Verve Energy —

Ms J.M. Freeman, Chairman.

Dr M.D. Nahan, Minister for Energy.

Mr J. Waters, Chief Executive Officer.

Mr W. Borovac, Chief Financial Officer.

Mr L. O'Callaghan, Principal Policy Adviser, Energy, Department of the Premier and Cabinet.

Mr S. Helm, Chief of Staff, Department of the Premier and Cabinet.

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

Members may raise questions about matters relating to the operations and budget of the off-budget authority. Off-budget authority officers are recognised as ministerial advisers. It is the intention of the Chair to ensure that as many questions as possible are asked and answered and that both questions and answers are short and to the point. The minister may agree to provide supplementary information to the committee, rather than asking that the question be put on notice for the next sitting week. I ask the minister to clearly indicate what supplementary information he agrees to provide and I will then allocate a reference number. If supplementary information is to be provided, I seek the minister's cooperation in ensuring that it is delivered to the committee clerk by Friday, 30 August 2013. 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 now ask the minister to introduce his advisers to the committee.

[Witnesses introduced.]

The CHAIRMAN: Member for Cannington.

Mr W.J. JOHNSTON: I note that Inalco has exited the Vinalco joint venture. When did Inalco exit the Vinalco joint venture? What consideration was paid to Inalco for its share of the joint venture?

Dr M.D. NAHAN: Could the member refer to the page?

Mr W.J. JOHNSTON: No; this is an off-budget entity. As the Chairman just explained, we are entitled to ask any question regarding the operations of the organisation.

Dr M.D. NAHAN: Okay.

Mr W.J. JOHNSTON: Does the minister want me to get the Chairman to repeat the statement?

Dr M.D. NAHAN: No, that is clear; I did not know.

Inalco exited the joint venture in late June.

Mr W. Borovac: Ministerial approval for the agreement to go ahead was given on 20 June 2013. The agreement was dated 15 April 2013.

Mr W.J. JOHNSTON: What consideration was paid to Inalco for its share of the joint venture?

Mr J. Waters: There was no consideration paid for its share of equity.

Mr J. NORBERGER: I refer to page 751 of budget paper No 2 and the expenditure for high-efficiency gas turbines. What benefits have been achieved from investing in these turbines?

Dr M.D. NAHAN: Thanks very much for the question; it is a very important one and somewhat controversial and debated. That was a major investment by Verve Energy into a new high-tech turbine. It was more or less completed in 2012, I believe. I will pass the member's question to the CEO of Verve Energy who is heavily involved in that and he can describe it. Before I do that, I must say that this would probably be one of the best investments in the grid that any investor has made. It is designed for a number of purposes but particularly to balance the load. The experts can talk about that. A range of organisations and generators add to the electricity system, so we have to smooth it out and make sure that the voltage and whatnot is optimal. A whole range of different types and scales of generating units are coming on, particularly wind, that are intermittent. That has created a need for something to balance more significantly. With this investment, Verve has the requirement to balance the load. I pass over to Jason.

Mr J. Waters: The minister is correct; Verve Energy provides a suite of services to the market. What we fundamentally call load-following ancillary services, as the minister described, are effectively services that ensure that at any given point in time there is a balance between the electricity being generated and the electricity being consumed. For a number of years, the balancing of frequency in the market was not a particular technical issue. However, in recent years, with the increased penetration of wind and the instability that comes from wind generators as wind speeds change, we found that we had a situation in which the balancing of load in the market became problematic. Verve Energy undertook a project to look at what was a new technology called high-efficiency gas turbines. We had moneys approved and have subsequently constructed two 100-megawatt GE LMS100s at our site at Kwinana. Effectively, they are an aeroderivative-type gas turbine, not dissimilar, but simply on a larger scale, to what we see out on the wing of a 747 or an A380. The benefits in system performance are that these turbines can be started and stopped regularly and can change load extremely rapidly; therefore, when we are trying to balance the control of electricity on a system, they do it in a way that no other gas turbine or, indeed, coal or gas-fired plant can do.

We are the first owners of this type of plant in Australia and we are the second owners of this type of plant in the southern hemisphere. From an insurance perspective, they are still considered prototypical, just to give members an indication of the newness of the technology. They have performed outstandingly for us. We brought them into commercial operation in about the middle of last year and they have operated for in excess of 12 months, so we have gathered quite a bit of data from the HEGTs. What we have seen in the last six months that is of direct benefit to the market is that the costs that we incur in balancing the system out have roughly halved over what they were when we used some of our different forms of technology prior to the HEGTs coming into service. Therefore, they have been extremely beneficial to the market broadly on that basis. They have performed at or above our expectations. To highlight the point again, the basis for the investment being made in Verve Energy and why it is so critical is that under the market rules, it is a service that only Verve Energy can provide, so it was very important that we owned and controlled those power stations. We have been very pleased with the decision and it is working out extremely well for us in the market.

