



STATEMENT OF CORPORATE INTENT

2009-2010

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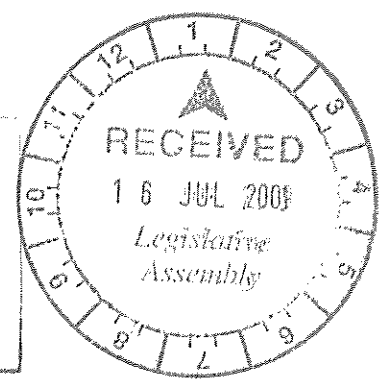
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## 1. SUMMARY

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

To realise its vision of being a vibrant and innovative energy business by being commercially, socially and environmentally successful, 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:

- the Vesting Contract between Verve Energy and Synergy is renegotiated on sound commercial terms in 2009/10;
- regulated electricity tariffs continue the path towards cost reflectivity in 2009/10 and the Government commits to a Community Service Obligation that fully covers the difference between cost reflective tariffs and any glide path chosen by the Government; and
- the Wholesale Electricity Market Rules provide for a fair, equitable and stable market environment.

The financial performance of Verve Energy in 2009/10 is expected to improve compared to 2008/09 reflecting the anticipated commencement of retail tariff adjustment towards cost reflectivity and the renegotiation of the Vesting Contract.

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

Key business risks to be managed in 2009/10 include:

- the uncertainty associated with the renegotiation of the Vesting Contract;
- decreasing gas supply security and increasingly frequent gas curtailments;
- ageing plant and workforce;
- increasing competition in the baseload market, leading to accelerated deterioration and reduced efficiency of thermal plant due to frequent starts and low capacity factors; and
- obligations under the Market Rules that require Verve Energy to provide balancing and ancillary services.

Verve Energy will target eight strategic areas in 2009/10:

- develop a customised investment and operational strategy for each power station based on its current and potential contribution to the value of the business;

## 2. THE BUSINESS

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

Verve Energy's core business in 2009/10 will continue to be the reliable and efficient generation of electricity.

Verve Energy currently owns or controls about 69% of the thermal and 7% of the renewable generation capacity on the South West Interconnected System (SWIS). Following the commissioning during 2008/09 of Bluewaters 1 and NewGen Kwinana by private operators, Verve Energy's share of the total thermal generation capacity on the SWIS will drop to 61% in 2009/10. Renewable generation capacity share is expected to remain static at 7%.

Verve Energy's existing electricity products include energy sales, capacity credits, and ancillary services. It is expected to remain the sole or primary provider of balancing and ancillary services during 2009/10. Verve Energy also engages in sales, swaps and purchases of natural gas, gas transport capacity and gas storage.

Synergy is by far Verve Energy's biggest electricity customer. About 82% of the electricity generated in 2009/10 will be supplied to Synergy under the Vesting Contract established between the parties at disaggregation under the *Electricity Corporations (Vesting Contract) Order 2006*.

## 3. STATUTORY FRAMEWORK

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

Verve Energy is governed by a Board of Directors, directly responsible to the Minister administering the Act (the Minister). This is currently the Minister for Energy, 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 before 2013, except as authorised by the Minister. The Minister has discretion to extend this prohibition until 2016. Parts 4 and 5 of

**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 can not invest in new capacity other than generation that is solely fuelled by renewable sources until plant retirements bring it below the cap, and can then invest only to the extent the cap is not exceeded.

Verve Energy will therefore not install new plant until Kwinana A (240 MW) is decommissioned in September 2011, after which there will be the opportunity, subject to Verve Energy's financial capacity to invest, to construct new, efficient plant or to expand capacity in existing plant.

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.

**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. This is an opportunity cost rather than a direct cost to Verve Energy.

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

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

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

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

Following the expiry of the exemption for electricity generators in mid-2009, Verve Energy expects to be subject to the *Energy Efficiency Opportunities Act 2006 (Cwlth)*.

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.

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.