Synergy —

Mr N.W. Morton, Chairman.

Dr M.D. Nahan, Minister for Energy.

Mr J. Waters, Chief Executive Officer.

Mr K. Matacz, Chief Financial Officer.

Miss S. Tasovac, Principal Policy Adviser.

Mr D. Tayal, Principal Policy Adviser.

[Witnesses introduced.]

The CHAIRMAN: This estimates committee will be reported by Hansard. The daily proof *Hansard* will be available the following day.

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 principal clerk by Friday, 3 June 2016.

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.

I give the call to the member for Cannington.

Mr W.J. JOHNSTON: I note that at page 54 of Synergy's annual report, the trade and other receivables for the corporation are set out as $515.072 million as at 30 June 2015, but the group's trade and other receivables are now only $368.196 million. That means that when the company, including its subsidiaries, is grouped, $147 million less is owed to the group than to Synergy as a standalone business. Is that because trade and other receivables are owed to Synergy by its own subsidiaries? If that is the case, how much of the $147 million is owed by Vinalco?

Dr M.D. NAHAN: Mr Matacz.

Mr K. Matacz: All of that $147 million is a receivable due from Vinalco.

Mr W.J. JOHNSTON: I note that between the 2013–14 and 2014–15 financial years, the gap between the receivables has increased by over $81 million. Is that $81 million increase related solely to Vinalco?

Mr K. Matacz: There has been no increase in receivables from Vinalco over that period.

Mr W.J. JOHNSTON: What is the explanation for that $81 million?

Dr M.D. NAHAN: It came from another source.

Mr W.J. JOHNSTON: Clearly, so it must have been another subsidiary.

Mr K. Matacz: I would have to answer by way of supplementary information what source that actually came from.

Mr W.J. JOHNSTON: If we could get that as supplementary information, it would be great.

The CHAIRMAN: Could the minister clarify that for *Hansard*?

Dr M.D. NAHAN: Synergy does not have a large number of subsidiaries, but there might be some transactions and other ways that I can only imagine. Anyway, we will get supplementary information to the member. Was it about the $80 million?

Mr W.J. JOHNSTON: There is an $81 million difference—extra—this year. The figure is $147 million now, but it was only $66 million last year, so what was the reason for the $81 million variation? That is me sitting there with a calculator; if I have got something wrong, that should be pointed out too.

The CHAIRMAN: Is the minister happy to provide that by way of supplementary information?

Dr M.D. NAHAN: Yes.

[*Supplementary Information No B37.*]

Mr B.S. WYATT: Following up on Vinalco, what dividends were paid by Vinalco to Synergy in the 2013–14 and 2014–15 financial years; and, how much is expected to be received for this financial year and for the 2016–17 financial year?

Mr K. Matacz: Vinalco is a wholly owned subsidiary of Synergy, and no dividends are paid, so it is accounted for as part of Synergy's financial operations. The profits associated with Vinalco are consolidated into Synergy's accounts.

Dr M.D. NAHAN: They are consolidated in Synergy's accounts, so the profits of the fully owned subsidiary Vinalco are consolidated into Synergy's overall profit statements.

Mr W.J. JOHNSTON: If I can clarify that, is the minister saying that it is in the group's statement of income or in the corporation's statement of income?

Mr K. Matacz: It is consolidated in the group's financial results.

Mr B.S. WYATT: Is Vinalco still for sale?

Dr M.D. NAHAN: We are considering disposal of the asset, but let me go through a couple of issues. We have been looking at the sale of individual generating assets. As members will see from Synergy's annual report, it is not the most profitable business in our range, and our energy market is particularly tough on Synergy. If we tried to sell individual assets, most of them would lose money and get into debt. Muja AB is one of the few profitable assets in Synergy's fleet. It made a profit last year of over $77 million, so it is one of the more profitable ones. It has a very lucrative contract attached to it. It has for periods of time also been given a dispatch instruction to operate as it is now.

[8.40 pm]

It has served a very good purpose of significantly stabilising weaknesses in the grid in the area, not only periodically, but also now. I am not sure what those weaknesses in the grid are. That is for systems management or the Australian Energy Market Operator to dictate. But it has been operating and it has been quite profitable.

As I said, we are not looking to immediately sell the asset. We are looking to reform and reduce the subsidies in the energy market and get to a stage at which we can sell, either individually or collectively, parts of Synergy's fleet to reduce our operations and the dominance of Synergy and get more competitive systems in the market. Our focus right now, particularly because of the poor returns on Synergy's assets and its position in the market, is to reform the market rather than sell individual assets. The aim is to step up a path whereby we sell them either to another party or, in part, to act as a major competitor in the market.