Mr J. NORBERGER: Out of curiosity, are those high-efficiency gas turbines operating on an open or closed circuit?

Mr J. Waters: They are open cycle. Closing the cycle of a turbine can achieve some increase in efficiency, given that it effectively captures the waste heat from the generator, uses it to raise steam and puts that steam through a steam turbine. In doing so, though, it reduces the operating flexibility from the facility. The benefit of these turbines is that they achieve efficiency output that is not significantly less than a closed-cycle gas turbine, but they retain the flexibility, from an operational viewpoint, of an open-cycle gas turbine. In fact, they are even better than the other open-cycle gas turbines of the older type that we own. They are open cycle, as I said, and they do that job well.

Mr F.M. LOGAN: I refer to the “Muja AB Power Station” line item under “Works in Progress” on page 751. I note that in the forthcoming financial year, $36 million capital expenditure is to be spent on Muja AB. Can the minister explain to the committee what that expenditure is for?

[2.10 pm]

Dr M.D. NAHAN: I thank the member for the question. There is extensive documentation and estimates in the budget papers more widely. This estimate is in there and only the capital amount is given in that table. It is for works in progress and it is $36 million on the assumption that Muja 1 and 2 will be completed, and that is the estimated cost if we go ahead and complete it. The decision has not been made but we decided to put the costs in the budget papers in case we did; $36 million is the estimated cost of completing the capital aspect of refurbishment.

Mr F.M. LOGAN: Assuming that a decision will be made to spend that money, what will it be spent on?

Dr M.D. NAHAN: I will pass to the CEO.

Mr J. Waters: The expenditure just really extends to the completion of the boiler repair works.

Mr F.M. LOGAN: Just to clarify that, is that completion of boiler repair works on boiler 2?

Mr J. Waters: It is on 1 and 2.

Mr F.M. LOGAN: So, both boilers are not working properly.

Dr M.D. NAHAN: No. Verve and its joint venturer, Vinalco, had started refurbishing both boilers 1 and 2, amongst other things earlier done, and in June of this calendar year we put a stop to it and put it in mothballs and had not finished 1 and 2; so this will be spent on completing the boiler works on 1 and 2.

Mr F.M. LOGAN: Further, there is a note to that expenditure that states —

> The final split between asset investment expenditure and non-asset investment expenditure may vary subject to the finalisation of Verve Energy’s … audit processes, …

Can the minister explain that further?

Dr M.D. NAHAN: Yes. I will pass to the CFO.

Mr W. Borovac: In relation to that note, the $36 million is specific expenditure for the boiler work. What that note highlights is that under the accounting standards, things like interest and other expenses may be capitalised against that expenditure that may be over and above the $36 million. However, that other expenditure is already catered for within the forward estimates as either forward expenses or other assets; for example, it may be assuming that there is coal on hand or cash on hand, but effectively it is just catering for the accounting treatment of that capital expenditure.

Mr F.M. LOGAN: Further to that explanation, could I then assume from that, minister, that the $36 million is simply cash allocated should a decision be made to get both boilers finally repaired and the power station operating, but the expenditure could be more even though it is treated in a different way by accounting practices?

Dr M.D. NAHAN: Yes. Just to clarify, this is the estimate of how much has to be spent on capital repair. Other expenditures will be identified elsewhere in the budget papers for other expenses other than capital if the plant is to be finished. The CFO was saying that some of that treated elsewhere as an expense rather than a capital item may have to be treated as a capital item under the accounting standards, but Treasury put it as an expense rather than a capital item. I am just flagging that.

Mr F.M. LOGAN: Finally on this, what is the estimate of the other expenditures that would be determined as non-asset?

Mr W. Borovac: At this stage in relation to the amount, that was problematic in terms of estimating it, and so we have left it to one side. I do not have a figure. However, the total estimated expenditure has been accounted for in the budget. So, it is simply an allocation between that capital and expenses. But I could not give the member an exact figure. It was just part of the process to actually identify the capital expense.

Mr W.J. JOHNSTON: Further on that, I want to clarify this question about whether this $36 million that appears in the budget papers has been approved or not, because I just draw attention to the "Under Treasurer's Certification" in which he states —

> The Government Financial Projections Statement presented in this budget is based upon Government decisions I was aware of or that were made available to me by the Treasurer on or before the budget planning cut-off date of 9 July 2013 …

Why is this amount in the budget papers if there is no decision, because it does appear that the Under Treasurer's certification is saying that it is a decision of government?

