

Chairman; Mr Ben Wyatt; Ms Andrea Mitchell; Mr Martin Whately; Mr Bill Johnston; Mr Bill Marmion; Mr Joe Francis

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**Verve Energy —**

Ms L.L. Baker, Chairman.

Mr W.R. Marmion, Minister for Commerce representing the Minister for Energy.

Ms S. In't Veld, Managing Director.

Mr W. Borovac, Chief Financial Officer.

Mr K. Lajszczak, Manager, Financial Planning and Analysis.

Mr B. Stratton, Chief of Staff, Office of the Minister for Energy.

**The CHAIRMAN:** Member for Victoria Park.

**Mr B.S. WYATT:** My first question on Verve is basically the same as my first question on Synergy. I refer the minister to page 597 and the line item “Internal Funds and Balances”. For Verve the 2009–10 budget estimated that the dividend payable by Verve to the government would be \$8.7 million. However, the budget outcome looks as though it will be \$19.2 million, a 221 per cent increase in that dividend. In the light of the fact that the budget for 2009–10 would have factored in a number of rises and increases in demands, what is making up the majority of that increase? Is it just the payout ratio or are there other elements there as well?

**Mr W.R. MARMION:** I will refer to the managing director to answer that question.

**Ms S. In't Veld:** My chief financial officer has offered to answer that question. I will refer it to him.

**Mr W. Borovac:** In relation to the dividends, last year’s estimates were based on a half-year profit and a payment of 50 per cent of the after-tax profit for the half year. As a result of the current policy, there was both a timing and ratio change. The timing was brought forward, based on the forecast profit for the year, and the ratio was increased from 50 per cent to 65 per cent of the after-tax profit. The estimated after-tax profit is \$30 million for the 2010–11 financial year, and 65 per cent comes out of that \$19.2 million.

**Mr B.S. WYATT:** That makes sense. Out of interest, why would the 2009–10 budget be based on the half-year profit and not the full-year profit?

**Mr W. Borovac:** The policy last year was based on two half-yearly dividends to be paid. We would have paid a dividend of approximately \$8 million after the half year. Then, after the audit was completed for 30 June 2010, we will be paying the other half year. The change in policy is now based on our estimated profit for this financial year.

**Mr B.S. WYATT:** That makes a lot of sense. I did not realise that. Even though there were two yearly dividends, the fact that one was being paid in the next financial year was causing the issue. Now, regardless of when it is being paid, it is being generated in that financial year and it has been brought to book for the entire amount. Has the half-yearly budgeted figure been a policy for a long time?

**Mr W. Borovac:** This is the first year that we are subjected to dividend. In previous years, having made a loss, we were not paying a dividend. This is the first time we have actually applied a policy.

**Mr B.S. WYATT:** I assume that the policy from here on in will be to factor in the forecast full-year dividend estimate?

**Mr W. Borovac:** The direction we have been given this year is that we will do this estimate and upon finalisation of the audit for 30 June 2010, if there is any adjustment, we will pay a catch-up or there will be an adjustment in our forward dividend after the audited financial statements come out. I am not certain about how the policy will apply next year.

**Mr B.S. WYATT:** That is a decision for the minister.

**Ms A.R. MITCHELL:** I refer to the heading “Sustainable Energy” on page 597. I note the allocation of \$2.6 million for expenditure on wind diesel systems situated outside the south west interconnected system. Can the minister provide more detail on the location, benefits et cetera of these systems?

**Mr W.R. MARMION:** I will refer that question to the managing director.

**Ms S. In't Veld:** Although Verve Energy is primarily involved in the south west interconnected system, we have a number of wind diesel systems scattered throughout the state outside SWIS—in Hopetoun, Coral Bay and Denham. Some of these are operated by Horizon, but we maintain them.

**Mr M.P. WHITELY:** I also refer to the \$2.6 million to be spent on wind diesel systems in the next three years. Where is it anticipated they will be located and what will it cost for each one of those systems?

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**Ms S. In't Veld:** These are existing wind diesel systems. It is for the maintenance of the existing wind diesels. For example, we have a system at Esperance, which last week or the week before was struck by lightning. A certain amount of maintenance has to be done to that turbine. It is for ongoing maintenance. The wind turbines in the diesel system that we have at Coral Bay, which is an area of cyclonic activity, occasionally require additional maintenance. It is very much driven towards maintenance of existing plant.

**Mr M.P. WHITELY:** Why is there no provision for sustainable energy generation in the 2013–14 out year?

**Mr W. Borovac:** At this stage the nature of this expenditure is actually upgrades to our system. It means that there are no anticipated upgrades to the system for that financial year. It is not to say that there will not be maintenance of the system, which is of an operating nature. As capital, they are in the nature of upgrades. Ongoing maintenance is in our operating expenses. I cannot tell the member that figure. In fact, it would be a provisional figure.

