



STATEMENT OF CORPORATE INTENT

2013-2014

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.

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 2013/14 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 operating subsidiaries required for 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) 2013/14 to 2017/18. 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.

In April 2013 the Premier of Western Australia announced the State Government's intention to merge Verve Energy and Synergy, with the full merger of both entities operating under the name of Synergy to be effective from 1 January 2014. The Verve Energy SCI and SDP were largely developed prior to the announcement of the merger. Therefore the 2013/14 SCI reflects the business intentions of Verve Energy as a disaggregated entity.

TABLE OF CONTENTS

1. SUMMARY	1
2. THE BUSINESS	3
3. STATUTORY FRAMEWORK	4
4. VISION AND VALUES.....	4
5. CORPORATE OBJECTIVES	5
6. PERFORMANCE TARGETS.....	5
7. NATURE AND SCOPE OF FUNCTIONS	7
8. MAIN UNDERTAKINGS 2013/14.....	8
8.1 STRATEGIC FOCUS AREA 1: PLANT	8
8.2 STRATEGIC FOCUS AREA 2: MARKET.....	8
8.3 STRATEGIC FOCUS AREA 3: PEOPLE.....	9
8.4 STRATEGIC FOCUS AREA 4: VALUE CREATION	9
8.5 STRATEGIC FOCUS AREA 5: BUSINESS SUPPORT	9
8.6 STRATEGIC FOCUS AREA 6: BUSINESS DEVELOPMENT	9
8.7 STRATEGIC FOCUS AREA 7: ENVIRONMENT AND COMMUNITY	10
8.8 STRATEGIC FOCUS AREA 8: RELATIONSHIPS	11
9. DIVIDEND POLICY	11
10. ACCOUNTING POLICIES AND GOVERNANCE STANDARDS.....	11
11. MINISTERIAL REPORTING	12
12. NATURE AND EXTENT OF OPERATING SUBSIDIES.....	13
13. OTHER NON-COMMERCIAL OBLIGATIONS	13
APPENDIX 1 STATUTORY FRAMEWORK	
APPENDIX 2 EXPLANATORY NOTES CONCERNING KEY PERFORMANCE INDICATORS	

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 negotiated and priced on sound commercial terms, including the ability to fully pass through Verve Energy's applicable Carbon Tax liability onto its customers;
- ancillary services including balancing, are appropriately priced; and
- the Wholesale Electricity Market (WEM) Rules provide for a fair, equitable and stable market environment.

The financial performance of Verve Energy in 2013/14, is expected to be robust reflecting the fact that existing major bilateral sales contracts are now negotiated on commercial terms.

The High Efficiency Gas Turbines (HEGTs) at Kwinana continue to perform an increasingly important role in light of the increased penetration of intermittent renewable generation on the SWIS, by helping to provide load following duties at lower cost than existing older generation assets. Since their commissioning in 2012/13, the HEGTs have largely displaced the operation of some older and less efficient plant formerly responsible for peaking and mid merit generation duties on the SWIS.

During 2012/13 Verve Energy introduced into service the Greenough River solar photovoltaic farm (10MW stage 1), a joint venture project between Verve Energy and GE Energy Financial Services. Verve Energy's commitment to work towards achieving a long term reduction in its carbon footprint is further reinforced with the commissioning of Mumbida wind farm (55MW) in May 2013. The Mumbida wind farm project has been developed under a joint venture arrangement between Verve Energy and Macquarie Capital¹.

The refurbishment of Muja AB coal-fired power station (240MW) in Collie continues with Units 3 and 4 (Muja B) both having entered service by March 2013 with successful operations recorded to date. Following a boiler tube incident in July 2012, the State Government in June 2013 announced a cessation of the works on Units 1 and 2 subject to a full technical and financial review. Subsequently in September 2013, the State Government gave approval for Verve Energy to continue with the refurbishment. The remaining two units are

¹ In January 2012, Energy Infrastructure Trust (EIT) acquired Macquarie Capital's 50% interest in Mumbida wind farm joint venture.

planned to enter service as early as the first quarter of 2014. The previously retired units were refurbished under the Vinalco Joint Venture (Vinalco JV) arrangement between Verve Energy and Inalco Energy. Inalco has subsequently exited the joint venture and Verve Energy currently owns 100% of Vinalco. The refurbishment provides transitional generating capacity to the SWIS, allowing Verve Energy to contribute to the longer term development of "clean coal" and Carbon capture and storage technologies.

