

Mr Eric Ripper; Mr John Day; Mrs Liza Harvey; Mr Chris Tallentire; Mr Ben Wyatt; Dr Mike Nahan; Chairman

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**Verve Energy —**

Mr P.B. Watson, Chairman.

Mr J.H.D. Day, Minister for Planning representing the Minister for Energy.

Ms S. In't Veld, Managing Director.

Mr W. Borovac, Chief Financial Officer.

**The CHAIRMAN:** This estimates committee will be reported by Hansard staff. The daily proof *Hansard* will be published at 9.00 am tomorrow.

Members may raise questions about matters relating to the operations and budget of the off-budget authority. Off-budget authority officers are recognised as ministerial advisers.

It is the intention of the Chair to ensure that as many questions as possible are asked and answered and that both questions and answers are short and to the point.

The minister may agree to provide supplementary information to the committee rather than asking that the question be put on notice for the next sitting week. I ask the minister to clearly indicate what supplementary information he agrees to provide and I will then allocate a reference number. If supplementary information is to be provided, I seek the minister's cooperation in ensuring that it is delivered to the committee clerk by Friday, 10 June 2011, so that members may read it before the report and third reading stages. If the supplementary information cannot be provided within that time, written advice is required of the day by which the information will be made available. Details in relation to supplementary information have been provided to both members and advisers and, accordingly, I ask the minister to cooperate with those requirements. I caution members that if a minister asks that a matter be put on notice, it is up to the member to lodge the question on notice with the Clerk's office. Only supplementary information that the minister agrees to provide will be sought by Friday, 10 June 2011.

I now ask the minister to introduce his advisers to the committee.

[Witnesses introduced.]

**Mr E.S. RIPPER:** I draw the minister's attention to page 288 of budget paper No 3, which indicates that Verve's five per cent efficiency dividend will produce a saving to net debt of \$63 million over the forward estimates. Given that Verve Energy is already in a competitive market and, therefore, presumably striving for maximum efficiency already, how will Verve seek to achieve this five per cent efficiency dividend; what measures is Verve contemplating to achieve this result?

**Mr J.H.D. DAY:** The intention of this efficiency dividend, of course, is to ensure that a greater amount of funding is available to be allocated to other important areas of government activity and the provision of public services. The intention is for there not to be any reduction in the service or increase in charges to the public as a result of the dividend being put into effect. I will ask the managing director to provide further information on how it will be managed.

**Ms S. In't Veld:** This will be a challenge for us, especially as we have already embarked on an efficiency program two or three years ago that largely involved taking 20 per cent out of our head office costs. We are looking at one avenue with the shutdown of our Kwinana A power station in October this year, which will give us an opportunity to reduce our labour costs. Last week we started looking at how we might achieve this but in any business, irrespective of whether it is in a competitive environment, there are always opportunities to look at greater efficiencies, whether they are operational, whether it means spending more money on plant to ensure it operates more efficiently, or whether it is how we utilise our people. If I may, I will ask my chief financial officer to elaborate on that.

**Mr W. Borovac:** I think my managing director has pretty much summed up Verve's position. We have taken the opportunity to utilise some of the initiatives we implemented two years ago. We have appointed a strategic procurement group that has been working systematically with the operations to look at opportunities to reduce our costs. It was a process that we have been following anyway. As Ms In't Veld intimated, it is a challenge for us from the point of view that we operate in a competitive environment. We always look for continuous improvement. We are undertaking a review at the moment and have been requested to come back to the minister with our plan of action by 30 June. We are asking each of our GMs to look at their areas and at other opportunities. We have started a number of these programs in the past, as Ms In't Veld alluded.

**Mr E.S. RIPPER:** I want to clarify my understanding of how this works. Verve achieves efficiencies and cuts costs; Verve's profit is therefore increased; therefore the income tax payments and the dividend payments to the government are increased; and therefore the government gets extra money out of Verve for spending on other purposes. Is that a reasonable description of how this works?

