

Delta Electricity

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NSW Auditor-General's Report
Volume Four 2011
DELTA ELECTRICITY

The loss resulting from the electricity sale transaction was \$902 million.

Proceeds from sale of electricity generation output equals 33.6 per cent of the carrying value of power station assets.

Audit Opinion

The audit of Delta Electricity's financial statements for the year ended 30 June 2011 resulted in an unmodified audit opinion within the Independent Auditor's Report.

The Independent Auditor's Report drew attention to significant uncertainty regarding the effects of the Australian Government's carbon price scheme.

Unless otherwise stated, the following commentary relates to the consolidated entity.

Operational Snapshot

Delta Electricity generates and provides electricity to its customers in different ways:

Coal fired thermal power stations	Open cycle gas turbine power station	Mini hydro generators
Vales Point	Colongra	Mount Piper
Munmorah		Chichester Dam Dungog Water Treatment Plant

Delta Electricity also operates and maintains the Mount Piper and Wallerawang coal fired thermal power stations. The output from these stations has been purchased by TRUenergy Pty Ltd (see below for details).

Delta Electricity made a loss of \$196 million after tax in 2010-11. The total cost to operate and maintain the power stations for the year was \$1.4 billion, which included an asset impairment of \$381 million. No dividend was paid to the government for the year.

Key Issues

Electricity Sale Transaction

As a result of the government's Energy Reform Strategy, GenTrader Transaction Implementation Deed were executed with TRUenergy Pty Ltd on 14 December 2010. Under the agreements all generation output for the expected useful lives of the Mt Piper (33 years) and Wallerawang (19 years) power stations (known as Delta West) was sold to TRUenergy Pty Ltd (GenTrader) with effect from 1 March 2011.

The upfront proceeds from the sale and the carrying value of assets immediately prior to the sale were:

Delta West	\$'000
Proceeds From Sale:	
Right to generation output	453,800
Fuel stock	75,996
Development sites	17,611
Total	547,407
Carrying Value of Assets at Time of Transaction:	
Power stations	1,348,748
Electricity derivative contracts	22,402
Fuel stocks	74,391
Development sites	4,029
Total	1,449,570
Loss	(902,163)

The proceeds from selling the generation output were 33.6 per cent of the carrying value of applicable power station assets. The carrying value represented Delta Electricity's expectation

of net cash to be earned over the remaining life of the power stations. The expectation did not include an estimate for the impact of a carbon price scheme.

Last year, I reported the government's strategy was to significantly increase private sector investment in new generation capacity for New South Wales and increase competition in the NSW electricity market. I indicated that achieving this objective may require some trade-offs between maximising the financial return to the government and minimising potential ongoing government liabilities.

An Australian Tax Office private ruling is currently being sought to clarify the tax deductibility of capacity charge payments made by the GenTrader. If a positive outcome is achieved, an additional amount of approximately \$60.0 million will be received.

In Volume One of my 2011 Report to Parliament, I identified a number of risks and uncertainties for Delta Electricity arising from the sale. The following is a summary of the financial impact of the risks for the period 1 March to 30 June 2011:

Uncertainties/Risks	Update
Availability Liquidated Damages	
Where contracted availability targets are not achieved, Delta Electricity must pay liquidated damages to the GenTrader. The annual amount of liquidated damages is capped.	Delta Electricity paid liquidated damages of \$221,479 1 March to 30 June 2011. Liquidated damages of \$46.3 million are forecast over the next four years. The Crown will reimburse Delta Electricity for liquidated damages above an agreed threshold.
Fixed Operating (Including Salaries and Wages), Maintenance and Capital Costs	
The variability between costs associated with operating and maintaining the power stations and the fixed, variable and pass through charges in the GenTrader Agreements is the responsibility of Delta Electricity.	Measures to manage the risk of cost overruns include establishment of cost reduction performance targets.
Risks associated with timing mismatches between fixed cash inflows from the GenTrader and variable cash outflows by Delta Electricity are Delta Electricity's responsibility.	Delta Electricity currently has cash surpluses associated with the variability between cash inflows and outflows.
Generation of Excess Electricity	
Delta Electricity must pay the GenTrader over-generation charges when more electricity is generated than instructed by the GenTrader.	Delta Electricity advised that controls are in place to manage the risk of over generation. Over generation charges paid during the year were minimal.
Development Sites	
The GenTrader agreements do not require the GenTrader to develop sites within specified timeframes.	The transaction involved the sale of development sites at Marulan and Mt Piper to the GenTrader and Bamarang to Lumo Generation NSW Pty Ltd resulting in a net gain on sale of \$13.6 million.
Mt Piper site encompasses a rehabilitated open cut mine area. Delta Electricity is liable for unlimited remediation costs at the site prior to development.	The sale of the Mt Piper development site was completed by 21 October 2011. The GenTrader is required to perform a contamination survey to determine whether the site has pre existing contamination. If contamination is identified, a remediation action plan will need to be developed at Delta Electricity's cost. I understand a contamination survey has not yet been performed and Delta Electricity is not aware of any contamination.

Uncertainties/Risks	Update
Coal	
The cost of remedial action to manage clinkering (the removal of incombustible residue arising from the burning of coal) is the responsibility of Delta Electricity.	Delta Electricity has advised that the likely impact of clinkering is minimal.
<p>Entitlement to Reimbursement Under the <i>State Owned Corporations Act</i></p>	
<p>Under the <i>State Owned Corporations Act 1989</i> (SOC Act) a State owned corporation is entitled to be reimbursed for the cost of complying with ministerial directions that the entity's Board consider to not be in the commercial interests of the entity.</p>	
<p>On 14 December 2010, the Special Minister of State issued a direction under section 20N(1) of the SOC Act to the Directors of Delta Electricity to, among other things, enter into the GenTrader Agreements. The directors advised that the transaction was not in the commercial interests of their entity.</p>	
<p>Delta Electricity has issued three letters to Treasury seeking reimbursement of costs associated with ministerial directions made under the SOC Act.</p>	
<p>As at the date of this report, total net costs to be claimed have not been quantified.</p>	
<p>Update on the Financial Status of Delta Electricity Australia Pty Limited (the Company) and Ongoing Obligations for Delta Electricity</p>	
<p>In Volume Four of my 2010 Report to Parliament, I reported that Delta Electricity's subsidiary company had breached its loan covenants and was trying to sell assets to repay \$68.0 million in bank loans. The sale process failed and the company was placed into receivership on 28 February 2011.</p>	
<p>In my 2010 report, I recommended Delta Electricity review and identify the factors contributing to the losses incurred from its participation in the joint venture (see below). Delta Electricity completed this review and identified the following contributing factors:</p>	
<ul style="list-style-type: none"> • the commissioning of the plant taking longer than planned • lower than forecast quantities of fuel (bagasse) for co-generation plants to burn • limited availability and higher than expected costs of alternative fuel supplies • the price of renewable energy certificates being lower than forecast. 	
<p>The joint venture was established to design, construct and operate two 30 megawatt renewable energy electricity co-generation plants at Condong and Broadwater. Delta Electricity has ongoing obligations to the joint venture under a Power Purchase Agreement and Cost Sharing Deed. These agreements terminate in November 2023.</p>	
<p>Costs incurred during 2011 were \$11.4 million (\$3.8 million in 2009-10). Future obligations were estimated at \$40.8 million.</p>	
<p>Adjustment to Delta Electricity's Dividend as a Result of the GenTrader Transaction</p>	
<p>Prior to the GenTrader transaction Delta Electricity agreed the basis for calculating dividends for 2010-11 with its shareholders. Following the GenTrader transaction the basis was changed, at the request of Treasury, to take into account the changed circumstances. The proposed dividend under this basis was \$62.3 million. However, because the amended basis was not approved by the voting shareholders by 30 June 2011 the proposed dividend was determined to be invalid. The final result was that no dividend was recognised because the operating result for the year was a loss.</p>	

