



# **STATEMENT OF CORPORATE INTENT**

**2011-2012**

**Verve Energy is the leading generator of electricity in Western Australia, contributing to the wealth and welfare of the State, its people and businesses by providing safe, reliable, secure and competitive energy.**

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**STATEMENT OF CORPORATE INTENT**

This Statement of Corporate Intent (SCI) is prepared in accordance with Part 5 of the *Electricity Corporations Act 2005*.

This document reflects the business intentions of the Electricity Generation Corporation, trading as Verve Energy, for the 2011/12 financial year.

Consistent with the requirements of section 99 of the Act, this SCI outlines the objectives, functions, main undertakings and performance targets for the year, the community service obligations required of the business, the dividend and accounting policies to apply and the information to be provided to the Minister.

The SCI is consistent with the Corporation's Strategic Development Plan (SDP) 2011/12 to 2015/16. The SDP sets out Verve Energy's economic and financial objectives and operational targets over the medium term, and the commercial strategies and initiatives it will pursue.

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## 1. SUMMARY

A strong, profitable Verve Energy is essential to maintaining electricity supply security and a flourishing Wholesale Electricity Market.

To realise its vision of being the leading electricity generator in WA, Verve Energy needs to achieve:

- a strong cash flow;
- returns consistent with good commercial practice;
- solid profits;
- sustainable business growth; and
- cost-effective investment in efficient, competitive plant.

A fundamental need is that Verve Energy receives appropriate payment for its products. This will only be achieved if:

- electricity sales contracts are, or continue to be, negotiated and priced on sound commercial terms;
- ancillary services including balancing, are appropriately priced; and
- the Wholesale Electricity Market Rules provide for a fair, equitable and stable market environment.

The financial performance of Verve Energy in 2011/12, is expected to be robust reflecting the fact that existing major bilateral sales contracts have now been negotiated on commercial terms. In addition, a significant increase in forecast total energy demand on the South West Interconnected System (SWIS) will enable an improvement in the utilisation of Verve Energy's generation portfolio during 2011/12. This improvement is further enhanced by the introduction of High Efficiency Gas Turbines (HEGTs) at Kwinana from October 2011 which will reduce the operation of older and less efficient plant that currently undertake peaking and mid merit generation duties on the SWIS.

During 2011/12 Verve Energy will introduce into service Grasmere wind farm (14MW) and Greenough River solar photovoltaic farm (10MW stage 1). Verve Energy's commitment to work toward achieving a long term reduction in its carbon footprint will be reinforced with the continued development of Mumbida wind farm with a joint venture partner for possible introduction into service during 2012/13.

Verve Energy will continue to exert stringent cost control, but with the biggest cost pressures being fuel, depreciation and interest, the impact on the bottom line of reductions in controllable costs is limited.

Key business risks to be managed in 2011/12 include:

- decreasing gas supply security;
- coal supply arrangement uncertainty;
- ageing plant and workforce;
- excess base load on the electricity system combined with inherently low overnight loads on the SWIS, increased penetration of intermittent wind farm generation and Verve Energy's current role of provider of balancing

and ancillary services, leads to accelerated deterioration and reduced efficiency of thermal plant due to frequent starts and low capacity factors;

- if the significant increase in forecast total SWIS energy requirements does not ultimately fully materialise; and
- obligations under the Market Rules that require Verve Energy to provide balancing and ancillary services.

Verve Energy will target eight strategic areas in 2011/12:

- customise investment and operational strategy for each power station based on its current and potential contribution to the value of the business and undertake feasibility for potential new plant investment;
- profitably participate in competitive energy markets;
- concentrate on recruiting, developing and retaining the right people in the right places with the right skills, incentives and leadership, with safety as the overarching core value;
- optimise our financial structure and continually improve our work practices;
- review and reform processes, systems and procedures, to ensure efficient and effective business support mechanisms;
- seek revenue diversification opportunities through developing new products and new markets, and providing innovative energy solutions to customers;
- improve our environmental performance and work towards a long term goal of reducing our carbon footprint and be socially responsible; and
- build and maintain constructive and productive relationships with all stakeholders.

## 2. THE BUSINESS

Verve Energy is the largest generation business in the State. It is unique among Western Australian generation companies in that it has a diverse portfolio of generating plant utilising a variety of fuel sources: coal, gas, oil, diesel, biofuels, wind and solar. It operates at all levels of the merit order in the competitive Western Australian Wholesale Electricity Market: base load, intermediate (mid-merit) and peak.

