Decision: Variation to Western Power's Access Arrangement for 2012/13 to 2016/17

4 June 2013

Economic Regulation Authority

WESTERN AUSTRALIA

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DECISION

1. On 17 May 2013, the Economic Regulation Authority (Authority) proposed a variation to Western Power's current access arrangement under section 4.38 of the *Electricity Networks Access Code 2004* (Access Code).[1] Sections 4.38 to 4.40 of the Access Code allow the Authority to vary the price control or pricing methods in an access arrangement during the access arrangement period and sets out the procedure for the Authority to follow when considering such a variation.

2. Western Power's current access arrangement covers a five year period from 2012/13 to 2016/17 and was approved by the Authority in November 2012 with the access arrangement becoming effective on 1 February 2013.

3. As required under section 4.39 of the Access Code, the Authority consulted the public in accordance with Appendix 7 of the Access Code. As part of this consultation, the Authority prepared an issues paper on the variation proposal to assist interested parties in understanding the proposal. The invitation for submissions was published by the Authority on 17 May 2013 with a closing date for submissions of 31 May 2013. All submissions received have been published on the ERA's website. Submissions were received from the following parties:

   - Advanced Energy Resources
   - Alinta Energy
   - Blair Fox
   - Chamber of Commerce and Industry (CCI)
   - Community Electricity
   - Energy Networks Association (ENA)
   - Perth Energy
   - Synergy
   - Verve Energy
   - WACOSS
   - WALGA
   - Western Power

4. The allowable revenue approved by the Authority for Western Power's third access arrangement period included $53 million to be recovered for the transmission system and $398 million for the distribution system (real dollar values at 30 June 2012) in relation to revenue deferred during the previous access arrangement period. As set out in the Final Decision, the Authority was of the view that the deferred revenue should be recovered over the life of the assets to which it related. However, modelling and forecasts at the time of the decision showed that reducing the recovery period to ten years resulted in average tariffs increasing broadly in line with CPI. On this basis the Authority considered that a recovery period of ten years could be accommodated without a price shock to customers.

[1] 17 May 2013, Economic Regulation Authority, Proposed Variations to Western Power's Access Arrangement for 2012/13 to 2016/17- Issues Paper

5. Subsequent to the Final Decision, the Authority became aware that the amount to be recovered from Western Power's customers in relation to the Tariff Equalisation Contribution (**TEC**) (an amount levied on users of the Western Power distribution network which is provided to Horizon Power to provide electricity services at a uniform tariff across the State) has been increased by $169 million (or 27 per cent) from $628 million over the four years from 2013/14. In addition, Western Power is forecasting further significant reductions in revenues, in addition to those already taken account of for 2011/12, much of which is attributable to the impact of lower energy demand as a result of domestic photovoltaic systems, revenue which must now be recovered from all users. Under a revenue cap form of regulation, Western Power's revenue is fixed and demand risk is faced by the users of the network. As a result, the expected under-recovery of revenue in 2012/13 must now be recovered. If the size of the forecast reduction in demand and increase in costs had been foreseeable at the time of the Final Decision, the Authority would not have shortened the period over which the deferred revenue is to be recovered.

6. The Authority considers that the revised revenue forecasts and increased TEC is a significant unforseen development and the impact is so substantial that the price control should be varied before the end of the access arrangement period, as the advantages outweigh the disadvantages (including the impact on regulatory certainty). The Authority considers that if the resultant large price increases were approved, this would have a significant negative impact on competition in upstream and downstream markets due to the instability and lack of certainty for participants in these markets from what was expected (or likely to be expected).

7. The Authority considers the requirements of section 4.38(b)(ii) of the Access Code have been met and that the impact is so substantial that the advantages of making the variation before the end of the access arrangement period outweigh the disadvantages, having regard to the impact of the variation on regulatory certainty. On this basis, the Authority has decided to vary the price control in Western Power's Access Arrangement such that the recovery period for revenue deferred from an earlier access arrangement period is amended from 10 years and is instead recovered over the life of the assets to which it relates.