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

Key business risks to be managed in 2013/14 include:

- Carbon emissions liability exposure associated with the introduction of a Carbon Tax under the Federal Governments Clean Energy Future Package (CEFP) legislation from 1 July 2012. The introduction of the Carbon Tax results in significant additional costs to Verve Energy's electricity production. The full extent of these costs cannot be absorbed by the Corporation without a significant and detrimental financial impact and thus Verve Energy will seek to pass the Carbon Tax costs onto its customers under contract;
- long-term gas supply security;
- long-term coal supply arrangement security;
- ageing plant and workforce;
- excess base load on the electricity system combined with inherently low overnight loads on the SWIS, increased penetration of intermittent renewable generation and Verve Energy's previous role of sole provider of balancing and ancillary services, has led to accelerated deterioration and reduced efficiency of thermal plant due to frequent starts and low capacity factors; and
- from 1 July 2012, the Independent Market Operator, under its Market Evolution Plan, introduced WEM market rule changes which are more in keeping with a competitive market and thus allows Verve Energy to be more adequately compensated for providing a range of balancing and ancillary services. At present, Verve Energy remains the main provider of both balancing and load following ancillary services to the SWIS. Therefore the negative impacts on Verve Energy's plant portfolio of providing balancing services such as deterioration of plant condition and reduced average thermal efficiency will remain. In order to maintain plant reliability and safety and at the same time appropriately manage the associated financial risks, Verve Energy will require that it is able to undertake the appropriate level of operations and maintenance expenditure on its generation assets.

Verve Energy will target eight strategic areas in 2013/14:

- customise investment and operational strategy for each power station based on its current and potential contribution to the value of the business and effectively manage project delivery risks associated with Verve Energy's generation projects;
- participate in competitive energy markets on a commercial basis;
- 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.

In April 2013 the Premier of Western Australia announced the State Government's intention to merge Verve Energy and Synergy. A common Board will govern the two entities from 1 July 2013 with the full merger of both entities operating under the name of Synergy to be effective from 1 January 2014. Verve Energy and Synergy will work closely and cooperatively with the Minister for Energy and Public Utilities Office to ensure a successful transition to the new merged entity.

Verve Energy's 2013/14 SCI was largely developed prior to the announcement of the merger and therefore the SCI reflects the business intentions of Verve Energy as a disaggregated entity. While the new merged entity will develop a Synergy SCI (and SDP) in due course, many of the key Verve Energy business risks and strategic focus areas outlined in this document are likely to remain common to the new merged organisation.

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, 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 2013/14 will continue to be the reliable and efficient generation of electricity.

In 2013/14 Verve Energy's share of the total thermal generation capacity on the SWIS will be approximately 53% and will include the newly commissioned HEGTs and the re-introduction into service by Vinalco JV of the Muja AB coal-fired power station. Renewable generation capacity share will rise to approximately 21% of renewable energy capacity on the SWIS with the entry into service of the Greenough River solar and Mumbida wind farm.²

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 2013/14. Verve Energy also engages in sales, swaps and purchases of natural gas, gas transport capacity and gas storage.

² Estimate of capacity share takes into consideration Verve Energy's relevant percentage ownership share of joint venture arrangements.

Synergy is by far Verve Energy's biggest electricity customer. Around 80% of the electricity generated in 2013/14 will be supplied to Synergy under bilateral contracts.

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 Power). Section 38 of the Act also prohibits Verve Energy from retailing electricity directly to users, except as authorised by the Minister. In March 2013 the Minister extended 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 for Verve Energy to grow to provide secure, affordable and cleaner energy for our State. This includes a strong focus on the key objectives of safety, reliability and efficiency and achieving these objectives will result in the business 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 2013/14 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;
- **Market** - 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** - build and maintain constructive and productive relationships with all stakeholders.

6. PERFORMANCE TARGETS

The table below shows Verve Energy's forecast performance for 2013/14. The terms used in the following table are explained in Appendix 2.