**Mr W.J. JOHNSTON:** On page 597 reference is made to the fossil fuel plant portfolio. After the allocation of this money to Verve's fossil fuel plant portfolio, how much energy is it estimated that Verve will be able to produce in 2010–11 and the out years and what percentage of the SWIS market share will this comprise?

[9.10 pm]

**Mr W.R. MARMION:** I refer that question to the managing director.

**Ms S. In't Veld:** We expect it will still at that time be capable of producing about 3 000 megawatts of generated electricity. Whether the market requires that remains to be seen because we currently have about 500 megawatts of surplus electricity in the system.

**Mr W.J. JOHNSTON:** So Verve Energy expects to be at more than 100 per cent capacity?

**Ms S. In't Veld:** Our share of the south west interconnected system is gradually declining. By about 2013–14 our expectation is that it will probably be closer to 60 per cent than 70 per cent.

**Mr W. Borovac:** The current size of the SWIS is somewhere in the vicinity of 5 000 megawatts officially. With the 3 000 megawatts our capacity is 60 per cent; however, the energy sent out can vary between 50 per cent to a much higher percentage of the total energy in the SWIS, depending on demand, from time to time.

**Mr W.J. JOHNSTON:** I have a further question. Of that \$388.4 million, \$82.6 million is allocated to the Muja power station. Is that for the refurbishment of Muja A and B? Are there any environmental questions about that?

**Ms S. In't Veld:** The refurbishment of Muja A and B is primarily being undertaken by our joint venture partner, Inalco Energy. Inalco will spend in excess of \$100 million on refurbishment of the Muja A and B units, which involves retrofitting the units with pollution abatement equipment. Therefore, it will contribute to the environmental performance of those units. This \$82.6 million—I ask my chief financial officer to correct me if I am wrong—is for the Muja C and D units.

**Mr B.S. WYATT:** I have a follow-up question about that recommissioning work. Is that work still on time according to the schedules originally announced, I think, by the Premier?

**Mr W.R. MARMION:** I will pass that question over to the managing director again.

**Ms S. In't Veld:** Yes it is. We are currently awaiting environmental approvals. The banking is all on time and the due diligence is currently underway. We are still awaiting section 68 approval from the minister's office but our expectation is that both environmental and section 68 approvals will be forthcoming within our time line.

**Mr A. KRSTICEVIC:** I refer to the statement at the top of page 597 of the *Budget Statements*, which states —

The primary functions of Verve Energy are to generate and supply electricity in the South West Interconnected System ...

What actions has Verve Energy taken to secure long-term gas and coal contracts?

**Mr W.R. MARMION:** I thank the member for the question. The government is aware of the importance of having long-term fuel supply arrangements in place. Verve Energy constantly reviews its current arrangements and future requirements so that fuel supplies match anticipated demand and electricity supplies can be maintained. New long-term coal supply arrangements with Wesfarmers Premier Coal from July 2010 will result in significantly lower average coal purchase costs. Verve Energy is also looking at strategic gas supplies beyond the current arrangements to secure long-term supplies for the benefit of the state and is negotiating with pipeline operators to convert legacy interruptible tranches of gas into firm capacity. Other initiatives include the extensive use of gas swaps to better match gas supply and demand, strategic gas storage arrangements and investment in

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high-efficiency gas turbines approved by the government as part of the 2009–10 state budget to make optimum use of available gas supplies. The managing director may add to that if she wishes.

**Ms S. In't Veld:** We are currently having discussions with the Gorgon joint venturers because our future gas supply is probably one of the biggest challenges we face. As the minister has mentioned, we are looking forward to our contract with Wesfarmers starting from 1 July, which will significantly reduce our coal fuel bill.

**Mr J.M. FRANCIS:** I have a further question on this point.

**The CHAIRMAN:** Member for Joondalup.

**Mr J.M. FRANCIS:** Jandakot, thank you!

**The CHAIRMAN:** The other one, sorry!

**Mr J.M. FRANCIS:** On the price of coal that Verve Energy has to pay for generation, I am curious whether the minister or Verve have done any impact assessment of the federal government's new resource super profits tax. Obviously, it will apply to coal. Does Verve Energy expect the increase in costs will be passed on to consumers and further add to the cost of electricity production?