8. The Authority notes that while the decision to change the recovery period will result in less revenue recovered in the third access arrangement period, the full amount of revenue deferred in the second access arrangement period will be recovered in future access arrangements to ensure Western Power is financially neutral[2] (which is also in accordance with section 6.5C of the Access Code).

9. Appendix 1 of this Decision lists all of the sections in Western Power's access arrangement which have been amended as a result of the change to the recovery period for the deferred revenue.

[2] The full value of the deferred revenue will be recovered in present value terms.

REASONS

Mid Period Variations to an Access Arrangement

10. An access arrangement details the terms and conditions, including prices, that apply to third parties seeking the use of regulated (covered) electricity networks.

11. Under section 4.38 of the Access Code, the Authority in certain circumstances may, by notice to a service provider, vary the price control or pricing methods in an access arrangement before the next revisions commencement date.

> 4.38 The Authority may by notice to a service provider vary the price control or pricing methods in an access arrangement before the next revisions commencement date, but only if the Authority determines that:
>
> (a) its approval of the access arrangement was based on materially false, misleading or deceptive information provided to it by the service provider, and the Authority considers that the impact of the materially false, misleading or deceptive information is of a sufficient magnitude to warrant making the variation before the end of the access arrangement period; or
>
> (b) either:
>
> (i) its approval of the access arrangement contains a material error or was based on materially false, misleading or deceptive information provided to it by a person other than the service provider; or
>
> (ii) significant unforseen developments have occurred that are:
>
> A. outside the control of the service provider; and
>
> B. not something that the service provider, acting in accordance with good electricity industry practice, should have been able to prevent or overcome,
>
> and the impact of the error, materially false, misleading or deceptive information or unforseen developments is so substantial that the Authority considers that the advantages of making the variation before the end of the access arrangement period outweigh the disadvantages, having regard to the impact of the variation on regulatory certainty.

12. Section 4.39 of the Access Code requires that before giving a notice under section 4.38, the Authority must consult the public in accordance with Appendix 7. Appendix 7 requires that the Authority undertake public consultation within a minimum period of 10 business days to a maximum period of 20 business days. Section 4.40 requires that the Authority must publish a notice under section 4.38.

13. In accordance with section 4.41B of the Access Code, the Authority is not required to undertake a complete review of Western Power's access arrangement in considering and implementing revisions under section 4.38.

Authority's Proposed Amendment

14. On 26 April 2013, Western Power submitted a proposed 2013/14 Price List and Price List Information to the Authority for approval. Western Power's proposed price list incorporated significant adjustments compared with the assumptions in the third access arrangement which results in 2013/14 tariffs increasing on average by

20 per cent (transmission and distribution combined), rather than broadly in line with CPI as was forecast at the time of the Authority's Final Decision.[3]

15. The forecast price increase included 2.5 per cent in relation to CPI. Taking account of information provided by Western Power, the Authority calculated that the increase above CPI comprised:

- 2.5 per cent in relation to a $36 million increase in the gazetted TEC[4] for 2013/14 gazetted subsequent to the Final Decision;
- 7.5 per cent relates to a $95 million forecast under-recovery in revenue for 2012/13 based on Western Power's latest forecast, compared with the approved 2012/13 revenue cap; and
- 7.5 per cent in relation to revisions to energy consumption growth forecasts for 2013/14 and other revenue charge parameters Western Power has made compared with the Final Decision assumptions.[5]

16. On 26 April 2013, the Western Australian Government gazetted revised amounts for the TEC for 2013/14 and the remaining years of the third access arrangement period. Western Power is now required to pay an additional $169 million (27 per cent increase) for the TEC during the remaining four years of the access arrangement period (the increases are: 2013/14, $36 million (21 per cent); 2014/15, $56 million (34 per cent); 2015/16, $37 million (25 per cent); 2016/17, $40 million (28 per cent)).

17. The allowable revenue approved by the Authority for Western Power's third access arrangement period included $53 million to be recovered for the transmission system and $398 million for the distribution system (real dollar values at 30 June 2012) in relation to revenue deferred during the previous access arrangement period. As set out in the Final Decision, the Authority was of the view that the deferred revenue should be recovered over the life of the assets to which it related. However, modelling and forecasts at the time of the decision showed that reducing the recovery period to ten years resulted in average tariffs increasing broadly in line with CPI. On this basis the Authority considered that a recovery period of ten years could be accommodated without a price shock to customers.