Verve Energy's core business in 2011/12 will continue to be the reliable and efficient generation of electricity.

Verve Energy currently owns or controls about 61% of the thermal and around 10% of the renewable generation capacity on the South West Interconnected System (SWIS)<sup>1</sup>. Verve Energy's share of the total thermal generation capacity on the SWIS will remain close to this level in 2011/12 with the introduction of two High Efficiency Gas Turbines (HEGTs) at Kwinana largely offsetting the reduction in capacity resulting from the retirement of Kwinana A generation units. Renewable generation capacity share will fall to 9% despite the planned introduction of the Greenough River solar and Grasmere wind farms, due to the commissioning of Collgar wind farm.

Verve Energy's existing electricity products include energy sales, capacity credits, ancillary services and renewable energy or environmental rights. It is likely to remain the primary provider of balancing and ancillary services during 2011/12. Verve Energy also engages in sales, swaps and purchases of natural gas, gas transport capacity and gas storage.

Synergy is by far Verve Energy's biggest electricity customer. Around 74% of the electricity generated in 2011/12 will be supplied to Synergy under bilateral contracts. From October 2010, the Replacement Vesting Contract 2010 replaced the previous Vesting Contract established between the parties at disaggregation under the *Electricity Corporations (Vesting Contract) Order 2006*.

## 3. STATUTORY FRAMEWORK

The Electricity Generation Corporation (trading as Verve Energy) is established under the *Electricity Corporations Act 2005* (the Act), which specifies its powers, functions and operational restrictions. It is not an agent of the State, nor is it a public sector organisation under the *Public Sector Management Act 1994*.

Verve Energy is governed by a Board of Directors, directly responsible to the Minister administering the Act. This is currently the Minister for Energy (the Minister), who is also responsible for energy policy, including market policy, and the development of energy sector regulation. The Directors are also subject to the *Statutory Corporations (Liability of Directors) Act 1996*.

The functions of Verve Energy are set out in section 35 of the Act and are listed in Appendix 1. Section 61 of the Act requires Verve Energy to act in accordance with prudent commercial principles and endeavour to make a profit consistent with maximising its long term value. However, the effect of section 61 is linked to other provisions of the Act.

Within the State but outside the SWIS, the Act restricts Verve Energy from owning any generating plant other than that using 100% renewable sources, although it may operate plant for the Regional Power Corporation (Horizon

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<sup>1</sup> Based on IMO capacity credit allocations for 2010/11 capacity year

Power). Section 38 of the Act also prohibits Verve Energy from retailing electricity directly to users before 2013, except as authorised by the Minister. The Minister has discretion to extend this prohibition until 2016. Parts 4 and 5 of the Act provide for the Minister to prescribe contracts or make directions that may be contrary to the commercial interest of the business.

#### 4. VISION AND VALUES

The corporate vision is that Verve Energy will be recognised as a vibrant, innovative energy business by being commercially, socially and environmentally successful.

A culture will be built and maintained that values:

- **People**
  - We live and work safely.
  - We treat each other with respect and dignity.
  - We guide and inspire others.
  - We create opportunities for personal growth.
  - We challenge poor performance and reward outstanding performance.
  - We encourage a balanced lifestyle.
- **Integrity**
  - We are ethical and honest in all our dealings.
  - We deliver on our promises and meet our obligations.
  - We are individually and collectively accountable for our behaviour and actions.
- **Performance**
  - We continuously pursue best business practice.
  - We eliminate inefficiency and waste.
  - We achieve our targets and celebrate our successes.
  - We act commercially to earn fair profits and grow our business.
- **Environment and Community**
  - We conduct our business in an environmentally responsible way.
  - We respect and value the communities in which we operate.
  - We create a valuable legacy for future generations.

#### 5. CORPORATE OBJECTIVES

Verve Energy's objective for 2011/12 is to achieve and maintain:

- a strong cash flow;
- returns and balance sheet performance consistent with good commercial practice;
- solid profits;
- sustainable business growth; and
- efficient, competitive plant.