We have to realise that there are a number of other challenges in this market. Firstly, Alinta Energy, which is a major player, is for sale. I do not know how well that sale is going; I cannot comment on that. However, the last time it tried to sell, the sale fell through. There are not a large number of players in this market. Around Australia very few companies are buying generating assets. To be honest, I think that if we were to try to sell our coal assets, we would struggle. Given that coal is by far our cheapest source of electrons, coal will continue to be a major player into the future. I think the problem with selling coal is largely due to environmental and other carbon issues. I expect coal to remain in state hands for some time.

Mr B.S. WYATT: Have you received any unsolicited bids for Vinalco Energy?

Dr M.D. NAHAN: We do not accept unsolicited bids from government except for land transactions.

Mr B.S. WYATT: The government accepts unsolicited bids only for land.

Dr M.D. NAHAN: That is right. Maybe Mr Waters can answer that.

Mr J. Waters: We have received no unsolicited offers to buy.

Dr M.D. NAHAN: A number of years ago people said they might be interested, but it was not a bid. Some of those people no longer exist in the market.

Mr W.J. JOHNSTON: The KPMG report on Muja AB that the minister tabled in 2013 was based on the idea that it would operate for 15 years. Is there an assurance that it will operate until 2028?

Dr M.D. NAHAN: That is the aim. Can I give the member an assurance that anything, including my car, will last as long as I expect? I do not think so. The aim is for it to continue to run that long. I will not be around to make that decision. Maybe the member will not be around either. The aim is to run it to life. Again, as the member knows, we have substantial excess capacity in this market. We will be shutting down 380 megawatts of installed capacity and after that there will be more accommodating growth in renewables, which will come on through the renewable energy target scheme and solar renewable energy target. Maybe the member should ask some questions about that. Given certain prices in the renewable space that Mr Waters has experienced in his bidding process, I would expect it to grow even more rapidly, strictly on a commercial basis. The 380 megawatts

is not installed capacity that we plan to cease. It is not specified. It will perhaps include some coal, but that is not committed to right now.

I might add that when we had those very hot days in February—four of the hottest days when we consumed a record amount of electrons in the south west interconnected system—99 per cent of the electrons were generated by gas and coal. The renewables at peak time were non-existent because the wind was not blowing and most of our solar is used in households, so it is not recorded. It is negative generation. We have some stability and cost issues to maintain our coal fleet.

Mr G.M. CASTRILLI: Under "Asset Investment Program: Generation" a total of $144.4 million is to be spent on Synergy's generation portfolio. On that list there, I cannot see any projects that refer to renewable or battery storage, but I know that the Alkimos Beach energy storage system was recently launched. Could the minister give us an update and clarify that for us given that it is not listed?

Dr M.D. NAHAN: I will give the specifics to Mr Waters or one of the team here, but Synergy funds renewables in a raft of ways. The renewable energy target scheme is large-scale, and it has Greenough River Solar Farm, which has been in it for a while, and others. Of course, it has wind in various ways and purchases electricity from some of them, like the Collgar Wind Farm, which is a 200-megawatt wind generator. It funds the solar renewable energy target for photovoltaics on rooftops. Those are the two commonwealth schemes. The state funds the SRET through the feed-in tariff, which is ongoing, and also the old feed-in tariff scheme; that is very generous but ongoing. It funds it through the FIT, the feed-in and also directly through power purchase agreements and the RET scheme. Its footprint on funding on subsidisation of renewables across the raft of those is about $180 million a year, or something like that.

Mr J. Waters: In that order.

Dr M.D. NAHAN: Contributing $180 million a year is quite substantial. Synergy has also undertaken experimentation in a couple of ways, like at Alkimos. There is a joint venture between LandCorp and Lendlease whereby the housing estate has mandates on energy efficiency and solar heating for water. I do not think it is mandatory, but it also has requirements for solar power, and the energy goes into a battery. That allows it to redistribute and generate the energy back. I think that was an Australian Renewable Energy Agency project with Synergy, LandCorp and Lendlease; that has been established for a while. I think it is a battery of about 1.2 megawatts.

Mr W.J. JOHNSTON: Is this a short answer?

Dr M.D. NAHAN: This is a very important issue. Is the member not interested? This is a very important issue. I know the member does not like it.

Mr W.J. JOHNSTON: Of course it is, but this is not the place to have the conversation; that is all.