18. As outlined above, subsequent to the Final Decision, the amount to be recovered from Western Power's customers in relation to the Tariff Equalisation Contribution (**TEC**) (an amount levied on users of the Western Power distribution network which is provided to Horizon Power to provide electricity services at a uniform tariff across the State) has been increased by $169 million (or 27 per cent) from $628 million over the four years from 2013/14. In addition, Western Power is forecasting further significant reductions in revenues, in addition to those already taken account of for 2011/12, much of which is attributable to the impact of lower energy demand as a result of domestic photovoltaic systems, revenue which must now be recovered from all users. Under a revenue cap form of regulation, Western Power's revenue is fixed and demand risk is faced by the users of the network. As a result, the

3 5 September 2012, Economic Regulation Authority, *Final Decision on Proposed Revisions to the Access Arrangement for the Western Power Network*.

4 An amount levied on users of the Western Power distribution network which is used to fund Horizon Power in its provision of electricity services at a uniform tariff across the State.

5 Western Power is subject to a revenue cap price control as permitted under section 6.2 of the Access Code. Consequently, tariffs are set each year to recover target revenue adjusted for any over or under recovery in previous years.

expected under-recovery of revenue in 2012/13 must now be recovered. If the size of the forecast reduction in demand and increase in costs had been known at the time of the decision, the Authority would not have shortened the period over which the deferred revenue is to be recovered.

19. On 17 May 2013, the Authority published a proposal to vary the price control in Western Power's Access Arrangement such that the deferred revenue is recovered over the life of the assets to which it relates.

20. The Authority proposed two options in relation to the annual profile of the revised revenue cap. The first option, a step change in 2013/14, would result in an average increase in network charges of 10.3 per cent (including CPI)[6] in 2013/14, followed by increases of around 1 per cent below CPI in the following three years. The second option was to smooth the price increase which would result in network charges increasing by around 2 per cent above CPI over each of the next four years.

Public Submissions

21. Generally the public submissions received were supportive of the Authority's proposed variation. Of the 12 submissions received, seven (being Alinta, Advanced Energy Resources, Blair Fox, Community Electricity, Perth Energy, Verve and WALGA) supported the proposed variation and considered a smoothed price profile preferable to a step change in 2013/14.

22. The submission from WACOSS stated that it considered "some of the price increases sought by Western Power to be questionable and unjustified", however, if the increases are to occur it did not take a particular view as to which pricing profile would be best as they both resulted in the same outcome over a four year period.

23. Synergy did not make any comment in relation to the proposed variation or which price profile would be preferable but requested the Authority to give regard to deferring the commencement date for the new tariffs to ensure sufficient time for them to be implemented. Alinta made similar points in its submission in relation to sufficient time being required to implement revised tariffs.

24. Submissions from CCI and ENA raised concerns in relation to regulatory certainty. CCI queried the consideration of the code objective from the service provider's perspective regarding the incentives for investment for Western Power.

25. WACOSS, Perth Energy, Community Electricity and Alinta all raised concerns in relation to Western Power's forecasting processes and considered that, given the importance of those forecasts, improvements should be made to increase accuracy.

26. Western Power states that it understands the issues raised in the paper and appreciates the pricing objective the Authority is seeking to achieve. However, it considers that the recovery period for deferred revenue should not be amended and instead, the target revenue approved in November 2012 should be maintained and the price increase smoothed over the access arrangement period.

27. Western Power raises the following concerns:

- The amount of deferred revenue to be collected will increase over time.

[6] Includes CPI of 2.5 per cent.

- Amending the service standard adjustment mechanism incentive rates part way through an access arrangement introduces regulatory uncertainty which is likely to affect investment decisions and the outcomes that can be delivered to customers.
- The Authority's proposed reduction in revenue and the additional TEC requirement will necessitate additional borrowings to keep expenditure levels constant and the additional interest costs will further increase the level of debt required. Western Power assumes that it will have the ability to access additional debt funding to offset the reduction in revenue but if this is not the case, the amount of expenditure it incurs will need to be reduced which will impact on the level of service and safety outcomes it can deliver.