Dr M.D. NAHAN: All I can say is that there has been no final decision on whether to progress with refurbishment of 1 and 2, and it is a decision yet to be made. However, the Treasurer decided to put the full cost of refurbishment of $36 million in the budget to illustrate what it would cost and to make sure that if it was done, it was catered for in the budget and was accurately recorded in the debt levels and expenditure levels. So it is an exercise in transparency. But to reiterate the member's question, a decision has not been made.

Mr M.H. TAYLOR: The minister touched briefly on load following auxiliary services in the member for Joondalup's initial question. Can the minister explain in a little more detail what it is and its effect on Verve?

Dr M.D. NAHAN: Yes. I will hand the question over to the CEO.

Mr J. Waters: I did touch on it briefly in discussing the high-efficiency gas turbines—HEGTs. Since market commencement in 2006, as I touched on, an emerging issue in the market has been that we have had costs that Verve Energy incurred as a result of managing ancillary services and load following in the market. We spoke about it in the context of the HEGTs in that we were permitted by government to invest money in these facilities as a means of controlling the cost of the services that we were providing. In addition to that, a few years ago the Independent Market Operator identified that Verve Energy was effectively providing a significant subsidy to the market as a result of the requirement to provide this load following ancillary services to the market providers. It is a critical service, as I mentioned, and it is also a service that has gotten harder to provide given the amount of renewable energy that has come in from not only wind farms, but also even the extent of rooftop solar that has penetrated the market in recent years. As the sun goes behind a cloud, the output from rooftop solar drops and we have to back our plant off. Until July 2012, Verve was the sole supplier of the service, and we were not provided any direct compensation for the work that we were doing and the costs we were incurring as a result of that. The IMO did two things in 2012. It implemented a new market or a new portion of the market that we now call the LFAS—load following ancillary services—market and the IMO also opened that market up to competition. So, since July last year, not only is there now a market and compensation paid to Verve Energy for the supply of the LFAS, but also independent market generators are now also free to participate in that market and actually supply the service that once upon a time we would have, or had for many years, provided on our own. At this stage there is one market competitor of ours that does enter that market and provide load following ancillary services in addition to us—particularly overnight. The outcome of the market is that we have made approximately $40 million of additional revenue in the last financial year that we did not make prior to that market, which I think from our point of view does one thing in that it points to the extent of the subsidy that we had actually provided over many years prior for which we were not compensated. We could not say that the number would have been $40 million every year since the market started because, as I said, the amount of wind that has come into the market has increased progressively since 2006 when the market started. We would certainly be of the view that maybe as much as $100 million of value had been transferred to the market by Verve Energy since the load following service arrangement kicked off and before we were earning proper revenue for the supply of the service. At least now, moving forward, we have a proper market and, importantly, we have something that the private sector can also access; it can compete with us and have its share of that revenue.

Mr W.J. JOHNSTON: I referred to the ANZ Bank facility that was entered into by Vinalco. Does that debt facility still exist and who now holds the debt? Does Vinalco continue to hold it or does someone else hold it?

[2.20 pm]

Mr J. Waters: I can confirm that the debt facility exists. It is held by Vinalco as part of the resolution of the Inalco equity arrangements in Vinalco.

Mr W.J. JOHNSTON: What is the spread between the ANZ Bank facility and the debt in Verve through the Western Australian Treasury Corporation?

Dr M.D. NAHAN: Could the member clarify that?

Mr W.J. JOHNSTON: The spread is the difference in the interest rate. It is a common term.

Dr M.D. NAHAN: There are many different definitions of spread.

Mr J. Waters: I would have to take that on notice for fear of misrepresenting the situation.

The CHAIRMAN: Is that supplementary or on notice?

Dr M.D. NAHAN: On notice.

Mr W.J. JOHNSTON: It would not —

The CHAIRMAN: It is up to the minister to make the decision.

Dr M.D. NAHAN: I will do it as supplementary information.

[*Supplementary Information No B33.*]

Mr W.J. JOHNSTON: Do you want me to repeat the question?

The CHAIRMAN: Yes.

Mr W.J. JOHNSTON: Could the minister clarify what the interest rate spread is between the ANZ Bank Vinalco facility and the debt provided to Verve by Treasury Corp? Is it intended to pay out the ANZ Bank facility and replace it with Treasury Corp debt?