Performance Information

Delta Electricity provided the following information regarding its performance:

Year ended 30 June	Target	Actual			
	2011	2011	2010	2009	2008
Generation of electricity – gigawatt hours sent out	22,738	21,501	21,999	23,746	24,054
Plant availability – total all stations (%)	88.4	91.4	92.0	86.8	77.3
Thermal efficiency – total all stations (%)	35.7	34.9	34.6	34.6	35.0
Earnings before interest and tax (\$m) (c)	184.1	(176.1)	189.7	146.4	212.1
Return on equity (%) (a) (c)	5.8	(38.3)	6.2	7.5	12.7
Return on assets (%) (b) (c)	6.1	(8.1)	5.9	4.5	7.7
Interest cover (times) (c)	1.7	(1.7)	1.7	3.2	4.9
Debt to equity (%) (c)	128.6	166.2	149.8	130.3	86.5
Total Distributions to Government (\$m) (c)	72.7	--	59.2	84.6	180.0
Capital expenditure (\$m) (c)	84.5	52.4	97.1	379.5	251.8

a profit after tax divided by equity.

b earnings before interest and tax divided by total assets.

c the 2011 figures are impacted by the sale transaction. As a result, comparison of financial performance with target or prior year information is not practicable.

Production of electricity was below target in 2010-11 mainly as a result of the sustained periods of low spot prices which made production of electricity uneconomical.

Targeted plant availability was exceeded as a result of the maintenance expenditure program focusing on reliability issues.

The production of electricity by Delta Electricity releases carbon dioxide and other greenhouse gases directly into the atmosphere. Based on draft data provided, Delta Electricity had direct carbon dioxide emissions of 19.8 million tonnes during 2010-11.

Thermal efficiency is a performance measure commonly used by power stations. The thermal efficiency percentages above indicate the average percentage of energy contained in the coal used by Delta's Electricity's power stations to produce electricity (i.e. measure of the overall fuel conversion efficiency for the electricity generation process). New South Wales government-owned coal fired power stations outperform reported worldwide averages for thermal efficiency.

Thermal efficiency is influenced by the design, age and condition of a power plant, as well as by the quality of coal used. A new state of the art power station can expect to achieve a thermal efficiency in excess of 45 per cent.

Other Information

Special Commission of Inquiry into the Electricity Sales Transactions

The government announced a Special Commission of Inquiry into the Electricity Sales Transactions, which commenced on 29 April 2011. The Special Commission has been established to report on a number of aspects relating to the electricity transactions including;

- the value for money achieved for the State compared to the retention value of the assets to the State
- the costs and benefits to the State of the electricity transactions, including potential risks and liabilities and the extent to which the transactions can deliver the stated objectives for entering into them.

The terms of reference of the Special Commission requires a final report to be issued on or before 31 October 2011.

Further information, including the full Terms of Reference for the Special Commission can be found on the Special Commission of Inquiry into Electricity Transactions website http://www.lawlink.nsw.gov.au/lawlink/Special_Projects/ll_splprojects.nsf/pages/sciet_index

Valuation and Remaining Life of Power Station Assets

The carrying value of Delta Electricity's remaining power stations of \$777 million represents 16 per cent of their gross replacement cost of \$4.9 billion. This indicates the power stations have, on average, less than one sixth of their service potential left and future capital investment may be required if the government wishes to maintain Delta Electricity's generating capacity.

The remaining lives for most of Delta Electricity's power stations range from 18 to 29 years, except for Munmorah, which has only two years left. Delta Electricity's total generation capacity decreased from 4,988 MW to 2,588 MW or 48 per cent, as a result of the GenTrader agreement. This includes 600 MW for Munmorah, which is unlikely to operate in 2011-12 because of the age of the plant, start up costs and electricity price volatility.