Considerations of the Authority

28. As noted above, Western Power's proposed 2013/14 Price List submitted to the Authority on 26 April 2013 would result in 2013/14 tariffs increasing on average by 20 per cent (transmission and distribution combined), rather than broadly in line with CPI as was forecast at the time of the Authority's Final Decision for the third access arrangement period in September last year.

29. In the second access arrangement period, Western Power proposed an alternative treatment of capital contributions from its approach in the first access arrangement period, which had the effect of significantly increasing the revenue requirement. To avoid price shocks whilst ensuring the change in treatment of capital contributions had a neutral commercial effect on Western Power's business in present value terms, Western Power proposed to defer an amount of revenue from the second access arrangement period to subsequent access arrangement periods.

30. As noted in its considerations throughout the review process on the price control for the third access arrangement period, the Authority was very mindful to ensure that the average prices during the period did not result in a price shock as per section 6.4(c) of the Access Code. In particular, the Authority determined the recovery period for the deferred revenue which, based on the forecasts at the time, would avoid a price shock to customers.

31. As outlined above, under section 4.38 of the Access Code, the Authority may, by notice to a service provider, vary the price control or pricing methods in an access arrangement before the next revisions commencement date for a number of reasons, including if it determines that the decision was based on materially false, misleading or deceptive information or significant unforseen developments have occurred that are outside the control of the service provider and not something that it should have been able to overcome, and the impact is so substantial that the Authority considers the advantages of making the variation before the end of the access arrangement period outweigh the disadvantages, having regard to the impact of the variation on regulatory certainty.

32. The Authority considers that significant unforseen developments have occurred which are outside the control of Western Power and not something Western Power should have been able to overcome.

33. The $169 million increase in the gazetted TEC over the four years from 2013/14 is a Western Australian Government decision and outside of Western Power's control.

34. In relation to the demand and revenue forecasts, in its proposed Price List for 2013/14, Western Power noted the 2012/13 Price List (published with the Further Final Decision) was based on its 2011 demand forecasts. Western Power noted the following issues regarding those forecasts:

- Forecast energy consumption was much higher than actual energy consumed since the forecasts were produced. It considers that photovoltaic penetration and customer behaviour due to increasing retail tariffs are the main causes. It estimates this has led to revenue under-recovery of approximately $40 million.

- Actual peak and off-peak energy consumption is considerably lower than forecast. As more off-peak energy (which is lower priced) has been consumed compared to peak energy, the revenue collected is lower. Western Power notes the main cause has been identified as an incorrect allocation in reporting of some weekend energy consumption to peak which contributed $20 million to the 2012/13 revenue under-recovery.

- Due to the 2012/13 Price List not taking effect until 1 February 2013, the CPI increase in relation to the first 7 months was effectively deferred until the following year, which contributed $22 million to the revenue under-recovery.

- The factors contributing to the remaining $12 million under-recovery for 2012/13 have not been specifically identified but Western Power has noted other possible contributors such as energy efficiency and movement of customers between tariffs categories.

35. Western Power's proposed 2013/14 Price List was based on an "interim refresh" of its 2012 demand forecast energy and customer numbers undertaken in March 2013. Western Power notes the forecast refresh was triggered due to the following factors becoming apparent:

- energy consumption was lower on consumption based tariffs despite it being a very hot summer;

- the number of photo-voltaic systems being installed has been increased to 2,250 systems per month consistent with recent applications and what is being used by the IMO for the 2013 Statement of Opportunities (instead of 2,000 per month); and

- the significant under-recovery in 2012/13 revenue compared to that forecast which, if unaddressed would grow over time.

36. Western Power is now forecasting total distribution energy consumption of 14,456 GWh in 2013/14 which is 1.2 per cent lower than the forecast underpinning the 2012/13 Price List. However, as outlined above, the reduction in the revenue forecast is significantly higher than this.