	2013/14
Financial Performance	
EBITDA Margin (%)	22.0%
EBIT Margin (%)	11.4%
NPAT Margin (%)	3.7%

Return On Capital Employed (%)	14.0%
Return on Assets (%)	7.4%
Operational Performance	
Safety – Medical Treatment Injury Frequency Rate	<30
Safety – Lost Time Injury Frequency Rate	0
Worksafe Breaches	0
Environmental Incidents	0
Water Licence Incidents	0
Market Rule Breaches	0
Electricity Sales (GWh) ³	10,596
Plant Availability (%)	85.7
Forced Outage Factor (%)	2.3
Portfolio Capacity Factor ⁴ (%)	33.6
Fuel Diversity of Thermal Plant (% input)	
Coal	62.0
Gas	38.0
Liquids	0.0
Biomass	0.0
Portfolio Thermal Efficiency (%) ⁵	31.6
Greenhouse Gas Emissions (MtCO ₂ e) ⁶	8.2
Carbon Intensity (tCO ₂ e/MWh s/out) ⁷	0.87
Renewable Energy Sentout (GWh) ⁸	349
Corporate Reputation Index (%)	65

Verve Energy is required by Government to implement a series of savings initiatives designed to meet the prescribed efficiency dividends in the financial years to 2015/16. The originally defined 5% efficiency dividend was advised in the 2011/12 State Budget process for savings to be achieved from 2011/12 to 2014/15. This was subsequently followed up by further budget corrective measures for Government Trading Enterprises via the 2012/13 State Budget process. The sum of the two efficiency dividends equates to a total savings of \$25.3 million in 2013/14. Both of the efficiency dividend targeted savings have been included in Verve Energy's budget forecasts and hence the financial performance targets in the above table reflect the 2013/14 operating expenditure reduction. An implementation plan has been developed by Verve Energy detailing how the savings measure will be achieved without compromising plant reliability and supply.

Verve Energy is continuing on the program of work required to return its plant to a condition able to ensure the reliable supply of electricity in the SWIS, given the significant underinvestment in its generation plant previously identified in 2007. Verve Energy has been able to deliver improved performance from its plant by ensuring that it has sufficient budget to maintain its plant and expend sustaining

³ Electricity Sales exclude Muja AB, Mumbida and Greenough River Joint Venture sales.

⁴ Portfolio Capacity Factor excludes Muja AB, Mumbida and Greenough River Joint Ventures.

⁵ Including PPAs but excluding Muja AB Joint Venture.

⁶ Including PPAs but excluding Muja AB Joint Venture

⁷ Including PPAs but excluding Muja AB, Mumbida and Greenough River Joint Ventures

⁸ Includes Mumbida and Greenough River Joint Venture plant output.

capital to ensure long term reliable operation of its plant. To the extent required, Verve Energy will seek the Government's support of its forward maintenance and capital budgets which continue to ensure safe and reliable operation of its plant. Budgetary requirements will be addressed annually through the Budget process.

7. NATURE AND SCOPE OF FUNCTIONS

Verve Energy's core functions during 2013/14 will be the efficient and competitive generation and trading of electricity. Verve Energy currently owns a generating portfolio of 3,058⁹ 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.

Kwinana A (240MW) was retired in September 2011 and from June 2012 two 100MW HEGTs were commissioned. From early 2013, two generating units of the refurbished Muja AB power station began operations, and the remaining two units are planned to begin operations from the first quarter of 2014. Also in 2012/13 Verve Energy introduced the Greenough River solar photovoltaic farm, a joint venture project between Verve Energy and GE Energy Financial Services, and currently the largest utility scale solar project in the southern hemisphere at 10MW. In addition, another new renewable energy project will began commercial operations during 2013/14 with the commissioning of the 55 MW Mumbida wind farm. The entry into service of these two new renewable energy facilities follows the introduction into service of the 14 MW Grasmere wind farm at Albany during 2011/12.

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 8.4 MW at various regional locations outside the SWIS under power purchase agreements with Horizon Power.

In 2013/14, about 80% 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 plant capacity and market support obligations.

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.

⁹ Nameplate capacity at 15°C and 1 atmosphere of pressure as at 1 July 2013. Figure includes Verve Energy's relevant percentage ownership share of joint venture arrangements.