Dr M.D. NAHAN: Treasury Corp and Verve have a whole spread of debt with different conditions, different rates and different durations.

Mr W.J. JOHNSTON: I will rephrase the question if that is easier.

The CHAIRMAN: Is this for the supplementary information?

Mr W.J. JOHNSTON: Yes. What is the interest rate spread between the ANZ Bank Vinalco facility and Treasury debt on the same duration as that provided to Verve by Treasury Corp? Are we happy with that?

The CHAIRMAN: Yes, that is good.

Mr W.J. JOHNSTON: Is it intended to pay out the ANZ Bank facility and replace it with Treasury Corp debt? If that is what the government intends to do, will it have to pay ANZ Bank for that?

Dr M.D. NAHAN: The decision has not been made on that yet.

Mr W.J. JOHNSTON: Are there fees if the government decides to do it?

Dr M.D. NAHAN: There could be some swap fees, but a decision on that has not been made yet.

The CHAIRMAN: Member for Alfred Cove.

Mr D.C. NALDER: Thank you, Chair.

The CHAIRMAN: That is all right. I was going to call you the member for Churchlands and get into trouble.

Mr D.C. NALDER: Do not call me the member for Churchlands, please. What is the status of Verve Energy's gas supply contracts, particularly in relation to the effectiveness of the domgas reservation?

Dr M.D. NAHAN: That is a very good question. As the member knows, a number of the Verve contracts with the North West Shelf, which have underpinned electricity production and consumption in Western Australia for a long time, are up for renewal. As a result, Verve has been in negotiations with the Chevron Gorgon joint venturers to renew or replace those contracts. The North West Shelf was approached but chose not to enter into negotiations to replace its contracts. Verve has negotiated a first tranche from the Gorgon project with the Gorgon joint venturers. The reservation does not apply to Gorgon. It has an agreement act and it has to build a plant for domestic gas for 150 terajoules a day, which it has done. It is in the market letting that. It had to build a plant for 300 terajoules a day to come in two tranches of 150 each. It has been marketing that 150 and Gorgon and Synergy have negotiated some of that. Verve is waiting to do the same with Wheatstone, which will put in excess of 150 terajoules on the market. Verve and Synergy will no doubt enter into negotiation with the Wheatstone joint venture, which is primarily Chevron, to negotiate some gas from the Wheatstone projects. The Wheatstone project is affected by the 15 per cent reservation policy. That specifically requires liquefied natural gas projects to reserve 15 per cent of the total production for the domestic market. Things are going well. There is some debate about the demand–supply position of gas in the market. I encourage people to look at the Independent Market Operator report. The IMO recently put out a report on the future gas outlook for the state and there is some debate about supply and demand. I urge members to take a look at it.

Mr F.M. LOGAN: We know.

Dr M.D. NAHAN: Good. It is different from what we found earlier, but nonetheless. In summary, Verve is in negotiation and has negotiated some. One of the reasons for the merger of Synergy and Verve is that they will more effectively negotiate together for their gas needs for both Synergy's and Verve's activities.

Mr F.M. LOGAN: Given the time when the gas contracts for Verve come to an end and the actual completion phase of Gorgon's domgas facility, for example, which is nowhere near complete at the moment, and given the delays that are happening in the construction up there, is there a possibility that those contracts will come off and the supply will not be available to Verve?

Dr M.D. NAHAN: It is an issue that is of concern and has been monitored by Verve, Synergy and the rest of the market. Will the Gorgon domgas production be put on the market in a timely manner and supply the gas as planned? I have had, and I am sure Verve has had, frequent discussions with the Gorgon joint venture partners and they assure us that they are on track. One reason is that they say they are expediting the production of the domgas facility ahead of other aspects so that it comes on the market. I have had numerous discussions with the Chevron joint venture partners on that. It is an issue, and it is an issue with monitoring. I will pass to the CEO and he can make a comment.

Mr J. Waters: We are quite confident that we have managed things so that we will have an overlap of supply between our outgoing and incoming contracts. We are in regular contact with the Gorgon team and we are tracking its delivery. We have a view that things are going well and we will achieve delivery within the targeted time frame. Therefore, we will have a small overlap of contracts. As the minister said, it is something that we were always alert to and monitoring closely, because clearly we would not want that situation to emerge.

Mr F.M. LOGAN: I refer to page 751 and the references to Muja A power station. The minister has talked at length about the decision to bring Muja AB back on or not bring Muja AB back on. What are the key indicators or factors that will determine the decision to bring on Muja AB or not bring on Muja AB?