Mr Eric Ripper; Mr John Day; Mrs Liza Harvey; Mr Chris Tallentire; Mr Ben Wyatt; Dr Mike Nahan; Chairman

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**Ms S. In't Veld:** It depends on what else is happening. If, for example, we have a problem with one of our plants and are forced to burn liquids, our profits would be severely impacted and may counter a benefit we have from efficiencies. It all depends on how we go operationally in that particular year.

**Mr E.S. RIPPER:** All things being equal, the dividend should deliver higher profits and therefore higher dividends and income tax payments to the government and this is how the government gets a benefit.

**Ms S. In't Veld:** All things being equal, yes, that is correct.

**Mrs L.M. HARVEY:** I refer to the reference to sustainable energy on page 617 in budget paper No 2. I am interested in hearing from Verve what measures it is taking to improve its environmental performance.

**Mr J.H.D. DAY:** In recent years a lot of effort has been invested in this area, particularly in the past three or four years on, to use a non-technical term, cleaning up the generation process. I will ask the managing director to elaborate.

**Ms S. In't Veld:** We have an extensive program under way at the moment that involves, firstly, a wind farm extension to the Albany wind farm, which is the Grasmere extension of 14 megawatts. It will mean that 50 per cent of Albany's power comes from a renewable source. We are also well underway with developing the Mumbida wind project, just south of Geraldton, which is 55 megawatts. We have spent close to \$200 million on improving the efficiency of the operations of our Muja C and D plants, putting in new control and instrumentation systems, which has certainly improved their efficiency. Kwinana stage B has been shut down completely. That was an old, very inefficient plant. As I mentioned earlier, we are looking at shutting down Kwinana A in October this year. That is another old, very inefficient plant that will be put out of the system. That will be replaced with 200 megawatts of high-efficiency gas turbine. It is the most efficient turbine technology in the world and will, in fact, be the first in Australia. Finally, we have a 10-megawatt solar photovoltaic project underway as well.

[5.40 pm]

**Mr C.J. TALLENTIRE:** Mention was made of the Muja power station. Can the minister confirm that the Muja A and B refurbishment will lead to plant that will be just as emissions intensive as it was prior to decommissioning?

**Ms S. In't Veld:** That is correct; it will be emissions intensive, but it will be a cleaner plant in that it will have baghouses attached to it so it does not throw particulates into the air, which is the way it operated previously. It is worth mentioning that the purpose of Muja A and B is very much tied up with energy security. It is seen as a transitional bridging mechanism for 10 or perhaps 15 years until new coal-fired technology is developed. Until clean coal technology is developed, we do not believe there is any merit in spending hundreds of millions of dollars on a new coal plant that has a 30 or 40-year life span. This was highlighted after the Varanus incident when we brought Muja A and B back, and this was prior to it being refurbished, so it did throw particulates into the air.

**Mr C.J. TALLENTIRE:** Can I confirm that there has been no improvement at Muja A and B in greenhouse gas emissions terms?

**Ms S. In't Veld:** No. Only two units will be operating at Muja A and B, so it will be operating as a mid-merit peaking plant. The two other units will be kept in reserve for potentially another gas crisis.

**Mr B.S. WYATT:** I refer to page 289 of budget paper No 3, which shows revenue of just over \$700 million to government from Verve Energy over the forward estimates. What is the expected debt level of Verve at the end of the 2010–11 financial year and what is it projected to be at the end of 2011–12?

**Mr J.H.D. DAY:** The expected debt level at the end of 2010–11 is \$1 007 million and at the end of 2011–12 it is expected to be \$951 million, and it progressively decreases after that. The level of debt that Verve has had has been a major issue for the organisation. One of its major costs of operation is servicing the debt. It is highly desirable from a public interest point of view to reduce the amount of debt that Verve is carrying. The debt is expected to go down to \$460 million by 2014–15, which is more than a 50 per cent reduction in the current level. That is clearly in the public interest.