8. MAIN UNDERTAKINGS 2013/14

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 Develop appropriate plant portfolio operation strategies to more effectively manage the operational and financial risks associated with Verve Energy's role as the primary provider of balancing services on the SWIS.
- 8.1.3 Review generation portfolio and develop a portfolio realignment plan to increase efficiency and decrease carbon intensity.
- 8.1.4 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.
- 8.1.5 Continue to implement the new asset management and plant maintenance regime to restore plant condition.
- 8.1.6 Reduce forced outage factors and minimise capacity credit refunds.
- 8.1.7 Improve fuel efficiency and leverage existing fuel contracts.
- 8.1.8 Undertake business-wide energy efficiency opportunities assessment consistent with the requirements of the *Energy Efficiency Opportunities Act (Cwlth) 2006*.
- 8.1.9 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 Effectively manage the participation in the competitive balancing and ancillary services markets to ensure prices incorporate due recognition of market risk and provide an appropriate commercial return.
- 8.2.3 Ensure forward carbon pricing is used in all capital expenditure decisions and carbon price pass-through provisions are included in all electricity sales contracts.
- 8.2.4 Continue to purchase energy from other generators where it is economically efficient to do so.
- 8.2.5 Focus on increasing sales of off-peak volumes and loads that better match production capability and improve the capacity factor of Verve Energy's thermal plant.
- 8.2.6 Maintain fuel trading activities to ensure profitability through sales, swaps and purchase of gas, gas transport capacity and gas storage.
- 8.2.7 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 safety strategic initiatives.
- 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 and develop markets for waste products such as flyash, carbon, subject to Government approval.
- 8.6.4 Participate as a key entity in the development and construction of the Bunbury to Albany Gas Pipeline.

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 Subject to State Government energy policy, 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 Subject to State Government energy policy, develop and expand the renewable energy portfolio as financial capacity and market opportunities allow, including:
 - a) 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; and
 - b) seek both Federal and State Government funding for the construction of new renewable projects that have been subject to feasibility studies.
- 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 will continue to be 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 (e.g. 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; and
 - c) 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 and Treasurer 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;
- consolidated financial statements with relevant accompanying notes; and
- detail regarding progress towards meeting efficiency dividend targets.

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 and Treasurer 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 and Treasurer 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 OPERATING SUBSIDIES

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 an Operating Subsidy payment to Synergy that covered the difference between the cost reflective tariffs and the tariff increases determined 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. Therefore the commissioning of HEGTs (200 MW) at Kwinana during 2012 was enabled by the decommissioning of Kwinana A (240 MW) in September 2011. The refurbishment of Muja AB power station under the Vinalco JV increases Verve Energy's non-renewable generation capacity to 3,012MW and therefore above the 3,000MW cap. The marginal increase above the capacity cap has previously been approved by the Minister.¹⁰

¹⁰ Verve Energy currently owns 100% of Vinalco. When Muja Units 1 and 2 are brought into service (likely in Q1 2014), Verve energy's non-renewable capacity will increase to 3,132MW while it maintains a 100% share of the Vinalco JV.

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 – Even with the competitive balancing market, Verve Energy continues to have a significant responsibility 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 or run at sub-optimal levels 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 large-scale and small-scale intermittent renewable 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 has been significant and has detracted 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 has been 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.

With the introduction of competitive balancing and load following ancillary services from 1 July 2012 Verve Energy is now more adequately compensated for performing this market support role but continues to be a major provider of balancing services even with a competitive balancing market thus the degradation of its thermal plant condition and associated requirement for additional maintenance costs to ensure plant reliability and safety is likely to remain in the short to medium term.

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 concurrence 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 \$46 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
Financial Performance	
Earnings Before Interest, Depreciation, Amortisation and Tax (EBITDA) Margin	Measure of operating profitability margin regardless of capital structure (depreciation and interest payments) or taxes, calculated as: EBITDA / Total Revenue.
Earnings Before Interest and Tax (EBIT) Margin	Measure of operating profitability margin regardless of capital structure (interest payments) or taxes, calculated as: EBIT / Total Revenue.
Net Profit After Tax (NPAT) Margin	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).
Return on Assets (ROA)	Measure of how profitable a company is relative to its total assets, calculated as: EBIT / Total Assets.
Operational Performance	
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.