**Mr W.R. MARMION:** The managing director can answer this question.

**Ms S. In't Veld:** We have looked at the resource super profits tax and have come to the conclusion that it is still too uncertain in terms of how it will apply for us to come to any definitive conclusions. However, our expectation is that there will be scope under some contracts to pass it on. For example, coal suppliers may think that they can pass it on to us and we may think that we can pass it on to our customers, but it really does depend on the wording in each contract. It is fraught with uncertainty at this stage.

**Mr B.S. WYATT:** I should have probably asked this as a follow-up question to the chief financial officer's answer a while ago because it is a question about those dividends.

**Mr W.R. MARMION:** Is this on page 597 of the *Budget Statements*?

**Mr B.S. WYATT:** It relates to the internal funds and balances on page 597. The chief financial officer explained to me about the half year and the full year and why it went up to \$19.264 million in 2009–10. There are also a couple of very large increases to \$37.2 million in 2010–11 and to just under \$60 million in 2011–12. Those large rises are obviously predicated on a number of assumptions, some of which will be electricity tariffs. Can the minister give me a run-down of what is driving that large growth in dividend payments?

**Mr W.R. MARMION:** I refer the question to Mr Borovac.

**Mr W. Borovac:** Can I clarify which page the member is referring to?

**Mr B.S. WYATT:** The dividend payments are from page 144 of volume 1 of the *Budget Statements*.

**Mr W. Borovac:** Sorry, I thought the member said page 597.

**Mr B.S. WYATT:** I was hooking my question to a page as the minister is wont to expect of us! I am pulling those figures from the "Electricity Generation Corporation (Verve Energy)" line item on page 144. There are quite large increases in the expected dividends to government from Verve. My question is: what is driving that surge in dividends? When we move from half year to full year, it suddenly goes from \$19 million to \$37 million to \$60 million.

**Mr W. Borovac:** Fundamentally, we have a transition period. We have the \$30 million this year that we make in after-tax profits; that is, we were estimating. In the subsequent year we expect to make somewhere in the vicinity of \$57.5 million net profit after tax, so 65 per cent of that again. The following year we expect profits in the vicinity of \$91 million and it will remain relatively flat for the next three years. Effectively, we will be paying tax at 65 per cent of that after-tax profit.

**Mr B.S. WYATT:** Is the primary driving force of that the increased tariffs?

**Mr W. Borovac:** A number of factors drive our improved performance. Certainly, the increased tariffs are making a significant contribution to that. As my managing director pointed out, we have a much more favourable coal contract that has added significant profitability and margin to our performance. The nature of our business is that on various cycles we have large maintenance programs, which fluctuate from year to year. For example, we have roughly \$200 million in financial year 2011 of maintenance to perform on our plant, both compliance and regulatory, as well as ensuring reliability. In the following two years it drops away and we have to run that maintenance again. That ensures the plant is working at optimum levels and in compliance with the manufacturers' requirements.

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[9.20 pm]

**Mr B.S. WYATT:** If the increased dividend payout ratio stayed at 50 per cent and did not move to 65 per cent, would that form part of the internal funds and balances? Am I correct in assuming that it would then be spent on the asset investment program or whatever?

**Mr W.R. MARMION:** I refer the question to the managing director.

**Ms S. In't Veld:** Our debt is unacceptably high at \$1.2 billion. We are conscious also of the need to reduce that and of using our profits to reduce the debt. I will ask Mr Borovac to elaborate further.

**Mr W. Borovac:** I guess that is right. There was the opportunity to either reduce debt or to internally fund our capital expenditure. In this instance, if we had the additional dividend, we would apply it to reduction of debt because our net cash flows are in excess of our cap ex requirements going forward.

**Mr B.S. WYATT:** Obviously, when Verve is at the 50 per cent dividend payout ratio, it had a debt reduction plan. Now that has gone to 65 per cent, I assume that has done one of two things: firstly, pushed out Verve's plans to reduce debt or, secondly, pushed out plans for the asset investment program.

**Mr W. Borovac:** Fundamentally, yes, we would not be reducing our debt. The debt we would have been aiming to reduce would be the debt with the Western Australian Treasury Corporation. We would not be, in this instance, applying that differential to that debt; that is correct.

**Mr W.J. JOHNSTON:** I am interested in this question about what is driving the increasing return out of the business. Mr Borovac has already said that the glide path in the budget for increases in residential tariffs is important to where Verve's profits are going. I am also interested in the large energy consumers who are acting in a completely open market with that 500 megawatt, I think Mr Borovac said, overhang of power supply.

**The CHAIRMAN:** Where are we on the budget papers?

**Mr W.J. JOHNSTON:** I am following up the very question asked before about the glide path for the dividend payments. I am wondering whether that overhang of power is driving down the prices of the large consumers of electricity. If there is 500 megawatts of extra energy in the system, are large power users getting good deals and, therefore, is Verve not expecting to get a profit out of that that it might otherwise get?