It will do this through targeting eight key strategic areas:

- **Plant** - customise investment and operational strategy for each power station based on current and potential business value;
- **Trading and fuel** - profitably participate in competitive energy markets;

- **People** - recruit, develop and retain the right people in the right places with the right skills, incentives and leadership, with safety as the overarching core value;
- **Value creation** - optimise the financial structure and continually improve work practices;
- **Business support** - review and reform processes, systems and procedures to ensure efficient and effective business support mechanisms;
- **Business development** - seek revenue diversification opportunities by developing new products, new markets (which includes increased marketing of overnight energy) and providing innovative energy solutions to customers;
- **Environment and community** - improve our environmental performance, with a view to working towards a long term goal of reducing our carbon footprint and be socially responsible; and
- **Relationships and influence** - build and maintain constructive and productive relationships with all stakeholders.

## 6. PERFORMANCE TARGETS

The table below shows Verve Energy's forecast performance for 2011/12. The terms used in the following table are explained in Appendix 2.

	<b>2011/12</b>
<b>Financial Performance</b>	
Earnings Before Interest & Tax (\$m)	192.2
Net Profit After Tax (\$m)	87.4
Return On Capital Employed (%)	12.9
Operating Cash Flow (\$m)	263.4
Gross Profit Margin (%)	24.0
<b>Operational Performance</b>	
Safety - MTIFR	<30
Safety - LTIFR	0
Worksafe Breaches	0
Environmental Incidents	0
Water Licence Incidents	0
Market Rule Breaches	0
Electricity Sales (GWh) <sup>2</sup>	11,503
Plant Availability (%)	89.2
Forced Outage Factor (%)	2.0
Portfolio Capacity Factor <sup>3</sup> (%)	36.6
Fuel Diversity of Thermal Plant (% input)	
Coal	63.9
Gas	35.2
Liquids	0.9

<sup>2</sup> Including PPAs

<sup>3</sup> As a business strategy, Verve Energy will seek loads that enable a high capacity factor to be achieved for plant that is least expensive to operate (baseload coal and combined cycle GT), but a low capacity factor for plant that is expensive to operate (oil-fired peaking plant).

Biomass	0.0
Portfolio Thermal Efficiency (%) <sup>4</sup>	31.8
Greenhouse Gas Emissions (MtCO <sub>2</sub> e) <sup>5</sup>	9.1
Carbon Intensity (tCO <sub>2</sub> e/GWh s/out) <sup>6</sup>	883
Renewable Energy Sentout (GWh)	91
Corporate Reputation Index (%)	65

As announced by the Government on 19 May 2011, Verve Energy has been requested to implement a series of savings initiatives designed to meet a 5% efficiency dividend between 2011/12 to 2014/15. The savings targeted for 2011/12 is \$14.4 million. This would increase the forecast EBIT displayed in the above table to \$206.6 million and provide for an associated increase in payments to government and a reduction in net debt.

## 7. NATURE AND SCOPE OF FUNCTIONS

Verve Energy's core functions during 2011/12 will be the efficient and competitive generation and trading of electricity. Verve Energy currently owns a generating portfolio of 2,952<sup>7</sup> MW, with a mix of both fossil fuel plant and renewable plant in the SWIS.

It will continue to operate major power stations at Muja, Collie, Kwinana, Cockburn and Pinjar, with smaller facilities at Geraldton, Kalgoorlie, Mungurra, Worsley and Albany.

During 2011/12 two 100 MW HEGTs will be commissioned and Kwinana A will be retired. These changes will result in the non-renewable generation portfolio remaining below the 3,000 MW generation cap directed by the Minister at disaggregation. In addition two new renewable energy projects will begin operations during 2011/12 with the commissioning of the 14MW Grasmere wind farm at Albany and the 10 MW Greenough River solar farm.

Verve Energy has established Power Purchase Agreements (PPAs) totalling 421 MW with a number of Independent Power Producers.

In addition to its SWIS plant, Verve Energy owns renewable and hybrid plant totalling 9.3 MW at various regional locations outside the SWIS under power purchase agreements with Horizon Power.

In 2011/12, about 74% of Verve Energy's generation and electricity purchases will be supplied to Synergy. The remainder will be committed to bilateral contracts with other Retailers, traded in the Short Term Electricity Market and used to provide balancing and ancillary services.

Verve Energy will seek to increase its bilateral contract sales by competing for attractive electricity loads within the limits of its capacity cap and market support obligations.

<sup>4</sup> Including PPAs

<sup>5</sup> Including PPAs.