**Mr B.S. WYATT:** In respect of the minister's comments on the cost of servicing the debt, how much will have been spent on interest by the time the current year finishes and what is projected for 2011–12? I am asking for the interest payments for both years.

**Mr J.H.D. DAY:** I refer that to Mr Borovac.

**Mr W. Borovac:** We anticipate interest payments of \$63.1 million in the current financial year and \$58.7 million in the 2011–12 financial year.

Mr Eric Ripper; Mr John Day; Mrs Liza Harvey; Mr Chris Tallentire; Mr Ben Wyatt; Dr Mike Nahan; Chairman

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**Mr C.J. TALLENTIRE:** How many staff are involved in doing the modelling on carbon pricing impacts on Verve's energy generation options?

**Ms S. In't Veld:** We have probably two or three staff who have done some modelling on that issue, but we have probably five or six people who are monitoring it very closely. I have certainly been involved with the federal ministers in terms of the interests of Western Australia in relation to how the scheme may end up operating.

**Mr C.J. TALLENTIRE:** How confident can Verve be in the accuracy of its modelling?

**Ms S. In't Veld:** We are not confident at all because we do not know how it will end up. We do not know what the price on carbon will be. We do not know when it will transfer to an emissions trading scheme. We do not know what the cap will be. To a large extent, we are speculating. The only thing we can say with some certainty is that if the carbon price was initially \$25 a tonne, that would add in excess of \$200 million a year to our operating costs. We are not certain that we can totally pass that on to our customers, because there is also ambiguity in our electricity supply agreements. To the extent that we can pass it on, we believe it would lead to an increase in tariffs in the order of 20 per cent, but to the extent that we cannot pass it on, it would lead to a reduction in our profits and a reduction in our dividends payable to government.

**Mr C.J. TALLENTIRE:** How accurate is the modelling that supports the public comments that have been made about the point at which Verve would switch to gas generation?

**Ms S. In't Veld:** The gas situation is seriously problematic for us because our North West Shelf contract will run out in about 2015 and 2016. At this stage, we do not have sufficient gas to replace that. If we did want to build another combined-cycle gas plant, we have not been able to source the gas for that.

**Dr M.D. NAHAN:** To summarise—this may have been said somewhere else—the managing director says that a 25 per cent carbon tax would add \$200 million to Verve's bottom line and it might not be able to be passed on. If it could be passed on to, say, the non-contestable consumers, approximately what increase would that represent?

**Ms S. In't Veld:** We think it would be in the order of 20 per cent.

**Dr M.D. NAHAN:** The reason for the carbon tax is to get a response from organisations such as Verve—that is, to get a market-based response to a higher cost. In the medium term, what kind of response would Verve be able to make?

**Ms S. In't Veld:** There is no scope for a response from Verve Energy, and this is because there are no opportunities for abatement. We do not need new baseload plant in this state until about 2018. No new baseload plant will come in in any event. We also need all the coal plant we have at the moment, both because coal is much cheaper than gas and because we have not been able to source gas available for new plant in any event. The other issue, of course, is that until the carbon tax is in the order of \$60 to \$70 a tonne, there is no incentive for any electricity generator in Western Australia to convert from coal to gas.

**Dr M.D. NAHAN:** What is the price differential between gas and coal?

**Mr J.H.D. DAY:** Is this commercially confidential?

**Ms S. In't Veld:** We can very broadly say that gas is about four times more expensive than coal.

**Dr M.D. NAHAN:** At current prices?

**Ms S. In't Veld:** At current prices per gigajoule.

**Mr E.S. RIPPER:** With regard to carbon abatement, there is perhaps a side of the debate that is missing; that is, under an emissions trading scheme, which the country will eventually get to, it might be possible for Verve to purchase emissions permits from other carbon-abatement operations outside the electricity system. For example, it is theoretically possible that people growing trees or undertaking certain agricultural practices in due course would be able to generate permits. Has Verve done any thinking about the possibility of purchasing permits from carbon-abatement measures? That would change the thinking that the whole cost would just have to be passed on at the rate of \$25 a tonne.