37. Whilst it is concerning that the forecasts provided in relation to the third access arrangement review and the 2012/13 Price List have proved to be considerably overstated, the Authority accepts that customer demand is mainly outside the control of Western Power, particularly in relation to the take-up of photovoltaic systems, and much of the significant reductions would have been difficult to foresee. However, the Authority notes the incentives to forecast revenue accurately are not as strong under a revenue cap price control compared with other price control mechanisms such as a price cap.

38. As noted above, the Authority's view prior to the third access arrangement period was that the deferred revenue should be recovered over the life of the assets. However, modelling conducted at the time of the Final Decision showed that reducing the recovery period to ten years resulted in forecast tariffs increasing broadly in line with CPI. On this basis the Authority considered that a recovery period of ten years could be accommodated without a price shock to customers. This represented an amount of $53 million to be recovered for the transmission system and $398 million for the distribution system (in real dollar values at 30 June 2012) for deferred revenue during the third access arrangement period.

39. If the Authority had known at that time that significant tariff increases resulting from revenue under-recovery, lower demand forecasts and increases in costs would be required, it would not have shortened the recovery period as it would have been apparent that to do so would result in price shock to customers.

40. The Authority considers that the impact of the revised revenue forecasts and increased TEC on customer charges, particularly the proposed 20 per cent average increase in 2013/14 tariffs (transmission and distribution combined), is so substantial that the price control should be varied before the end of the access arrangement period, as the advantages outweigh the disadvantages (including the impact on regulatory certainty). The Authority considers that if the proposed large price increases were approved, this would have a significant negative impact on competition in upstream and downstream markets due to the instability and lack of certainty for participants in these markets from what was likely to be expected based on the Final Decision.

41. The Authority notes that the Western Australian Government has already announced its decision to increase retail electricity prices by 4 per cent for residential customers for 2013/14. While the Authority's proposed decision to amend Western Power's price control will not affect this price increase, it will immediately impact all generators and around 21,000 contestable customers[7] which together make up an estimated 40 per cent to 60 per cent of the total market by volume.

42. For the reasons outlined above, the Authority considers that the requirements of section 4.38(b)(ii) of the Access Code are met, which allows the Authority to vary Western Power's price control. Accordingly it has decided to retain a life of asset recovery period for deferred revenue, rather than reduce it to 10 years, due to the unforseen increase in costs and reductions in revenue resulting in price shock to customers when the recovery period is shortened to 10 years.

43. The Authority has not undertaken a complete review of Western Power's access arrangement, and has limited its consideration to the deferred revenue item and its affect on Western Power's price control as permitted by section 4.41B of the Access Code.

44. The Authority has recalculated target revenue for the third access arrangement period taking account of:

- recovering deferred revenue over the life of the relevant assets;
- increases in the gazetted TEC; and

[7] A customer is contestable if it can choose its electricity retailer. In Western Australia, a customer can choose its retailer if it consumes more than 50 MWh per year. All other customers are non-contestable.

- latest information from Western Power in relation to revenue and demand forecasts.

45. After taking account of these factors, the net present value of total target revenue over the third access arrangement period reduces by $185.5 million ($324 million reduction in relation to deferred revenue offset by an increase of $139 million[8] in relation to the TEC). This net reduction partially reduces the impact of Western Power's latest revised revenue and demand forecasts on customer charges.

46. The Authority notes the concerns raised by WACOSS in its submission that "some of the price increases sought by Western Power to be questionable and unjustified". However, the Authority in amending the price control pursuant to section 4.38 considers it is only appropriate to re-open the access arrangement decision in relation to the recovery period of deferred revenue.

47. Similarly, in relation to the concerns raised by CCI regarding efficient investment outcomes requiring Western Power to have a high degree of certainty as to what its investment program will be and how it will be funded, the Authority has not amended any aspect of Western Power's operating or capital expenditure requirements or the efficient level of return required to fund that expenditure.

48. The submission from ENA suggests that the Authority's decision represents a significant departure from sound, predictable and consistent regulatory practice and is concerned that it has not made a compelling case to exercise its powers under section 4.38 of the Access Code and that the variation negatively impacts on regulatory certainty intended to be fostered by the regime.