<sup>6</sup> Including PPAs

<sup>7</sup> Nameplate capacity at 15°C and 1 atmosphere of pressure as at 1 July 2010

Verve Energy is developing its fuel trading business through sales, swaps and purchases of gas, gas transport capacity and gas storage. It is also seeking opportunities to diversify its revenue stream in areas such as service provision and commercialising specific expertise.

## **8. MAIN UNDERTAKINGS 2011/12**

### **8.1 Strategic Focus Area 1: Plant**

*Customise the investment and operational strategy for each power station based on current and potential business value*

- 8.1.1 Increase return on assets through improved utilisation of existing assets (including increased plant availability particularly for base load plant), inventory management and asset development.
- 8.1.2 Review generation portfolio and develop a portfolio realignment plan to increase efficiency and decrease carbon intensity.
- 8.1.3 Investigate the commercial merits of proven technologies to make better use of our off-peak capacity and prepare the portfolio for greater penetration of intermittent renewable generation.
- 8.1.4 Continue to implement the new asset management and plant maintenance regime to restore plant condition.
- 8.1.5 Reduce forced outage factors and minimise capacity credit refunds.
- 8.1.6 Improve fuel efficiency and leverage existing fuel contracts.
- 8.1.7 Undertake business-wide energy efficiency opportunities assessment consistent with the requirements of the *Energy Efficiency Opportunities Act (Cwlth) 2006*.
- 8.1.8 Work with Government and industry on improving peak demand management.

### **8.2 Strategic Focus Area 2: Market**

*Profitably participate in competitive energy markets.*

- 8.2.1 Submit commercially prudent bids to retailers seeking new power supplies where this is compatible with Verve Energy's portfolio profile and business objectives.
- 8.2.2 Renegotiate existing contracts where necessary to bring terms in line with appropriate commercial practice.
- 8.2.3 Review balancing and ancillary services prices to ensure they incorporate due recognition of market risk and provide an appropriate commercial return in the absence of a competitive market for these services. Review pricing against the principles published by CIGRE (International Council on Large Electric Systems).
- 8.2.4 Ensure forward carbon pricing is used in all capital expenditure decisions and carbon price pass-through provisions are included in all electricity sales contracts.
- 8.2.5 Continue to purchase energy from other generators where it is economically efficient to do so.
- 8.2.6 Focus on increasing off-peak sales volume to better match production capability.
- 8.2.7 Maintain fuel trading activities to ensure profitability through sales, swaps and purchase of gas, gas transport capacity and gas storage.

- 8.2.8 Develop and market total energy solutions that offer customers power security and reliability.

### **8.3 Strategic Focus Area 3: People**

*Recruit, develop and retain the right people in the right places with the right skills, incentives and leadership, with safety as the overarching core value.*

- 8.3.1 Continued implementation of the safety strategic plan developed in the 2009/10 year.
- 8.3.2 Continue to develop a long-term human resources strategy, focusing on staff development and retention issues.
- 8.3.3 Implement a multi-faceted approach to drive cultural change, recruit and retain appropriately skilled and experienced staff, and create a performance-focused, commercially aware workforce.
- 8.3.4 Ensure negotiated Certified Agreements remain appropriate as the basis for a single enterprise-based remuneration structure.
- 8.3.5 Continue the successful graduate program, training graduates in all aspects of the business and offering attractive career paths.
- 8.3.6 Continue to extend recruitment efforts in WA, across Australia and overseas to attract skilled, enthusiastic and motivated professional staff.
- 8.3.7 Ensure that the size and composition of the workforce is aligned with our reduced plant and energy production, and is benchmarked against similar businesses.

### **8.4 Strategic Focus Area 4: Value Creation**

*Optimise the financial structure and continually improve work practices.*

- 8.4.1 Ensure the balance sheet provides a sound foundation for investment and prudent growth.
- 8.4.2 Review the current mix of insourcing and outsourcing and adjust as appropriate for the best commercial outcome.
- 8.4.3 Realise the value of assets that are surplus to requirements.

### **8.5 Strategic Focus Area 5: Business Support**

*Review and reform processes, systems and procedures to ensure efficient and effective business support mechanisms.*

- 8.5.1 Review and reform business support services across the business.
- 8.5.2 Consolidate the current business structure to better manage risks, integrate operations and exploit opportunities.
- 8.5.3 Simplify and streamline procedures, policies and systems.
- 8.5.4 Review and reform the internal KPI framework to measure progress towards strategic outcomes and support business decisions, and develop an appropriate benchmarking strategy for key business performance indicators.
- 8.5.5 Improve business decision support systems.
- 8.5.6 Continuously refine and implement the Risk Management Framework and integrate risk management into key processes.