**Ms S. In't Veld:** We have certainly thought about that, but that would still be a cost to us. Our production costs would still go up by virtue of buying those permits.

**Mr E.S. RIPPER:** But it might be a cost of \$10 a tonne. There would be an economic incentive for Verve to search out those opportunities and it would take up anything that was less than \$25 or \$26 a tonne.

[5.50 pm]

**Ms S. In't Veld:** That is correct. We would look at what was happening with the market price of carbon and we would look for opportunities to source it as cheaply as possible.

Mr Eric Ripper; Mr John Day; Mrs Liza Harvey; Mr Chris Tallentire; Mr Ben Wyatt; Dr Mike Nahan; Chairman

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**Mr J.H.D. DAY:** I suppose one issue would be the quantity available that we could purchase.

**Mr E.S. RIPPER:** And the design of the scheme. If it is a fixed-price scheme, it would make it a bit harder, but eventually the intention is to move to an emissions trading scheme.

**Dr M.D. NAHAN:** Further to the Leader of the Opposition's comment about offsets, I understood that people were offering to plant trees and other things in the South West some years ago, and that overseas firms, such as Mitsubishi and others, had put money into tree plantations to offset their obligations to mitigate carbon. Is the minister aware of any of that going on in the state?

**Ms S. In't Veld:** The member is quite right; there were groups of people who were looking at planting trees, growing algae and doing all sorts of other things to tap into this market, but until there is actually an emissions trading scheme in place that creates a market for the permits, it is of no relevance.

**Mr B.S. WYATT:** I refer to page 617. The asset investment program shows a significant decline across the forward estimates. In light of the earlier comments about debt, it is no surprise that the asset investment program is declining. Why is there such a substantial decrease in the asset investment program for Verve? Is it simply because, as Ms In't Veld said, there is no need to build baseload power until 2018?

**Ms S. In't Veld:** There are two reasons. One is that because we have had such a huge amount of new baseload power come in with new entrants—Bluewaters I and II and the NewGen power station in Kwinana—we are facing a situation in which Verve has 800 megawatts of spare baseload capacity. In fact, on a day like today, we would be operating at 1 300 megawatts capacity at 10 o'clock in the morning, when there is almost 3 000 in our portfolio. It is a combination of new entrants coming into the market and Verve having spare baseload, so there has been no need to build new plant. I should also add that it is complicated by the fact that the uncertainty of the carbon situation would make it very difficult to decide what sort of plant we would build.

**Mr J.H.D. DAY:** As Ms In't Veld said, there is effectively a lot of spare capacity for baseload generation in the south west of the state at the moment, and that is a consequence of the disaggregation of the former Western Power. That is fine on the basis of a theoretical model, but it has resulted in private sector organisations being able to establish baseload generation capacity that has to somehow be paid for. All this extra generation capacity, of which a lot is unused at the moment, has to be paid for somehow. That has clearly been a factor in increasing the price of electricity.

**Mr E.S. RIPPER:** It is also an incentive for Verve to be more efficient, is it not, minister? The minister has clearly recognised, with the government's efficiency dividend, the scope for that to occur within Verve.

**Mr J.H.D. DAY:** Maybe, but it probably could have been even more efficient and there probably would have been even more downward pressure on electricity prices—that is a phrase that was used in debate in Parliament quite a lot several years ago—if the disaggregation had not occurred and if we did not have all the spare and often unused capacity that is there at the moment.

**Mr E.S. RIPPER:** I think the minister will find that he is very lonely in the energy sector in holding that opinion.

**The CHAIRMAN:** You go through the Chair, Leader of the Opposition; this is not a chat fest.

**Mr J.H.D. DAY:** I am not lonely as far as the views of the Premier are concerned; I think the Leader of the Opposition knows what his views are on all that.