**Mr W.R. MARMION:** Verve is a generator of electricity so it is probably a bit of a left-field question. The managing director may want to answer.

**Ms S. In't Veld:** The member has just touched on a very complex area, because the market rules are such that we do not control how our electricity is dispatched. We do not have direct relationships with our customers, apart from Synergy. Given the contract with Synergy is essentially the vesting contract and has been signed, there is no scope for changing that. The other contracts we have are also long-term, so there is no scope for changing that aspect. The fact that we have some surplus electricity does not have an impact on the prices that the bigger consumers are paying at this stage.

**Mr J.M. FRANCIS:** I refer the minister to the first dot point on page 597, under "Fossil Fuel Plant Portfolio", where it refers to "\$177.6 million to complete the construction of two 100 megawatt high efficiency gas turbines". My question is to do with the benefits of investing in these turbines. Can the minister comment, given what we heard about the resource super profits tax? Obviously, gas will not be taxed under it but coal will be. To me, that would create a huge incentive to use more gas and less coal. My concern is about what impact that may also have on the coal industry in Collie, for example. I am wondering whether the managing director can comment on the benefits of investing in those gas turbines and, once again, the incentives to use more gas and less coal.

**Mr W.R. MARMION:** I will ask the managing director to respond.

**Ms S. In't Veld:** The high-efficiency gas turbines have a number of benefits for Verve Energy. Probably one of the biggest is very simply the more efficient use of our gas. They can operate at very high efficiencies of 44 or 45 per cent at 100 per cent load and can also operate at high efficiencies even when they are cycled back. In terms of our role as balancer in the market, they are ideal for load following, in that we can cycle them up and down without any great loss of efficiency, which is far preferable to using the coal-fired baseload plant, which is not designed to do that. It is a combination of more efficient use of gas and being able to run in a way that enables us to carry out our role as balancer more effectively.

On the question about the super profits tax, our gas contract with the North West Shelf is due to run out in about 2016-17, so there is a limited time frame for certainty of our gas supply going forward. Gas is still significantly

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more expensive than coal, so at this time, even assuming there is not an emissions trading scheme in operation, it is far, far cheaper for us to use coal.

**Mr W.R. MARMION:** From what I understand, the way we can extend our gas contract is to be more efficient in the use of gas so that we can minimise the use of gas through more efficient use of it; and if we can take advantage of coal, we can maintain what is a very well-priced coal contract for much longer. It is likely that the next gas contract will be very much dearer than the one we have, and that will obviously put pressure on our pricing structure.

**Mr J.M. FRANCIS:** Looking at Verve's mix between coal and gas generation, a super profits tax on coal, as the minister alluded to, would have to have a net impact on the bill for the end user. Even if Verve has a small mix on coal and a large mix on gas, it will still have a net impact. I am curious because I have not heard too many comments from anyone about the impact of the super profits tax on the electricity bill of the average Western Australian. I cannot see how it would not impact considering we still have such a large amount of coal-generated electricity.

**Mr W.R. MARMION:** I think the managing director half-answered the question quite well last time, but maybe she can elaborate quite specifically.

**Ms S. In't Veld:** Probably the two points worth clarifying in that area are, firstly, we are not sure we can pass it through to the customer, and the coal producer may not be able to pass it on to us. It very much depends on the wording of the contract in place. That is uncertain. To give the member an idea of the difference between the gas price and the coal price, if an emissions trading scheme were introduced, the cost of carbon would have to be around \$80 a tonne before gas was competitive with coal, so there is still a huge differential.

**Mr W.J. JOHNSTON:** Regarding the difference in price between gas and coal, I understand that the SWIS is one of the systems with the largest difference between minimum and peak load. Is that therefore an attraction to gas because of the more flexible issues?

[9.30 pm]

**Mr W.R. MARMION:** It is a good question. The peaks are the expensive part of the system. From my limited knowledge of power stations, even though I worked as a trades assistant on the Bunbury power station in 1972 and 1973, firing up a gas turbine is a lot quicker and can come in peaks and troughs very quickly whereas I have seen a coal-fired turbine start up and it takes ages. The answer to the question, which will be elaborated on by the managing director, is that gas is far more reliable and useful in terms of peaks.

**Ms S. In't Veld:** I will just add to that to say certainly if we take a hot summer day and the need to peak close to 3 000 megawatts, the open cycle gas turbines are ideal but they are still far more expensive. We would not want to run the baseload off gas because of the impact that would have on tariffs.

**The CHAIRMAN:** That completes the examination of Verve Energy.