## **8.6 Strategic Focus Area 6: Business Development**

*Seek revenue diversification opportunities through developing new products and new markets, and providing innovative energy solutions to customers.*

- 8.6.1 Seek partnerships and alliances with compatible businesses.
- 8.6.2 Actively seek market opportunities for Verve Energy expertise and intellectual property and displaced generation capacity.
- 8.6.3 Engage in secondary markets, for example transport capacity and fuel trading.
- 8.6.4 Develop markets for waste products such as flyash, carbon, subject to Government approval.

## **8.7 Strategic Focus Area 7: Environment and Community**

*Improve Verve Energy's environmental performance and work towards a long-term goal of reducing our carbon footprint and be socially responsible.*

- 8.7.1 Take a leading role in sustainable energy development through:
  - a) being a purchaser of renewable technology IP and focus on the funding, development approvals and project development for new renewable projects; and
  - b) continuing to keep a watching brief on other renewable energy technologies such as solar, wave, geothermal and bioenergy technologies as they develop.
- 8.7.2 Develop and expand the renewable energy portfolio as financial capacity and market opportunities allow, including:
  - a) seek funding in addition to the \$70 million approved by the Government for construction of new renewable projects that have been subject to feasibility studies; and
  - b) conduct feasibility studies for development of new renewable projects that are consistent with delivering efficient portfolio generation outcomes for both Verve Energy and the SWIS.
- 8.7.3 Continue to implement Verve Energy's Environmental Policy and Water Strategy, and ensure staff participate in environmental awareness programs.
- 8.7.4 Verve Energy recognises that the introduction of commercial clean coal technology with carbon capture and storage (CCS) may be essential to substantially reducing carbon emissions in WA in the long term. Verve Energy is a key industry partner in the development studies of a carbon storage site in the Lesueur Basin.
- 8.7.5 Implement a Sustainable Practice Strategy consistent with industry practice and international standards.
- 8.7.6 Increase staff awareness of the financial and environmental benefits of improving energy efficiency, and facilitate initiatives in this area.
- 8.7.7 Actively participate in community/industry liaison groups.
- 8.7.8 Continue to support community values, including sponsorship of opportunities and events as appropriate.
- 8.7.9 Encourage community leadership roles among Verve Energy personnel.

## 8.8 Strategic Focus Area 8: Relationships

*Build and maintain constructive and productive relationships with all stakeholders.*

- 8.8.1 Establish and maintain effective stakeholder communication and engagement processes.
- 8.8.2 Actively participate in industry and relevant community forums.
- 8.8.3 Build understanding and support for the business activities in "neighbour" communities like Collie, through outreach programs, including promotional tours and provision of information (eg school and community presentations).
- 8.8.4 Encourage and contribute to debate about energy policy.
- 8.8.5 Build and maintain constructive and productive relationships with Government in its role as owner to achieve commercial objectives.
- 8.8.6 Work with Government in its role as policy maker and regulator to:
  - a) ensure that as competition develops, the Market Rules are amended so that Verve Energy is able to participate on equal terms with other market participants;
  - b) identify and calculate the impact of market development obligations imposed on Verve Energy through Wholesale Electricity Market Rules, Ministerial Directions and other instruments of Government policy;
  - c) continue to support market reform through assisting Government to make legislation, regulation, policies and market rules that are efficient, non-discriminatory and that deliver appropriate incentives for sustainable investment; and
  - d) inform the Government when electricity market policy, decisions and outcomes may have the impact of degrading the operation of Verve Energy's key generating plant to the extent that the value of these State assets are materially reduced and/or wholesale electricity prices on the SWIS will be adversely affected.

## 9. DIVIDEND POLICY

Consistent with the performance targets, dividends are agreed annually with the Government according to the profit results. Verve Energy accepts the Government's policy of a dividend rate of 65%, to be paid from after tax profits.

## 10. ACCOUNTING POLICIES AND GOVERNANCE STANDARDS

Verve Energy's accounting policies are consistent with Corporations Law requirements. Financial statements adopt the historic cost convention and reflect the accrual basis of accounting. Consistent with the State Budget, the projected financial outlook is in accordance with the International Financial Reporting Standards.