[2.30 pm]

Dr M.D. NAHAN: Thanks for the question; it is a very good one. A thorough engineering review of what has been done to date is underway. It has a mandate to look at what has been done and whether anything is missing, and to come up with a risk assessment. If we were to complete it, what other capital needs to be invested? What are the technical risks of bringing on an old plant?

That is underway. In parallel and interacting with that there is a financial review of the total cost of that refreshing, the returns of doing so and the outlook of output of the gas in the market in the future—so we look at technical risk. As the member well knows, with the decision to refresh that plant, there were a whole range of unforeseen technical failures that have significantly increased costs. Advice from myriad sources is that refreshing old plants is technically risky, and we want to make sure there is nothing out there we do not know about, both with technical risk and the cost of it going forward. We will then do a financial assessment, including the cost, the timing and the returns both to the state and from the market. I add that power from Muja AB units 3 and 4 is sold to a private retailer and the capacity credits for Muja AB units 1 and 2 lie with the private sector venture, too.

Mr F.M. LOGAN: Is any work at all being undertaken at the moment on Muja AB 1 and 2?

Dr M.D. NAHAN: No, we mothballed it. There might be some people patrolling the site and other protective measures, but we mothballed the site some time ago

Mr J. NORBERGER: How important is it for the state government trading enterprises to be involved in long-term gas supply contracts as new major projects come online?

Dr M.D. NAHAN: As I indicated earlier, gas is basically the main fuel supply for this state, particularly up north. It is the only source for Horizon Energy and is the dominant source of energy supply here not only for electricity, but also for supplying the mining sector, which generates most of its own electricity. The challenge is that for the last 15 to 20 years we have been used to relatively low-priced gas from the North West Shelf. Those contracts will finish and we will go to new sources and suppliers, and their prices are much higher. There is also significant gain in a large entity like Verve–Synergy being able to take large take-or-pay contracts without any variations on them. The price goes down sharply in terms of both the size of the contract and the reduction in the number of conditions put on it. Combined organisations like Verve–Synergy, particularly given their asset base and the state guarantee, can get gas cheaper than just about anybody except maybe Alcoa, which buys a lot of gas. Therefore, it is very important we become involved in that, particularly with the transition to new sources of gas, to mitigate the price rises when we shift to those higher priced sources of gas.

Mr W.J. JOHNSTON: On page 185 of budget paper No 3 it states that the impact of the Muja AB project on the 2012–13 general government operating balance is minus $3.6 million. However, I also note that in Parliament we have been told that Muja AB is “actually still net present positive”, and we have also been told that the electricity is being sold at a profit. Can the minister please tell us which of these statements is true? Are the budget papers correct in stating that the Muja AB project has negatively impacted on the state’s bottom line or are the budget papers wrong and the project therefore traded profitably in 2012–13? Which is it; did it have a negative impact on the bottom line of the state or was it trading profitably?

Dr M.D. NAHAN: All I can say is that Muja 3 and 4 have been operating since March or so and they have been operating cash positive, which is expected to continue over the period we are now examining. So two units have been operating well and cash positive.

Mr W.J. JOHNSTON: I am not quite sure why the budget papers show the opposite. What does “cash positive” mean? Is the minister saying costs of sales are less than the costs being received? Does that include the depreciation of the asset?

Dr M.D. NAHAN: It is operating cash positive, so the sales exceed the operating costs of the plant. That is what was predicted and that is what is happening.

Mr W.J. JOHNSTON: Does that mean that it is not currently paying its capital costs?

Dr M.D. NAHAN: As the member remembers, it was funded through a debt facility of $150 million, which is part of the cost. Part of the $150 million, of course, went to units 1 and 2. It was funded 100 per cent by debt and it is operating and paying the debt as well as the operating costs.

Mr W.J. JOHNSTON: As I understand it, the intention was to capitalise interest payments into the debt facility. Is that correct?

Mr J. Waters: The original engineering, procurement and construction works component was $107 million and the total borrowings were $150 million. Those total borrowings included the capitalisation of interest drawn down during the EPC phase. Now that units 3 and 4 are running, the cash flows from the business, minus the operating costs, leave sufficient funding to repay the debt and ensure, ultimately, the profitability of the project in an operating sense.

Dr M.D. NAHAN: Because of that, the outstanding debt is about $140 million, because about $10 million has been paid back through the operating profit of units 3 and 4.

Mr W.J. JOHNSTON: But that is after another one hundred and something million dollars was put into the project through special decisions.

Dr M.D. NAHAN: No; the additional money is going into units 1 and 2.