Approval was granted last year for a \$500 million upgrade to Munmorah under the government's revised energy reform strategy. Recommendations from the Special Commission of Inquiry and the government's response may affect the future of Munmorah. Delta Electricity's Board and management continually review the future operational role of Munmorah power station. The most recent review confirmed that Munmorah was unlikely to operate in 2011-12. Most staff have been relocated to Vales Point, and most costs are incurred in keeping the site secure, storing the plant to remain suitable for future refurbishment, safety works and environmental protection. Closing the station may enable cost savings.

Impact of Carbon Price

The Australian Government released 'Securing a Clean Energy Future – the Australian Government's Climate Change Plan' on 10 July 2011. The announcement provided a framework for the scheme, including the start date and the carbon price for the initial three year fixed period.

Delta Electricity assessed the expected impact of the scheme on the carrying amount of its remaining power station assets at Vales Point, Munmorah and Colongra (Delta Coast) using a discounted cash flow analysis. This necessitated a \$318 million write down in the carrying value of these assets.

Under the GenTrader Agreements, the GenTrader is responsible for any carbon tax liability arising from the carbon emissions of the Delta West power stations.

Delta Electricity provided the following information regarding direct carbon dioxide emissions at Delta Coast power stations during 2010-11:

Power Station	Carbon Emissions (tonnes) *
Vales Point	5,508,445
Munmorah	178,813
Colongra	38,535

* based on draft data only and may be subject to change.

Major Projects

Colongra Gas Turbine Power Station

The 667 megawatt, \$500 million Colongra gas turbine was completed during 2010. Colongra operates as a peaking plant supplying electricity at short notice during times of high demand. Colongra sent out 57 gigawatt hours of electricity this year.

Carbon Capture Project

In February 2010, Delta Electricity received grant funding of \$28.3 million for stage one of a demonstration scale carbon capture and storage project. The project aims to demonstrate post combustion capture, road transport and permanent geological storage of 100,000 tonnes of carbon dioxide per annum.

Coal Supply

Coal prices have increased significantly in recent years, increasing the risk for Delta Electricity in securing supplies of coal at competitive prices. Delta Electricity has entered into a long term supply contract with the government-owned Cobbora Holding Company Pty Limited to supply coal at competitive prices. Further details appear in the Energy Industry Overview earlier in this report.

Financial Information

Abridged Statement of Comprehensive Income

Year ended 30 June	Consolidated		Parent	
	2011 \$'000	2010 \$'000	2011 \$'000	2010 \$'000
Total Revenue From Continuing Operations	1,109,473	1,042,270	1,109,772	1,043,549
Profit/(Loss) Before Finance Costs, Depreciation and Tax From Continuing Operations	(78,833)	362,638	(82,345)	305,884
Finance costs	96,898	103,722	96,898	103,722
Depreciation	100,969	118,470	100,969	118,470
Profit/(Loss) Before Tax From Continuing Operations	(276,700)	140,446	(280,212)	83,692
Income tax equivalent (benefit)/expense	(79,629)	39,666	(82,082)	39,921
Profit/(Loss) After Tax From Continuing Operations	(197,071)	100,780	(198,130)	43,771
Gain/(Loss) from discontinued operations after income tax	1,488	(44,963)	--	--
Profit/(Loss) After Tax	(195,583)	55,817	(198,130)	43,771
Other Comprehensive Income				
Gain on cash flow hedges taken to equity	77,921	51,640	77,921	53,646
Cash flow hedges losses transferred to Statement of Comprehensive Income	(149,937)	(34,476)	(149,937)	(38,264)
Defined benefit superannuation actuarial loss	(1,712)	(27,442)	(1,712)	(27,442)
Loss on revaluation of property	(854,700)	(150,000)	(854,700)	(150,000)
Income tax benefit on items of other comprehensive income	278,528	48,084	278,528	48,618
Total Other Comprehensive Income/(Expense)	(649,900)	(112,194)	(649,900)	(113,442)
Total Comprehensive (Expense)	(845,483)	(56,377)	(848,030)	(69,671)
Dividend provided	--	36,608	--	36,608

Total revenue included \$803 million in electricity sales compared to \$1.0 billion in the previous year. The reduction is primarily due to the sale of Delta West generation rights from 1 March 2011 and a reduction in the average price for electricity by 17 per cent from \$44.19 to \$36.74 per megawatt hour. The decrease was partially offset by \$88.1 million received from the GenTrader for operating costs.