In addition, the following guidelines and standards are considered to be most relevant to Verve Energy's corporate governance practice:

- Government of Western Australia: Corporate Governance Guidelines for Western Australian Public Sector CEOs.
- Australian Standard: AS 8000-2003: Good Governance Principles.

- Australian Standard: AS 3806-1999: Compliance Programs.
- Australian Standard: AS 4360-2004: Risk Management.
- Australian Stock Exchange Corporate Governance Council: Principles of Good Corporate Governance and Best Practice Recommendations (“ASX Guidelines”).

Although Verve Energy is not obliged to comply with the ASX Guidelines, the business has committed to adopt best practice principles and practices that are in the best interests of its stakeholders.

## **11. MINISTERIAL REPORTING**

To meet the reporting requirements as outlined in the Act, Verve Energy will provide the Minister with a quarterly report, for the first three quarters, and an annual report for the whole financial year.

Each *Quarterly Report* will be submitted one month after the end of the quarter. It will include:

- an overview of performance including specific performance indicators;
- highlights of important achievements; and
- consolidated financial statements with relevant accompanying notes.

The following additional confidential information will be provided:

- on a quarterly basis, for the profit and loss statement, a summary of key variances to year-to-date budget with accompanying commentary; and
- on an annual basis, within three months of the end of the financial year, a schedule comparing actual capital expenditure against budgeted capital expenditure, by project.

The *Annual Report* will follow the end of the financial year and will be provided to the Minister within the time specified by the Act. It will include:

- consolidated statutory financial statements;
- other statutory information required of any company under the Corporations Law;
- an overview of major achievements and an appraisal of future prospects;
- a comparison of performance with the SCI targets; and
- other information required by the Act to be included, such as the particulars of any directions given by the Minister.

In addition to quarterly and annual reports, the Minister will be provided with:

- a five-year SDP and a one-year SCI;
- a report on staff compliance with any Board issued codes of conduct; and
- any information in Verve Energy’s possession requested by the Minister.

In communicating with the Minister, a formal protocol has been developed with the Minister's Office covering comprehensive communications with the Minister. The protocol is consistent with the Act and the *Public Sector Management Act 1994*. It seeks to ensure that the Minister is provided with information that is factual, timely and reflect the best information available at the time. Consistent with the requirements of the Act, Verve Energy will consult the Minister on items of significant public interest.

## 12. NATURE AND EXTENT OF COMMUNITY SERVICE OBLIGATIONS

Section 99(1) of the Act defines "community service obligations" as "*obligations to perform functions or to meet performance targets that it is not in the commercial interests of the corporation concerned to perform or meet*".

Verve Energy is subject to a number of obligations that are not in its commercial interests. These are primarily transitional obligations imposed on Verve Energy to facilitate the development of the electricity market.

It has been the Government's view that until the market is more fully developed, Verve Energy should be subjected to specific market power mitigation measures in addition to existing trade practices legislation.

These obligations reduce Verve Energy's ability to act on commercial principles, and, in the case of the fixed tariffs combined with the previous Vesting Contract netback pricing arrangement, have had a significant negative impact on Verve Energy's financial position since disaggregation. Verve Energy's position improved significantly from 2009/10 as Verve Energy was paid a reasonable price under the Vesting Contract due to the increases to the retail tariffs and the provision of a Community Service Obligation payment to Synergy that covered the difference between the cost reflective tariffs and the glide path chosen by Government. Following the outcomes from the Oates Review, from October 2010, the Vesting Contract has been replaced by the Replacement Vesting Contract (ES10) that is a simpler more transparent bilateral contract negotiated on commercial terms. The remaining other non commercial obligations are described in Section 13 below.

## 13. OTHER NON-COMMERCIAL OBLIGATIONS

**3,000 MW capacity cap** – In 2006, the Minister issued a Direction imposing a cap on Verve Energy's non-renewable generating capacity in order to mitigate Verve Energy's market power in the generation market. Unless the policy in relation to the cap changes, Verve Energy cannot invest in new capacity other than generation that is solely fuelled by renewable sources until plant retirements bring it below the cap, and can then invest only to the extent the cap is not exceeded. Verve Energy will therefore not commission new plant until Kwinana A (240 MW) is decommissioned in 2011.