Mr W.J. JOHNSTON: I do not understand. My understanding was that the Vinalco joint venture was for both Muja A and B. Is the minister saying that if the part that does not work is ignored, the other bit pays for itself?

Dr M.D. NAHAN: We have not made a decision to refresh units 1 and 2, which is what this whole issue is about. The member's question related to what the project is now. Units 3 and 4 are operating and they are creating an operating profit, which covers the loan.

Mr W.J. JOHNSTON: That is not the question I asked. I asked about Muja AB. If the minister wants, I will ask it again: is the Vinalco joint venture repaying its capital costs? According to the budget papers, that figure is $330 million.

Dr M.D. NAHAN: Part of the Muja AB joint venture is operating and part of it is mothballed. The mothballed part is not paying for itself, obviously—it is not generating because it is mothballed. Therefore, of course, the operation of units 3 and 4 is covering the loan, but not covering all the capital costs associated with units 1 and 2, so, obviously, the capital and the non-working part are still sitting there.

Mr W.J. JOHNSTON: When is it expected, over the 15-year life of this plant, that the total investment of the state, whether that is loan capital or straight investment by the taxpayer, for the whole package—that is, the Vinalco joint venture, which was both Muja A and B—will be repaid?

[2.40 pm]

Dr M.D. NAHAN: First, as the member knows, when we make the decision about whether we will complete units 1 and 2 and therefore know the total capital cost, we will be able to make that decision. As I indicated, we have work underway into the financial aspects that will address those questions. So until we make a decision on units 1 and 2, I cannot answer the question the member has put forward.

Mr W.J. JOHNSTON: Is the minister saying that the $330 million that is shown in the budget papers could in fact increase, because, as the minister has said, he does not know what the final cost will be?

Dr M.D. NAHAN: No. What I said is that $330 million is our current estimate of the total outlays for the project from the state for refurbishing Muja AB units 1, 2, 3 and 4. The member's question was of that $330 million total outlay—which includes, I might add, the $150 million worth of loans—when will we get a repayment for that? I quite rightly said that that is one issue that we are trying to address and make a decision on, so I cannot answer that question until we decide what the size of the project will be and specifically whether we will complete the refurbishment of Muja AB 1 and 2.

Mr W.J. JOHNSTON: Is the minister saying it could be more than $330 million?

Dr M.D. NAHAN: Right now, our estimate is that the total outlay to refurbish the plant is $330 million.

Mr F.M. LOGAN: My question relates to the overall discussion that we are having about the value of the project. What is the asset value of Muja AB as of 30 June 2013?

Dr M.D. NAHAN: Mr Borovac.

Mr W. Borovac: At the moment, on the books, the capital asset is being carried at $228 million. The overall value is something that we are at this stage still to determine for accounting purposes. It does not take into account the commercial value. It is an accounting valuation that we are currently working on. But at the moment, the value on the books is $228 million.

Mr F.M. LOGAN: So the book value is $228 million?

Mr W. Borovac: Yes. That is the underlying asset value.

The CHAIRMAN: Through the minister, please.

Mr F.M. LOGAN: Through the minister, a value is needed to complete the balance sheet, so is the book value for Muja AB $228 million?

Mr W. Borovac: That is currently the value that is sitting on our books. However, that is subject to final audit.

Mr W.J. JOHNSTON: This has thrown up a question for me, because in the 30 June 2012 annual report, the total valuation for all the joint ventures was $16.236 million. Is the CFO saying that —

Dr M.D. NAHAN: No; through me, please.

Mr W.J. JOHNSTON: I am, minister. Is the CFO saying that the value of this joint venture has gone up by over $200 million over the last 12 months?

Dr M.D. NAHAN: Mr Borovac.

Mr W. Borovac: Currently, upon our taking control of the Vinalco entity, we have now fully consolidated the underlying assets and liabilities of the entity, and per the budget papers we are now reflecting the $228 million that is its underlying asset value. In the 2012 balance sheet, we reflected the net equity value of our investment in those joint ventures, because there was no requirement to consolidate those. There was simply a requirement to reflect those as an investment and account for the underlying value, if you like, through our net equity value.

Mr W.J. JOHNSTON: I just want to clarify this, minister. As I understand it, Inalco, which was Verve's joint venture partner in this project, could not get anyone to pay one cent for the project. How could Verve get a valuation of $228 million for the project, when 50 per cent of the project was valued at zero? How could that occur?

Dr M.D. NAHAN: How does the member know that it could not get anybody to buy it?

Mr W.J. JOHNSTON: Because it is in the briefing papers.

Dr M.D. NAHAN: It did put it to market, and I understand it did get some indications. The first point is that I am not sure that the member's preamble in the question is accurate.