**Mr E.S. RIPPER:** No, the minister and the Premier are twins on this issue!

**The CHAIRMAN:** Leader of the Opposition, do you have a question?

**Mr E.S. RIPPER:** The managing director made reference to the difficulty of obtaining new gas. Perhaps we could have some further information on that. When was the last time that Verve signed a contract for new gas? What gas contracts are we operating on at the moment? New projects are supposedly coming on that are going to provide domestic gas; has Verve been able to obtain any of that domestic gas?

**Ms S. In't Veld:** We signed a 15-year gas contract in 2004–05 with North West Shelf. That is the contract I referred to earlier. We believe we will have utilised all the volume under that contract by about 2015–16. That is our sole supplier of gas.

**Mr E.S. RIPPER:** You have signed no contracts since that 2004–05 contract?

**Ms S. In't Veld:** We have not needed to, because it has provided 100 per cent of our gas requirements, so it is only when that contract rolls off that we will be in a position in which we will need gas to replace that. We have been having lengthy discussions with the Gorgon joint venturers to source gas from the Gorgon project, and also with the other producers, North West Shelf and Woodside. We have made inquiries about the Macedon and

Mr Eric Ripper; Mr John Day; Mrs Liza Harvey; Mr Chris Tallentire; Mr Ben Wyatt; Dr Mike Nahan; Chairman

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Browse projects, but we have been unable to source gas in the quantities and for the terms that we have needed to date.

**Dr M.D. NAHAN:** Is Verve considering trying to get a similar long-term contract for gas, or will it go for a shorter and more rollover gas contract?

**Ms S. In't Veld:** Our preference is for long-term contracts and to lock in pricing as much as we can, but it all depends on the willingness of the producers to do that.

**Mr E.S. RIPPER:** We had some discussion on Muja A and B. Can the minister tell us about the current status of that refurbishment and when it is likely to be completed?

**Ms S. In't Veld:** Muja A and B is a 50–50 joint venture with a new entrant in the market, and the joint venture party is providing all the capital for the refurbishment process. The refurbishment of those four units is well underway, and baghouses are currently being installed. We expect commissioning of unit 4, which is the first unit to be commissioned, to take place in January next year. We expect all four units to be fully commissioned by the end of 2012, so the project is going well.

**Mr E.S. RIPPER:** How is the revenue shared, given the nature of that arrangement?

**Ms S. In't Veld:** It is shared 50–50.

**Mr C.J. TALLENTIRE:** I am curious to know about the level of risk that the partner is exposed to; is it the case that if there was a problem with that project, the risk would be worn solely by Verve and not by the partner?

**Ms S. In't Veld:** No, the risk is fully borne by our joint venture partner, Inalco Kempe Engineering.

**Mr E.S. RIPPER:** What will be the total payments to Verve directors in the forthcoming financial year? What is the payment for a Verve director, and how many of them are there?

**Mr J.H.D. DAY:** That information is published in the annual report.

**Ms S. In't Veld:** It is far less than the private sector; it is in the order of \$50 000 for each non-executive director and, I think, in the order of \$120 000 for the chairman. But that information is publicly available in our annual report. We have four non-executive directors and the chairman.

**Dr M.D. NAHAN:** In 2007–08, Verve and the other utilities faced huge problems in acquiring skilled labour and costs started going up. Is Verve still experiencing that now?

**Ms S. In't Veld:** We still have a lot of difficulty attracting the engineering expertise we need for our operations, but we have found that a very good way of dealing with that is to recruit from South Africa and the UK; we have been able to get very good engineers from South Africa and the UK. We were previously getting engineers from the eastern states, but they did not always stay, whereas those coming from South Africa and the UK tend to stay. But it is a challenge for us, because we cannot compete with the oil and gas sector with remuneration.

*Meeting suspended from 6.00 to 7.00 pm*