No expiry date has been set for the cap, which hinders Verve Energy's ability to exploit commercial opportunities and grow the revenue base. While this constraint is contrary to Verve Energy's commercial interests, it imposes an opportunity cost rather than a direct cost to the business. Verve Energy believes that it will continue to play an important role in ensuring the security of energy supply to the SWIS into the future, and therefore this may require the removal of the capacity cap in due course, subject to Government approval and the wider operation of the market.

**Prohibition on retailing of electricity** – The Act prohibits Verve Energy from supplying electricity to a customer for the customer’s own use until 2013 (extendable to 2016), other than as authorised by the Minister. This means that large customers, who do not wish to purchase through a third party retailer, are prevented from purchasing power from Verve Energy. Verve Energy may be prevented from maximising value from its portfolio, especially its base load assets by selling to large wholesale customers as opposed to end users directly. The prohibition on retailing of electricity is currently under review as per the requirements of the Act.

**Market support** – In the absence of a competitive balancing market, Verve Energy is responsible for compensating for any mismatch between supply and demand in the market. This may mean either turning down or switching off its own plant when there is an oversupply by other participants, or turning up or burning liquids on peak days when other generators are unable to meet their demand.

Verve Energy’s experience to date has seen its base load portfolio being switched off for extended periods. This outcome has been exacerbated by a current oversupply of base load plant on the SWIS. When combined with the growing penetration of intermittent wind generation, this means that some of Verve Energy’s base load generating units are frequently switched off or operate at less efficient reduced capacity (especially over night). The frequent stop – start operating regime of the base load units increases maintenance cost requirements and reduces the life expectancy of the plant.

The cost to Verve Energy of the market support obligation is significant and detracts from its ability to engage in the market on equal terms with other market participants. The actual cost varies because it depends on the intricate relationship between demand, available capacity from all market participants and the behaviour of market participants. The key issue is the high level of risk that Verve Energy must accept under the Market Rules, which requires pricing to be set to short run marginal cost and fixed the previous day.

Following the outcomes of the Oates Review and the IMO review on market rules, Verve Energy may be relieved of some of these obligations through increased competition for these services. Verve Energy expects that it will continue to be a major provider of balancing services even with a competitive balancing market.

## APPENDIX 1 - STATUTORY FRAMEWORK

The Electricity Generation Corporation, trading as Verve Energy, is established under Section 4 of the *Electricity Corporations Act 2005* (the Act). Section 8 of the Act specifies the composition of the Board of Directors, and Section 9 provides that the Board is to perform the functions, determine the policies and control the affairs of the corporation, subject to the Act and accountable to the Minister. The Directors are subject to the *Statutory Corporations (Liability of Directors) Act 1996*.

Section 15 of the Act provides that, subject to the control of the Board, the Chief Executive Officer (CEO) is responsible for, and has the powers needed, to administer the day-to-day operations of the business.

Verve Energy's principal functions are set out in Section 35 of the Act as:

- a) *to generate, purchase or otherwise acquire, and supply electricity from sources of energy including renewable sources;*
- b) *to acquire, transport and supply:*
  - (i) *gas; and*
  - (ii) *steam;*
- c) *to acquire, develop, operate and supply energy efficient technologies;*
- d) *to provide ancillary services;*
- e) *by agreement with the Regional Power Corporation:*
  - (i) *to provide consultative and advisory services to that corporation in relation to electricity generation; and*
  - (ii) *to operate and maintain any electricity generation plant or equipment on behalf of that corporation; and*
- f) *to undertake, maintain and operate any works, system, facilities, apparatus or equipment required for any purpose mentioned in this section.*

Section 56 gives the corporation discretion over how, when and if it performs any of the functions given to it by the Act. It is subject to independent monitoring of its financial performance as part of its statutory obligations.

Within the State but outside the SWIS, the Act restricts Verve Energy to owning only generating plant that uses 100% renewable sources, although it may operate plant for the Regional Power Corporation (Horizon Power). Section 38 of the Act also prevents Verve Energy from retailing electricity before 2013, except as authorised by the Minister. The Minister has discretion to extend this prohibition until 2016.

Section 61 of the Act requires Verve Energy to act in accordance with prudent commercial principles and endeavour to make a profit consistent with maximising its long term value. However, this obligation may be over-riden by the Minister through prescription of contracts under Section 82 of the Act, by direction under Section 111 of the Act (subject to consultation with the Treasurer) or by direction under Section 114 of the Act.

