Queensland Competition Authority, basic utility services will soon become a privilege in Queensland, rather than a right.

The social impact of increased electricity prices cannot be underestimated. Pensioners, veterans and those on disability payments in my local area suffer financial hardships and cannot understand why their bills are so high when they have disconnected nearly every electricity consuming item in their home.

**Longer-Term Sustainability**

Investment requires risk. When an individual undertakes investment in a company they require a sufficient rate of return for the risk. In the marketplace, opportunities for abnormal returns are rare, as shareholders pounce on these aberrations driving the risk-return relationship back to equilibrium.

Energex’s shareholders at time of writing, LNP Members of Parliament, The Honourable Tim Nicholls, Treasurer and The Honourable Mark McArdle, Minister for Energy and Water Supply have received excessive returns from Energex than would normally be achieved by the same level of funds invested in another company with the same risk.

Allowing continual excessive returns is fiscally irresponsible, increases consumer power prices and adds another layer of fat that could be detrimental to the long-term sustainability of Energex.

As the then CFO, Darren Busine said to the Parliamentary Committee on Electricity Prices in October 2012, “Energex supports the actions that could be taken to reduce the overall costs of electricity while not compromising on a balanced approach to safety, efficiency and reliability”. Longer term sustainability can only be obtained via prudent financial and asset regulation now.

Revaluating the Regulated Asset Base to market value and ensuring the WACC reflects a realistic cost of capital will neither compromise the network’s safety, efficiency and reliability but it will provide immediate relief for Queenslanders who are struggling financially to pay for something that should be seen in Australia as an essential service, not a luxury.