Mr W.J. JOHNSTON: Verve Energy told us that in the briefing papers.

The CHAIRMAN: Member, let the minister answer the question.

Dr M.D. NAHAN: As the CFO said, it consolidated it in its own books in this budget and valued it at $228 million.

Mr B.S. WYATT: I just want to clarify something, and I think the minister can answer this quite quickly. I refer again to page 185 of budget paper No 3. Is it correct that when the minister said it is cash positive, that is in respect of units 3 and 4 only; and the figures at page 185 for general government net operating balance of negative $3.6 million, negative $18.6 million, negative $25.9 million, negative $8.8 million and negative $10.7 million are for the value of Muja AB 1, 2, 3 and 4, including the capital cost? Have I understood that correctly?

Dr M.D. NAHAN: Yes. To answer the member's first question, the cash positive relates to the operating position for units 3 and 4. That is cash positive, and that is paying off the loan. There are other expenses that have been incurred and will be incurred if we refurbish the plant going forward, and they are represented in the table at page 185 that the member is referring to. I will pass over to the CFO to explain that.

Mr W. Borovac: Those figures represent what we in a preliminary way have valued the entire project at. We have taken an impairment in the current year of around $30 million, and we expect to take an impairment in the subsequent year of about $30 million. These figures represent prudent accounting and valuation of the total project value and bring us in line with the accounting standards. As I said earlier, we are still waiting for the final valuation, and once that valuation comes through, we will then confirm what those impairment values will be. Again, they represent what we would call basically the equivalent of depreciation and effectively writing down the underlying asset values. At this stage, as I said, the book value is $228 million. We will in the current year make a final decision on how much we write down that total investment.

Mr B.S. WYATT: And I assume that is likely to be more than $30 million?

Mr W. Borovac: In the current year under the consolidated books, it will be in the vicinity of $30 million or $32 million, and in the subsequent year we expect to write it down by another $40 million.

Mr F.M. LOGAN: I want to come back to an answer that was given to the committee by the CFO about the asset value of Muja AB. I am having difficulty understanding how half a power station can be valued at $228 million. Two turbines are working, and the remainder is mothballed, and it has been valued at $228 million, which could be seen as half the valuation of Muja C. How did the CFO come to such a significant amount with half a power station?

Dr M.D. NAHAN: Mr Borovac.

Mr W. Borovac: In relation to the $228 million that is shown in the budget papers, that represents the capital investment, if you like, so I guess it is the current value of the cost, without the valuation adjustment. The final underlying value of the asset —

[2.50 pm]

Mr F.M. LOGAN: The asset itself —

Mr W. Borovac: Yes; the plant and equipment is still subject to valuation. As I said, we have taken this preliminary position that over two years we are writing it down by $70 million. To answer the member's question, I guess we are looking at two different figures; one is what we have expended and will expend, and the second aspect is the actual underlying valuation. I guess the impairment reflects that adjustment.

Mr F.M. LOGAN: Further to that —

Dr M.D. NAHAN: I just want to clarify something before the member goes to his question. The $228 million refers to the whole asset; two of the units are working and one is in a partly repaired state. The valuation relates to the total asset and not just units 3 and 4.

Mr F.M. LOGAN: Further to that, the chief financial officer clearly indicated that the book value is related to the capital cost, because obviously the plant and equipment has not yet been properly audited to contribute anything—if anything—to the overall asset value. Why, then, is the capital cost written up as $228 million, given that over $300 million has been spent?

Dr M.D. NAHAN: In relation to that, units 3 and 4 are operating and units 1 and 2 are in a suspended state of repair. That would have some value. Someone might want to buy it and finish it off.

Mr F.M. LOGAN: That might be the minister's view, but that is not what the CFO said.

Dr M.D. NAHAN: I will pass over to him to clarify what he said.

Mr W. Borovac: Could the member clarify the question?

Mr F.M. LOGAN: The information Mr Borovac provided to me in terms of the asset value relates to the capital expenditure so far, because the plant and equipment has not yet been properly audited.

Mr W. Borovac: Yes.

Mr F.M. LOGAN: Given that over $300 million of capital has been spent on the project, why is it valued at only $228 million?

Mr W. Borovac: If I can clarify, the $330 million that is disclosed in the budget papers relates to expenditure, including prospective expenditure, should the government decide to proceed to complete the M1 and M2 refurbishment. The $330 million is to the end of the project to get it up and running.

Mr F.M. LOGAN: True, but it would still be $294 million if the $36 million that has been allocated is taken out.