Under Section 68 of the Act, Verve Energy is obliged to obtain Ministerial approval before entering into any commercial contracts with a value exceeding the greater of \$20 million or 1% of the written down value of its assets. An agreement between the Minister and the Treasurer means that the Treasurer's approval is also required for such contracts. An exemption has

been granted for electricity and fuel transactions with a value of up to 2.5% of the written down value of assets and investments (currently \$42 million).

Verve Energy is granted certain powers and obligations under the *Energy Operators (Powers) Act 1979* and the *Electricity Industry Act 2004*. The latter includes licensing obligations and conditions administered by the Economic Regulation Authority.

Verve Energy will continue to be exempted from the *Energy Efficiency Opportunities Act 2006 (Cwlth)* after the exemption period was extended until 30 June 2013 in mid 2009.

In common with other Government Business Enterprises established by statute, Verve Energy is a "Schedule 1 Entity" under the *Public Sector Management Act 1994*. This specifically exempts it from many policies and legislative provisions applicable to public service departments and general public sector agencies. These exemptions exist in recognition of the need for commercial government business enterprises to operate from a position of competitive neutrality in competitive markets. This commitment to competitive neutrality for Government Business Enterprises is a key element of the Competition Principles Agreement, to which Western Australia is a signatory. There are however, some areas, such as staff management, where the Board is to have regard for the principles set out in the *Public Sector Management Act*.

Verve Energy's activities are subject to legislation and regulations covering:

- licensing obligations and conditions;
- environmental standards;
- occupational health and safety;
- electricity safety standards;
- industrial relations;
- trade practices;
- corporate governance and accounting standards;
- wholesale electricity market rules; and
- network access requirements.

## APPENDIX 2 EXPLANATORY NOTES CONCERNING KEY PERFORMANCE INDICATORS

KPI	Explanation
<b>Financial Performance</b>	
Earnings Before Interest and Tax (EBIT)	Measure of operating profitability or cash generated by the business regardless of capital structure (interest payments) or taxes - i.e. the difference between the operating income and operating expenditure.
Net Profit After Tax (NPAT)	Measure of profits of business operations - i.e. what remains after subtracting all the costs including depreciation, interest, and taxes from total revenue.
Return on Capital Employed (ROCE)	Measure of capital return, i.e. how much profit a company generated for each \$1 in capital employed (shareholder' capital plus short and long-term borrowed funds), calculated as: EBIT/ (Total Assets – Current Liabilities – Non-Interest Bearing Liabilities).
Operating Cash Flow	The amount of cash generated from operating activities, excluding costs associated with investment on capital items.
Gross Profit Margin	Measure of operating margin, i.e. how much profit a company makes (before subtracting depreciation, interest and taxes) on each dollar of revenue earned, calculated as: EBITDA / Total Revenue.
<b>Operational Performance</b>	
Safety - MTIFR	Medical Treatment Injury Frequency Rate – amount of medical attention injuries per one million working hours.
Safety - LTIFR	Lost Time Injury Frequency Rate – amount of lost time injuries per one million working hours.
Worksafe Breaches	Proven breaches of occupational health and safety legislation.
Environmental Incidents	Proven breaches of environmental protection legislation.
Water Licence Incidents	Proven breaches of conditions of water licences.
Market Rule Breaches	Proven breaches of market rules resulting in penalties.
Electricity Sales	Total electricity sales to customers sourced from both internal generation and purchases from other power producers.
Plant Availability	Measure of the percentage of energy a generating unit could deliver in any given period operating continually at full load.

Forced Outage Factor	Measure of plant reliability, i.e. the impact of unscheduled plant outages resulting in market penalties. Reductions in FOF are made possible by increases in Maintenance Outage Factor.
Portfolio Capacity Factor	The total portfolio generation in megawatt hours divided by the product of the period hours and the maximum dependable capacity in megawatts.
Fuel Diversity of Thermal Plant	Percentage of total fuel use represented by each fuel type.
Thermal Efficiency	Fuel to electrical energy conversion ratio, i.e. Energy Generated/Fuel Input.
Greenhouse Gas Emission	Million tonnes of carbon dioxide equivalent emitted.
Carbon Intensity	Tonnes of carbon dioxide equivalent emitted per Gigawatt of electricity sent out of generation portfolio.
Renewable Energy Sentout	Quantity of electricity sent out generated through renewable sources.
Corporate Reputation Index	Composite index compiled through survey results.