Dr M.D. NAHAN: The member for Bunbury asked me a valid question about Synergy. It has also invested in renewables in an experimental manner, just like at Alkimos. Synergy will do more.

Mr W.J. JOHNSTON: I refer to the report written by the full-time chairman of Synergy into Horizon Power's Pilbara grid. How much did Synergy charge for the preparation of this report and who did it invoice for the report—the government or Horizon Power?

Dr M.D. NAHAN: The full-time chairman of Synergy did that at no cost.

Mr W.J. JOHNSTON: Sorry?

Dr M.D. NAHAN: The member asked me a question: how much Synergy billed Horizon Power —

Mr W.J. JOHNSTON: I do not know who it billed.

Dr M.D. NAHAN: The full-time chairman of Synergy did that work gratis for Horizon Power and the government.

[8.50 pm]

Mr W.J. JOHNSTON: If I can clarify this, is the Treasurer saying to me that Synergy paid its chairman —

Dr M.D. NAHAN: No, Synergy paid its chairman for the work that the chairman does for Synergy. The chairman did not work on behalf of Synergy on that project.

Mr W.J. JOHNSTON: So who paid him?

Dr M.D. NAHAN: As I said, no-one; he did not receive any money.

Mr W.J. JOHNSTON: But he receives a full-time salary as chairman.

Dr M.D. NAHAN: Does the member do work outside his regular pay and charge for everything?

Mr W.J. JOHNSTON: No.

Dr M.D. NAHAN: No. The chairman led a project to oversee—I think the member is referring to the north west interconnected system work?

Mr W.J. JOHNSTON: Yes. Nobody has seen the report because it has not been tabled.

Dr M.D. NAHAN: It will come.

Mr W.J. JOHNSTON: Was it paid for by Synergy?

Dr M.D. NAHAN: No, it was not.

Mr W.J. JOHNSTON: Synergy paid his salary.

Dr M.D. NAHAN: I have just told the member; just listen to me. He did some work on behalf of the government for no charge. He works full time. Is the member saying that he is slacking off in his job in Synergy? Is the member accusing —

Mr W.J. JOHNSTON: Yes, clearly, because if he is paid full time, how did he have the time to do this other work?

Dr M.D. NAHAN: He is a busy man. He did the work gratis. He did not get any remuneration from Synergy or the government for the work he did on the NWIS. As chairman, he also participated in areas of the market review.

Mr W.J. JOHNSTON: Yes, well —

Dr M.D. NAHAN: Well?

The CHAIRMAN: Further question, member.

Mr W.J. JOHNSTON: But his work on the market review, as the Treasurer acknowledged in his statement to the chamber, was done as chairman of Synergy.

Dr M.D. NAHAN: And he provided a wide range of issues outside Synergy, giving his background; yes, he did.

The CHAIRMAN: Further question, member.

Mr W.J. JOHNSTON: Thank you, Chair, given that I was interrupted by the Treasurer. The point I am making is that the chairman has a legal obligation to work on behalf of his employer, which is Synergy.

Dr M.D. NAHAN: Yes, he does. Is the member accusing him of not working on behalf of Synergy?

Mr W.J. JOHNSTON: Clearly, he did not. If he did a report on behalf of the government into Horizon Power, why was it paid for by Synergy?

Dr M.D. NAHAN: It was not. If the member has evidence of remuneration from Synergy or any other source for the project, please table it or indicate what it is. People do work for government outside their main occupations all the time on a whole range of issues. It was not a very onerous task for him. Other people in the Public Utilities Office did the lion's share of work.

Mr W.J. JOHNSTON: How many hours of work did the Synergy chairman put into doing the report?

Dr M.D. NAHAN: I will have to get back to the member on that but it was not much. It is not as much as I do on voluntary work on all sorts of issues. He did not write the report. He was not working on behalf of Synergy on the report and Synergy did not pay him. The government did not pay him for the work he did. Most of the work was done by officers of the PUO and otherwise.

The CHAIRMAN: Is the Treasurer prepared to provide —

Dr M.D. NAHAN: Yes, I will ask the Synergy chairman how many hours, roughly, he put into chairing that report.

[*Supplementary Information No B38*.]

Mr B.S. WYATT: Treasurer, while we are on the topic of the chairman of Synergy, I refer to the speech by the chairman of Synergy to the Committee for Economic Development of Australia on 1 December last year. How much did Synergy pay to sponsor this event and how many Synergy employees attended? I will start with that.

Dr M.D. NAHAN: I will provide supplementary information. Of course, I would not know.

The CHAIRMAN: For Hansard, what are you going to provide by way of supplementary information?