Mr W. Borovac: Yes. If I could complete that, at page 751 of budget paper No 2 we show that Muja power station is expected to have capital expenditure of $264.4 million by the time it is ready. The difference between that and $330 million represents, as I said, other assets that will be in there—coal on hand, cash, receivables et cetera. The balance represents what we have funded in interest costs that have been expended, other ongoing costs et cetera and capacity refunds. That is the net expenditure. The difference between the $264 million and $330 million is made up of a mixture of other assets and losses in the underlying period from the time the project began to the time it is completed.

Mr W.J. JOHNSTON: I have a further question on this. What the entity is saying is that the current carrying value of the asset of $228.4 million is 100 per cent of what has been spent on it, and the value has not actually been written down at all.

Mr W. Borovac: The $228 million is in fact what we have spent on the project. As I said earlier, in the budget we have taken an impairment in the current year of $30 million or thereabouts. That is reflected on pages 185 and 186 of budget paper No 3 and contributes to the losses we are disclosing in both 2013 and 2014. In effect, we are reflecting, if the member likes, the impairment to that. As I said, once we finalise the audit, of course this will all come out in the annual report. However, this is our best estimate. We have taken the impairment through the budget papers to ensure that the impact is reflected in the state's books.

Mr W.J. JOHNSTON: I note that it states on page 28 of the *Pre-election Financial Projections Statement* that an engineering and financial analysis of the Muja AB project had been commissioned. I understand that this reported to the minister in April this year. I have a couple of issues arising from that. With regard to the engineering analysis, who commissioned that analysis, how much did it cost, who conducted it, when did it report and to whom did it report? With regard to the financial analysis, who commissioned this analysis, how much did it cost, who conducted it, when did it report and to whom did it report?

Dr M.D. NAHAN: I will take those on notice.

The CHAIRMAN: As a question on notice or as supplementary information?

Dr M.D. NAHAN: On notice.

Mr W.J. JOHNSTON: What does that mean? Is the minister asking me to place the question on notice?

The CHAIRMAN: To place it on notice.

Mr W.J. JOHNSTON: I have a further question. I note that when the minister was briefed on the financial analysis of the project, the consultants were critical of the initial establishment and governance of the project. Could the minister let us know the reason for that criticism?

Dr M.D. NAHAN: I received a lot of advice from a variety of sources on the project.

Mr W.J. JOHNSTON: I am just —

Dr M.D. NAHAN: Let me finish.

The CHAIRMAN: The member can ask a further question.

Mr W.J. JOHNSTON: I was just going to clarify my question. I referred not to just any advice but specifically to the briefing the minister received from the consultants who provided the financial analysis.

Dr M.D. NAHAN: I received briefings from a number of consultants and parties on this issue. Some were very critical of the report. Of course, the biggest criticism was that it was losing money and that there was a serious blowout in the heating tubes. There was an issue with the joint venture falling apart; that is, Inalco wanted to get out and was struggling to meet its obligations within the joint venture arrangement. There was a whole raft of issues with it. As I have indicated before, the joint venture structure itself, which Verve underwrote, was criticised. The strength of Inalco was criticised; as it turned out, it did not have the fiscal capacity to stay with the project. When it got into trouble in providing its engineering, procurement and construction services, it had little cash or capability to meet any overruns in the EPC. Of course, there were the problems with the heating tubes. There was a whole range of issues. There was the technical issue of identification of the cost of it. Of course, there was also a blowout in the EPC. Kempe signed a fixed-price contract for the EPC. It ran into significant problems with that contract, which led to a knock-on effect on its ability to sustain its position in the Vinalco joint venture. I received a whole range of briefings on a range of issues delivered by many consultants and, I might add, there were many aspects to the criticism, much of which we have discussed in this place before.

The CHAIRMAN: I will be putting the question in about 30 seconds.

Mr F.M. LOGAN: This question goes to the joint venture the minister just referred to. How much did the Vinalco joint venture pay to the Kempe group, including Inalco, as development cost recovery? Why was the payment made and when was the payment made?

Dr M.D. NAHAN: Could the member just repeat the question?

[3.00 pm]

Mr F.M. LOGAN: How much did Vinalco joint venture pay the Kempe group, including Vinalco, as a development cost recovery; why was the payment made and when was this payment made?

The CHAIRMAN: Does the member want to do that on notice?

Mr F.M. LOGAN: We can do that on notice.

The CHAIRMAN: As supplementary information?

Dr M.D. NAHAN: Yes, as supplementary.

[*Supplementary Information No B34.*]

The CHAIRMAN: That completes the examination.