ANTICIPATED IMPACTS: ENERGY MERGER AND EFFICIENCY SAVINGS

Background and Summary

In the lead-up to the January 2015 election, the Government committed to pay down General Government Sector debt by keeping Government owned corporations (GOC) in the hands of Queenslanders, improving their performance, and using GOC dividends to pay down debt.

The pre-election *Our State Our Assets Fiscal Strategy and Debt Action Plan* identified more than $150 million per annum in savings by consolidating government owned corporations in the energy sector.

Since the 2015-16 Budget, the Government has undertaken a detailed review of possible merger options for the government-owned energy network, generation and retail businesses to optimise the efficiency and effectiveness of the State's energy businesses.

Following this review, the Government has decided to merge Energex and Ergon Energy under a parent company to streamline operations, harness efficiencies, and prepare the distribution business for the challenges of a rapidly changing energy industry. A parent company is expected to be put in place by mid-2016, with further integration of the Energex and Ergon Energy businesses to continue progressively once the new management team is in place.

Powerlink will remain separate and independent from the merged distribution businesses, but will be reviewed to align work practices with the other network businesses, and identify opportunities to improve efficiency.

To ensure a competitive wholesale market is maintained, the generation businesses (CS Energy and Stanwell) will not be merged. The Government will consider further how best to position these businesses to adapt to the challenges of an aging fleet and competition from alternative technologies. There will be a renewed focus on pursuing efficiency savings and optimising capital investments to provide portfolio flexibility as the wholesale electricity market continues to evolve.

The merger, along with efficiency initiatives across all energy businesses, will achieve a number of important benefits:

- driving savings of more than $680 million to 2019-20;
- delivering value to customers by releasing funds to invest in better services;
- preparing the business for the future by encouraging innovation and investment in renewable energy;
- investing in regional Queensland businesses and support regional jobs; and
- providing employees with world-class career opportunities in the Queensland electricity sector.

Review Process

The Electricity Merger Working Group (EMWG) established within Queensland Treasury Corporation led the review of merger options and estimated savings. In undertaking its assessment, the EMWG:

- reviewed analysis by external consultants assisting the network businesses achieve efficiency savings required by the Australian Energy Regulator's final regulatory determinations;
- consulted with the respective businesses;
- considered potential savings in light of other merger processes;
- sought legal advice and consulted with the Australian Competition and Consumer Commission on the competition impacts of merging the generation businesses.

Results

Energex and Ergon Energy

Energex and Ergon Energy will be merged under a new network parent company.

- The parent company will consolidate executive, corporate, shared services and strategic asset management groups.

- The merged business will include Ergon Energy's existing retail business and a new energy services business, to be based in Townsville.
- Energex and Ergon Energy will be subsidiaries of the network parent company, with the respective field delivery, field support and operational asset management groups remaining within the subsidiary businesses.

Powerlink

Powerlink will remain separate and independent from the merged distribution businesses.

Powerlink will continue to:
- pursue corporate efficiency savings and network investment optimisation to deliver an efficient, reliable high-voltage network; and
- play important roles in supporting wholesale market competition and delivering new connections for renewable generators and large energy users.

Stanwell and CS Energy

The generation businesses will remain as separate businesses. The Queensland Government will undertake a strategic review of the businesses to identify further efficiency opportunities.

The generators will deliver business savings through improved cost management and continued optimisation of capital investment.

Savings from Efficiencies and Merger Synergies

The following table shows the estimated efficiencies and merger synergies savings across the energy GOCs, after accounting for implementation costs and savings required to meet the AER's regulatory determinations for Energex and Ergon, and estimated AER reductions for Powerlink from 2017-18. The estimated savings from the merger of the distribution entities have been based on an expected date of mid-2016 for the establishment of the parent company. The efficiencies across each of the energy GOCS are assumed to commence in 2015-16.

The profile of savings will be influenced by the time needed to negotiate the required outcomes with stakeholders, including employees, unions, customers and suppliers, as well as the impact of the next regulatory determination for each of the network businesses.

$M	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Distribution Merger and Efficiency Savings	(8)	10	178	180	202	562
Transmission Efficiency Savings	1	5	(4)	0	6	8
Generation Efficiency Savings	17	31	(1)	57	6	110
TOTAL	**10**	**46**	**173**	**237**	**214**	**680**

Impact for GOCs

The savings will be reflected in the accounts of the GOCs as reductions in capital expenditure and operating expenditure, which should result in lower debt levels and interest costs in the GOCs and for the Public Non Financial Corporations Sector.

Operating cost efficiencies should improve profitability, meaning that the GOCs will pay higher taxes and dividends to Government. Capital efficiencies may allow for higher capital returns to Government by continuing the Government's regearing strategy (70%-75% of net debt to regulated asset base).

The modelling undertaken by QTC makes a number of assumptions about the timing of efficiencies and the areas where these can be achieved within each of the businesses. However, the boards and management of each of the electricity businesses, including the new parent company of the merged entity, will be tasked with achieving the efficiencies within their respective businesses. Accordingly, the profile and timing of savings may differ from the table above.

In particular, delivering the efficiencies will need to be consistent with the Government's policy on no forced redundancies.

Returns to Government

The efficiencies and savings identified above will not all flow to the General Government sector; as noted above, some savings are retained in the businesses to maintain the target gearing level. The Government derives a return from its investment in GOCs in the form of dividends, taxes and competitive neutrality fees. The regearing strategy, which targets achieving a ratio of 70% to 75% of net debt to RAB, provides a capital return to Government.

An indirect benefit to government is the interest savings from paying down Government debt with the additional flows to Government. The Government expects that the benefits from the efficiency and merger savings and capital returns from the energy businesses will allow it to further reduce General Government debt.

Impact for Customers

The Queensland Government is focused on reducing the cost of living and is taking action to minimise the impact of network costs on consumers. Firstly, the Queensland Government directed Energex and Ergon not to challenge the Commonwealth's AER final decision on revenues, to provide consumers with certainty on prices and provide bill relief.

As the merger will drive efficiencies, it is expected to reduce pressure on network costs in the long-run. Government also expects that the efficiency gains from the merger and other efficiency savings will reduce pressure on electricity prices over the longer term. The next regulatory determination will likely include the efficiency savings in the baseline for calculating network prices from 2020 to 2025.