Dr M.D. NAHAN: On the speech in question to the Committee for Economic Development of Australia, I will provide by way of supplementary information how much Synergy paid for attending and how many of Synergy's employees went to listen to their chairman talk on a major issue of reform, both to energy policy and, of course, to Synergy. I would imagine there were a few.

[*Supplementary Information No B39*.]

Mr B.S. WYATT: During that speech, the chairman proposed that Synergy should be split into two or perhaps three gentailers and these businesses should be privatised. Does the government share that view?

Dr M.D. NAHAN: The chairman was speaking on behalf of his own view. He has expressed that view for numerous years. The government will make an announcement when it makes a policy on it. Right now, the government's policy is to have Synergy as it is, though we indicated that when we go towards full retail contestability—that is some years off now—we will look at divesting those assets in a manner that increases the number of retailers and generators in the market. Whether that is one, two, or three gentailers that are made up of Synergy, we are not in a position to make a policy change at this time. We are looking at reform of the market but we have a number of years of reducing the subsidy and other things before we get to that point. We do not have a policy position on that.

Mr W.J. JOHNSTON: Is the Treasurer saying that the government's policy is that that is not a good idea?

Dr M.D. NAHAN: I did not say that. Do not put words in my mouth.

Mr W.J. JOHNSTON: I am asking.

Dr M.D. NAHAN: I just said—I will repeat what I said; Hansard will record it if the member does not—that the market needs reform. We are progressing on a whole raft of areas of reform. One of those is with the aim of getting the subsidy down so that we can go to full retail contestability. When we approach that, we will have to look at the potential and the need to diminish Synergy's dominance in the market, which has overshadowed the effectiveness in the market, and we will look to divest assets. Whether that is selling individual assets or splitting some of Synergy's assets into a separate business is yet to be decided. It would be premature to make a decision about what is optimal.

Mr B.S. WYATT: I note that the chairman of Synergy said that government ownership of Synergy is one issue that is holding back Synergy's performance. Does the Treasurer share that view?

Dr M.D. NAHAN: No, I do not. Synergy has always been a government entity. Indeed, we would not want Synergy, in its current state of dominance, to be split apart. We would not want a business that effectively—either directly, through ownership, or through power purchase agreements—controls 70 per cent of the generating capacity in the south west interconnected system owned by anything other than a government, particularly since its overall regulation is not a regulated dominant entity. Our problem has been, just like it was when the Labor Party went into the reform process, how, when, and what path will reduce the dominance of the entity that was then Western Power and is now Synergy. We are trying to get the market capable of dealing with competition without heavy subsidies and that will entail reducing Synergy's dominance and, I suggest we also reduce, if not totally dispose of, its level of government ownership.

Mr W.J. JOHNSTON: In his speech, the chairman of Synergy also said that if certain energy market companies did not stop complaining to government about Synergy's market power, they should remember that Synergy could start to sell gas to retail consumers. Is the chairman's warning right?

Dr M.D. NAHAN: As the member knows, a large number of firms have made claims that Synergy is exploiting its dominance. Many of them, however, have a strategy of not generating electrons themselves but buying them on the balancing market at a short-run marginal cost, which means not allowing for capital replacement at a very low price. Then they compete in the contestable market against Synergy. As a result, Synergy's market share in the contestable market has declined precipitously. This is a structural problem in the market because, if people do not pay for capital, eventually they do not get capital; it gets eaten. A large number of people in those firms are using their comments in the community and politically to make sure that the status quo ends so they can have a business plan to make money from the selling of electrons without having the risk of owning and generating a plant. Okay; that is fair enough. I think that is what the chairman is referring to. If it wished, Synergy could—but we will not allow it—go into the gas market. I indicated some time ago that, once we get to full retail contestability, the agreement—I am not sure whether it is written down—was I think on disaggregation. Until we get to a place of full retail contestability, Synergy would not go into gas retailing and Alinta Energy would stay out. Maybe the member for Cockburn can confirm this.

[9.00 pm]

The question is, when we get to full retail contestability and Alinta could compete in the retail market for electricity, would the quid quo pro be that Synergy could go into the gas market? Again, that will be some time off, but I think it is very reasonable. Our aim is to allow the Alintas of this world, if they still exist, to compete with Synergy, or its remnants, on electricity and, if they so wish, the Synergies to go in and compete on gas. However, up until that time, no, the policy remains that Synergy does not necessarily compete in the gas field.

Mr F.M. LOGAN: That was the government's plan, but our plan was to merge Synergy and Verve.