A loss before and after tax was incurred largely due to the \$381 million impairment of Delta West and Delta Coast power stations on entering the GenTrader agreement.

Abridged Statement of Financial Position

At 30 June	Consolidated		Parent	
	2011 \$'000	2010 \$'000	2011 \$'000	2010 \$'000
Current assets	570,400	434,131	570,400	403,581
Non-current assets	1,598,618	2,696,173	1,598,618	2,733,668
Total Assets	2,169,018	3,130,304	2,169,018	3,137,249
Current liabilities	317,435	278,747	317,435	283,144
Non-current liabilities	1,340,419	1,944,911	1,340,419	1,944,911
Total Liabilities	1,657,854	2,223,658	1,657,854	2,228,055
Net Assets	511,164	906,646	511,164	909,194

Current assets increased mainly due to a \$150 million increase in cash and cash equivalents and a \$95.2 million increase in receivables, offset by a \$73.9 million reduction in fuel stock sold to the GenTrader. The significant increase in cash and cash equivalents was due to:

- the sale of Delta Electricity's shares in Mid West Primary Pty Ltd to Cobbora Holding Company Pty Ltd on 28 February 2011. The shares were sold for \$43.2 million, equivalent to Delta Electricity's investment in the company, as part of the NSW Energy Reform process
- sale of fuel stocks for \$76.0 million to the GenTrader
- sale of development sites for \$17.6 million.

Non-current assets decreased mainly due to a \$1.2 billion reduction in the value of power stations following the sale of the right to generation output and introduction of the carbon price scheme.

The reduction in non-current liabilities is largely due to a \$450 million debt assumption by Treasury and a reduction in deferred tax liabilities associated with the sale transaction. Delta Electricity advises that Treasury intends to further reduce Delta Electricity's debt following a review of its earning capacity in the post sale environment. This review is expected to be finalised in 2011-12.

Corporation Activities

See the 'Electricity Industry Overview' section earlier in this report for general industry comment.

Delta Electricity was constituted in March 1996 as an electricity generator under the *Energy Services Corporations Act 1995* and as a statutory State owned corporation under the *State Owned Corporations Act 1989*. The voting shareholders are the Treasurer and the Minister for Finance and Services.

Delta Electricity operates the Mount Piper, Vales Point, Wallerawang and Munmorah coal-fired power stations, and three mini hydro generators. The Colongra gas turbine power station was opened in December 2009. The output from the Mount Piper and Wallerawang power stations is purchased by TRUenergy Pty Ltd, whilst Delta Electricity maintains ownership of output from its other power stations. Delta Electricity provides around 12 per cent of electricity to the National Electricity Market.

For more information on Delta Electricity, refer to www.de.com.au.

Controlled Entities

Delta Electricity Australia Pty Ltd

As noted above, the company was placed in receivership on 28 February 2011. Although Delta Electricity continues to own the shares in the company, it no longer exerts control. As a result, the company's assets and liabilities were derecognised in the consolidated financial statements.

Mid West Primary Pty Ltd

Mid West Primary Pty Ltd was formed on 7 August 2008. The company is a participant in a joint venture to explore, investigate and operate coal resources in New South Wales. The company has a 38.3 per cent interest in the joint venture and is entitled to 38.3 per cent of the output.

As part of the NSW Energy Reform process, Delta Electricity sold its shares in the company to Cobbora Holding Company Pty Ltd on 28 February 2011 for \$43.2 million, equivalent to Delta Electricity's investment in the company.

The proceeds were retained by Delta Electricity for working capital purposes.