49. The Authority agrees that sound, predictable and consistent regulatory practice is essential and has not made this decision lightly. However, as set out clearly in the draft and final decisions for the third access arrangement period, the Authority considered that the deferred revenue should continue to be recovered over the life of the assets as had been determined in the second access arrangement decision. In order to take account of views expressed in submissions the Authority considered shorter periods and, based on the information available to it at the time in relation to costs and revenues, decided to accept a shorter period on the basis that it could be incorporated within tariff increases in line with CPI. The basis of changing from life of assets to ten years was purely related to the fact that doing so would not result in price shock to customers.

50. In its submission, the ENA notes that the approved access arrangement "provides explicit mechanisms to address the issues of concern to the ERA" as section 5.7.6 explicitly provides for the recovery of the TEC and volume variation is accommodated through the revenue cap control mechanism. The ENA considers that revenue under-recovery and lower demand forecasts are factors which are already accommodated under the access arrangement, rather than significant unforeseen developments which represent a trigger to reopen the price arrangement. The Authority agrees that the increased TEC and revenue under-recovery and lower demand forecasts are provided for in the access arrangement and is not proposing to amend this. As outlined above, the amendment only relates to the recovery period for deferred revenue.

51. The ENA raised concerns that the Authority's approach is "directed at amending an element of the final access arrangement decision which was determined

[8] $169 million expressed in net present value terms.

independently of the factors which are now the subject of the Authority's concern". As outlined above, the basis of the Authority's decision to shorten the recovery period for deferred revenue from the life of the relevant assets to 10 years was that it could be accommodated without resulting in a price shock to customers based on the forecast price increases at the time of the decision. It was not foreseen that those forecast price increases could change so substantially (i.e. from approximately CPI to CPI + 18 per cent) in such a short space of time due to increases to the TEC, which was gazetted in August 2012, and significant downward revisions to Western Power's demand and revenue forecasts from those provided to the Authority in September 2012. It is on this basis that the Authority is amending its decision in relation to the recovery period for deferred revenue.

52. The ENA states it considers that "ad hoc amendments to the approved access arrangement to maintain preferred network tariffs paths put into question the capacity of network businesses to rely on the outcome of final determinations made by the ERA". The Authority does not consider this to be an "ad hoc" amendment and it was not made on the basis of "maintaining preferred network tariff paths." In fact forecast tariff increases, after the Authority's amendment, are still higher than those forecast at the time of the third access arrangement decision.

53. The ENA raises concerns that this variation will have broader implications for Australian regulatory practice and notes that the National Electricity Rules confines re-opening of access determinations to a narrow set of circumstances based on a material error or deficiency. The Authority notes that the circumstances of this variation are of a very specific nature and does not consider that it should raise general concerns. Western Power's access arrangement does not fall under the National Electricity Rules as Western Australia has its own Access Code. The Authority considers that there is no inconsistency in the reasoning behind its determination as, in making its decision, the Authority took into account the price control objective of avoidance of price shock movements, that is sudden material tariff adjustments, which has been a key consideration in the Authority's reasoning in previous decisions regarding the recovery period for deferred revenue.

54. Although the ENA raised concerns about regulatory certainty for service providers, it made no mention of certainty for users, which is of no lesser importance for promoting economically efficient investment in and operation and use of network services.

55. Western Power notes in its submission that recovering the deferred revenue over a longer time period results in the value collected from customers increasing in nominal terms from $1 billion to $2.6 billion as a result of adjustments for the time value of money. This matter has been dealt with extensively as similar issues were raised during the third access arrangement review with claims this leads to inter-generational inequity. However, Western Power did not establish that inter-generational equity (or more precisely equity between users paying for network services in different regulatory periods) is a relevant consideration in considering the timing of recovery of deferred revenue. As set out in the Draft and Final Decisions for the third access arrangement, neither the Access Code objective nor the price control objectives include objectives relating to "inter-generational equity" per se.

56. The Authority notes that standard regulatory practice is to charge customers based on the depreciation profile of the relevant assets.