Mr W.J. JOHNSTON: As I understand it, the Labor Party has delayed full retail contestability from 2018 until 2020.

Dr M.D. NAHAN: No, the aim was 2018, and it depends upon the capacity of Synergy to reduce its subsidy. That is the determinant factor. It is a very tough market. Despite huge efficiencies driven by Synergy in this market, it is a struggle to head towards full retail contestability. Until that happens—whether in 2018, 2019 or 2020—we are not going to go into that. Until we get the subsidy level down to a small manageable level, we are not going to go to full retail contestability that is determined as much by the market as our objectives. Our objective is to get there as soon as possible.

Mr M.H. TAYLOR: On page 405, budget paper No 2 states —

> A total of $141.4 million will be spent on Synergy's generation portfolio …

Can the minister outline the differential in the cost of producing electricity from different forms of generation and how that is shaping the business's future profitability and commercial decisions?

Dr M.D. NAHAN: One of the issues we face—maybe the member for Collie–Preston can ask questions about this—is the differential in costs particularly between coal, gas and renewables. It is different because there is no fuel in renewables, at least not for the main renewables. There are high fuel costs for gas but lower capital and most of our coal involves very high capital spending and low fuel production, so there are some variations. Maybe Mr Waters can go through and explore some of the differentials.

Mr J. Waters: I will categorise it into three broad areas: coal, gas and renewables. We burn coal in and around the Collie region under long-term legacy coal contracts. Depending on the plant in which the coal is consumed, without giving away specific details, we typically generate at between $20 and $40 dollars a megawatt hour; so, between, say, 2c and 4c per kilowatt hour, to put it into language equivalent with the residential tariff in Western Australia. Burning gas is a bit more complicated because we burn gas in baseload plant where its costs typically around 4c to 5c. The gas consumed in some of our peaking power stations can go as high as 10c a kilowatt hour, but they are really the machines that run for only the very high peaks. I guess that indicates that decisions into the future will be made around the plant; for example, we are still very much dependent on our coal backbone as the low-cost, baseload supplier in the system.

Compare that with renewables. We have invested extensively in renewables in recent years and we will continue to do that. The price of renewables has come down dramatically, but we are still looking typically at energy from a wind farm north of 10c per kilowatt hour. Bear in mind that I am not talking about fuel, because it is obvious the fuel cost is zero; it is simply the cost recovery of the capital investment over the life cycle of the facility, given the yield or the production from that wind farm. A typical wind farm will operate at between 30 and 40 per cent yield over the course of a year.

We are, I guess, facing a fairly challenging period as a business as we migrate towards renewables, which I think we accept as being necessary. We have a target to achieve in that regard, but, in addition, no doubt, as we move to reduce our carbon emissions and the carbon intensity of our fleet, renewable energy will become more of a feature. In so doing, from a carbon production perspective, we need to offset the generation of energy from coal. It is clear we have to address the cost differential, which will ultimately be met by consumers. The role of businesses such as Synergy is to make decisions in the best interests of consumers so that we minimise that impact as we transition.

Mr M.H. TAYLOR: How much has the cost of renewables dropped over the last five years, for example?

Mr J. Waters: It has come down probably 40 to 50 per cent. It has been really quite significant. We are continually talking—that is, across both solar and wind. Solar has come off a high base; wind has always been a bit cheaper. Progress continues to be made in more advanced methods of manufacture and in the manufacturing scale globally we will continue to see a fairly impressive downward price path for renewables projects.

Dr M.D. NAHAN: Synergy has put out some expressions of interest for its renewable energy target program. Some of the cheapest are the integration of solar and wind. Wind blows at night. Coal glows like hell but solar works during the day. Efficiencies can be made on transmission connections, and some of the costs are very low and are declining.

Mr W.J. JOHNSTON: I appreciate Mr Waters' comments about the cost profile of the different generating stations. The minister has said in the media that he will not build another coal-fired power station. I assume that is true, so there must be a plan for the dates of retirement for the existing plants.

Dr M.D. NAHAN: There are some technical issues, and Mr Waters can go through those. I did say that I do not think the state would ever build one. There are some newer plants—Bluewaters 1 and 2 are relatively new and have quite a long life. Collie has quite a long life. Of course, Collie has a facility to add on to that—another one.

The ones that are ageing are Muja AB, C and D. They have very large added capacity to them. My understanding is that they come due to their technical end of life in the middle of the next decade. Often that does not mean anything. Hazelwood came to its end of life back in the 1990s and it is still going. The life of many of these facilities can be extended with major investment. Given the modelling we are looking at and given the growth of the RET, the Small-scale Renewable Energy Scheme, the growth of renewables and the excess capacity in the market, we will see the renewables, SRES and Large-scale Renewable Energy Target absorbing all additional growth in the market, plus some, and putting pressure on existing stock. Another factor is that with intermittence, gas becomes an important back-up. High-efficiency gas turbines and all those types of issues are essential. Put all that together and there will not be an expansion in coal, but a continuation of the three newer and cheaper coal-fired power stations. I am not looking beyond 2030, but there will be real pressure on replacing Muja AB, C and D. Mr Waters can give some timing on the technical nature of Muja D and C in particular.

Mr J. Waters: I think the approximate dates the minister provided are accurate. Current plans certainly see Muja AB and C's retirement around the mid-2020s, Muja D from about 2030, and the Collie power station probably around 2035. To echo the minister's comments, currently there is certainly a technology gap in organisations like ours to undertake long-term planning. The logical thinking is that the natural fuel that we will transition to beyond coal will be gas and that we will burn a lot of gas for a long time until we achieve a reliable and dispatchable form of renewable energy or, indeed, we achieve sufficient scale and cost of storage to be able to make renewable forms of energy production dispatchable to the market.

Until that happens, there is still a question mark over what will be the build profile in that post 2025 or 2035. I would not rule out that a significant amount of investment is underway around the world looking at clean coal Technology—the Japanese in particular. We are aware of a plant owned and developed by Mitsubishi that is currently undergoing an expansion.

[9.10 pm]

Dr M.D. NAHAN: Where is it?

Mr J. Waters: It is in northern Japan; I cannot remember the name of the site.

It is operating reliably and has been for some years. Through the gasification of coal that enables the separation of the CO_2 stream for further cleansing and storage, we have what I believe could become a very good CO_2 storage site in the south west. The reality is that this technology will remain on our radar.

Mr F.M. LOGAN: I refer to note 28 to Synergy's accounts on page 108 of the 2014–15 annual report. What is the total amount lent to Premier Coal Ltd so far in accordance with the convertible loan agreement? When does that convertible loan agreement expire?

Dr M.D. NAHAN: I will give a bit of history and then will pass over to the CEO. As the member well knows, Premier Coal was the provider of coal to Synergy at that time.

Mr F.M. LOGAN: A very good deal it was too.

Dr M.D. NAHAN: Yes; it was a very good deal—almost too good—nonetheless a good deal.

Mr F.M. LOGAN: If you say that was too good, you better go back to the Premier and tell him that his gas pipeline deal was too good!

Dr M.D. NAHAN: Yes, I know. It was an excellent deal and changed the nature of the coal market in Collie altogether. Some years ago, Premier Coal was losing a large amount of money. It is an essential provider of coal to Synergy. It approached Synergy and told it that it was struggling significantly and that it might indeed go under. Our concern was that if it did, Synergy was the value proposition in that chain and Synergy would be the purchaser of coal and the funder of that business and all its losses until the liquidator or receiver did something. We needed some capacity to have influence over the receiver in case that happened. Under the existing contract, we did not. Advice from Synergy was that one way to do that was to convert some of the uplift into a loan, and in case of receivership that would allow Synergy to have rights over the process. It was never meant to be large. Mr Waters can take us to what he has done today.

Mr J. Waters: I think the agreement is approaching two years old. We made the agreed uplift. As to the question about the current quantity of the loan, if you do not mind, I will provide that as supplementary information and provide it separately so that it is current.

The CHAIRMAN: Can the minister clarify that?

Dr M.D. NAHAN: It is the total amount of the loan and when it expires under the current Premier Coal contract.

[*Supplementary Information No B40.*]

Dr M.D. NAHAN: It cannot be a large amount. It is meant to be a leverage right into the receivership if that happened and for no other purpose.

Mr J. Waters: It does two things. As the minister described, it protects the state's rights in the event of receivership. First, it secures Synergy's position as a secured creditor over the business, given that we have that loan and it has been documented and structured that way, which strengthens our rights regarding our ability to influence the course of the business under receivership. Second, should we choose to, and subject to further approvals, the loan can be converted to equity at a later date in the event that the business undergoes such a transformation that it goes from loss-making to profit-making. It provides a measure of protection to the state. In the event that the amount of the agreed uplift sees the business become profitable such that its equity value is converted from a negative to a positive, we can convert the loan and take a share of equity and therefore recover a portion of the value invested in the business by the state through the course of the coal price uplift.

Mr F.M. LOGAN: Is the term of the loan directly related to the length of the actual coal contract or is it for a shorter time?

Mr J. Waters: I believe it is shorter. If you do not mind, I will provide that as supplementary information.

Dr M.D. NAHAN: What is the potential duration of the loan under the Premier Coal contract?

[*Supplementary Information No B41.*]

Mr F.M. LOGAN: This question goes to the point you were making, which was about converting the loan to equity and whether the loan is recoverable. Are you seeing the loan as recoverable at some stage or that it simply sits there as an uplift in terms of the price paid for by the coal, which may then be converted into equity should Premier Coal make a profit?

Dr M.D. NAHAN: Potentially, it is recoverable in two ways. First, in case it goes into receivership, it gives us rights in the receivership. Second, if we so wish—there is no great expectation of this—and the business becomes very profitable, not because of price uplift but because of cost or something like that, it will give Synergy the right to convert it to equity and recoup it through that means. Those are the two mechanisms of the uplift, otherwise it is paying a higher price where a small proportion can convert into a loan for those two purposes.

Mr B.S. WYATT: If there is insolvency, whether it is receivership, administration, liquidation or whatever, does Synergy have priority over the assets as a secured creditor or are there other charges against assets that we are subordinate to? Are we the priority secure creditor over Premier Coal's assets?

Mr J. Waters: Unlike the prior agreement that gave us, I guess, weak rights, at best in the event of an insolvency, as the member described, the design of the mechanism now is to give us priority over all other creditors regarding rights in the event of receivership.

Mr B.S. WYATT: Presumably, other creditors that had interests and rights prior to this agreement have accepted their subordination to this agreement?

Mr J. Waters: My understanding is that there were no other parties of that nature at the time we established the right to the agreement.

Mr B.S. WYATT: There was no bank with a charge over an asset?

Mr J. Waters: No; it is a 100 per cent equity arrangement, effectively.

Dr M.D. NAHAN: The system we face particularly was brought to our mind with the Griffin Energy Bluewaters power station takeover. Unless we have some kind of right like this, we have no control over the receiver operating that asset at a loss; that is, Synergy would have to absorb it almost in full for a long duration. We had no input to that decision of the receiver and that was a really big exposure.

Mr B.S. WYATT: I agree. I am curious about whether, if we are subordinate to, say, a bank with a charge over the majority assets, the bank could still appoint a receiver to do what it wants in the interests of that bank. That is what I was trying to seek clarity around—to make sure our rights in the event of active insolvency are not subordinate to another creditor.

Dr M.D. NAHAN: They would also have limited influence over whom the receiver sold the asset to. We learnt some lessons.

[9.20 pm]

Mr W.J. JOHNSTON: This will be my only other question. Sometimes when a company is owned by a larger company, there is a loan between the parent and the subsidiary. Is there no loan between the parent and the subsidiary?

Mr J. Waters: No. It is a clean balance sheet in that regard.

Mr F.M. LOGAN: Has there been any further call for loans from the state?

Dr M.D. NAHAN: No. In fact, I read in the paper that it is doing quite well. It has made a small profit, which is good.

Mr F.M. LOGAN: That is good—maybe the loan can be converted into an asset or equity.

Dr M.D. NAHAN: No, the profit is not that big yet; I said a small profit, and things go up and down in that industry. But Synergy did other things. It did a very good job of ascertaining the asset base, making sure it runs it well, and making sure that it planned for the expansion of the coalfields, and it built that into the cost structures. It regularly gives mining engineers and others access to monitor the operation of the facility. To be fair, Premier Coal is a professionally run asset with some good infrastructure.

Mr F.M. LOGAN: Just a final question. Given the nature of the situation Synergy was facing with Premier Coal, did the Minister for Energy need to get involved at any stage in those negotiations?

Dr M.D. NAHAN: No, I did not. I was briefed on the choices. I met the chief executive officer of Yancoal, the parent company, but I have not met any of the other ones, to my knowledge.

Mr W.J. JOHNSTON: It is noted on page 62 of the 2014–15 annual report that the tariff adjustment payment received by Synergy from the government increased from $244.746 million in 2013–14 to $386.008 million in 2014–15; that is, it went up by $121.26 million between 2013–14 and 2014–15. What is the expected outrun for the tariff adjustment payment for 2015–16, and what is the budgeted amount for 2016–17?

Mr K. Matacz: At the moment in the budget papers, an amount of $320 million is included for the 2015–16 financial year for the tariff adjustment payment. For the full period 2015–16 through to 2019–20, the amount in the budget papers totals $937 million. So, over those five years it goes to $937 million.

Mr W.J. JOHNSTON: Synergy has two bits. One bit operates in a regulated environment without competitors and one bit is in a deregulated environment with competitors, and of course one of the issues that competitors raise is about which bit of Synergy the TAP goes to. Can the minister assure us that none of the TAP is being used to subsidise Synergy's —

Dr M.D. NAHAN: That is an issue the member raised last time and it is a valid issue. It was one of the first things I asked Synergy and Verve when I first became energy minister, and we have had the Public Utilities Office look at this regularly to ensure that the subsidies for the non-contestable market do not underwrite the contestable market, and that is still the case. We have undertaken major cost efficiencies in this operation for the TAP, and because of the structure of the market, Synergy struggles. The greatest section of the market in which Synergy struggles—of course it has a monopoly on the non-contestable part—is the contestable market, which is particularly vigorous. One thing that has been noticed is that the electricity costs in the contestable market are low and have decreased substantially over a number of years. There have not been increases in contestable market prices, which is a testament to the benefits of competition to some extent, but also I think they are often below cost. Maybe Mr Waters can talk about that.

Mr J. Waters: Just to provide further comfort on the question of any cross-subsidy, Synergy has historically had its tariff adjustment payment established on the basis of an analysis of its cost stack, and it would notionally apportion aspects of its cost stack to the franchise market and portions of its cost stack to the contestable market. I can understand that as that issue progressed over a number of years, there was suspicion that as market share rebalanced between losses in the contestable market and the franchise market, effectively costs were able to be moved under the cost structure model into the franchise market and therefore recoverable via the tariff adjustment payment. About two years ago we initiated, through the PUO, a change in methodology whereby the establishment of the subsidy payment is no longer established in any way based on Synergy's cost structures. It is actually based on independent modelling that is undertaken around the size and load type of the franchise market, and it uses an assessment of an efficient new entrant to determine what a perfectly efficient player entering that market would be able to provide that portion of the market for. It uses that to then establish what is a cost reflective tariff, and to the extent that tariffs are not at that level, it establishes a subsidy payment to the gap. Under our current cost structure, we are actually able to offer about a 15 per cent discount to that number, so we are actually at a cost level that is 15 per cent below that of an efficient new entrant. That is just to, I guess, provide the reassurance that in the establishment of the tariff adjustment payment at the initial stage, it pays no regard to Synergy's actual costs; it is based purely on a calculation based on an efficient new entrant.

Dr M.D. NAHAN: We calculated long-run marginal costs, which is a common methodology based on a new entrant, and to give incentive to Synergy we imposed a 15 per cent discount on the cap and that saving in the TAP.

Mr W.J. JOHNSTON: Synergy has the business efficiency program, which is trying to drive costs out, and that is $450 million collected over four years. How much of those savings are made up from recurrent expenditure, and how much is saved from investing and sustainment expenditure?

Mr J. Waters: I ask Mr Matacz for the breakdown. There is a split there.

Mr K. Matacz: I can say that, for instance, in the 2015–16 financial year, we are looking at a reduction in our operating costs in the order of $40 million, but in addition to that there are costs associated with our capital. We have been able to actually reduce our capital expenditure. Also, we have been able to increase our revenue and at the same time reduce our cost of goods sold. The total benefit that has actually been generated in the 2015–16 financial year is $87 million, which is basically allocated across revenue, costs of goods sold and our operating costs, as well as reduction in capital spend.

Mr W.J. JOHNSTON: What was the reduction in capital spending?

Mr K. Matacz: In 2015–16, it was $19 million.

Mr W.J. JOHNSTON: Then there is revenue of $28 million.

Mr K. Matacz: Revenue benefit driven in 2015–16 was $10 million; the cost of goods sold benefit in 2015–16 was $13 million; and our operating expenses dropped by $39 million.

Mr W.J. JOHNSTON: Perhaps, given the time, the minister could give me this information as supplementary information. I know the target for 2015–16, and then further targets for the next three years add up to $450 million, as Mr Matacz explained when he briefed me.

Dr M.D. NAHAN: We can provide that data.

Mr W.J. JOHNSTON: Yes, for four years, as supplementary information.

Dr M.D. NAHAN: Four years on the forecast benefits from the business efficiency program, broken down by major categories.

Mr W.J. JOHNSTON: Yes, operating expenditure, capital expenditure, and revenue.

[*Supplementary Information No B42.*]

The CHAIRMAN: That completes the examination of Synergy.

[9.30 pm]