57. In its proposed variation, the Authority included a consequential amendment to the incentive rates for the service standard adjustment mechanism (**SSAM**) to reflect the revised revenue caps. In its submission, Western Power has raised concerns that a change in the incentive rates may materially change the financial viability of investments and that there is no opportunity to improve the efficiency of the investment or avoid a penalty where investments have already been committed. It considers that a change to the incentive rates part way through an access arrangement introduces regulatory uncertainty which is likely to affect investment decisions and the outcomes that can be delivered to customers. The Authority notes the concerns of regulatory uncertainty raised by Western Power regarding the proposed amendments to the incentive rates (rewards and penalties) for those service standard measures that were based on the level of allowable revenue. The Authority considers that while the proposed amendment to incentive rates was relatively small, it could affect investment decisions already made by Western Power. As a result, the Authority has decided against making the minor changes to the service standard measures proposed in the Issues Paper to avoid investment uncertainty.

58. In relation to the concerns raised by Western Power regarding the financial impact of the variation, the Authority notes that it has not amended any aspect of Western Power's operating or capital expenditure requirements, or the efficient level of return required to fund that expenditure. The additional TEC payments are included within the revised allowable revenue and the continued operation of the revenue cap results in its revenue being fixed with any further reductions in demand being paid for by customers. As noted above, while the decision to change the recovery period will result in less revenue recovered in the third access arrangement period, the full amount of revenue deferred in the second access arrangement period will be recovered in future access arrangements ensuring that Western Power is financially neutral in respect of deferred revenue.

59. Western Power states that if it is unable to access additional debt funding there may be an impact on the level of service and safety outcomes that it can deliver. The Authority expects that Western Power would always prioritise its expenditure to ensure safety is not compromised.

60. Western Power considers its revenue cap for the third access arrangement period should not be revised and has proposed two alternatives which smooth the price impact over the remaining four years of the third access arrangement period. Its first alternative increases charges by 7.8 per cent plus CPI in 2013/14 followed by increases between 2.8 per cent to 3.8 per cent plus CPI over the remaining three years. The second alternative shows rising price increases each year starting from 3.7 per cent plus CPI in 2013/14 to 6.5 per cent plus CPI in 2016/17. Although these price paths are relatively smoother than initially proposed by Western Power in its proposed 2013/14 Price List, the overall increases are substantially more than forecast at the time of the decision, which was that prices would increase in line with CPI. The Authority considers that, regardless of the profile of the increase, it still constitutes a price shock and does not alter the Authority's view that the recovery period for deferred revenue should not be shortened from life of the relevant assets.

61. In relation to the annual profile of the revised target revenue, the Authority considered two options. The first option was a step change in 2013/14 followed by increases below CPI for the remaining three years. The second option was a smooth profile with increases of around 2 per cent plus CPI in each of the four years. All submissions which supported the variation considered a smoothed

profile was preferable as a step change in 2013/14 would result in a price shock to customers. The Authority considers a smoothed revenue profile, taking account of the forecast 2012/13 revenue under-recovery which will impact on 2013/14 tariffs, would best meet the requirements of section 6.4(c) of the Access Code to avoid price shocks. Forecast increases are shown in the table below. Changes for individual customers will vary depending on which tariff applies and the customer's demand. The forecasts are based on Western Power's demand forecasts so are dependent on the accuracy of those forecasts.

Table 1 Forecast change in average tariffs

Financial year ending	30 June 2014	30 June 2015	30 June 2016	30 June 2017
Transmission	-9.6%+ CPI	-11.3%+ CPI	-11.4%+CPI	-11.4%+ CPI
Distribution	7.4% + CPI	5.9%+ CPI	5.8%+ CPI	5.2%+ CPI
Combined average	2.2%+ CPI	2.1%+ CPI	2.5%+ CPI	2.5%+ CPI

62. The Authority notes the concerns raised by Western Power, Synergy and Alinta in relation to sufficient time being required to implement revised tariffs. To facilitate this process the Authority has published this decision as early as possible. The approval date for the 2013/14 Price List is dependent on when Western Power submits a revised price list to the Authority for approval. Alinta has advised that, ideally, it would require 3 to 4 weeks to implement revised tariffs. Synergy considers it could implement revised tariffs with minimal risk from 16 August with 1 September being its preferred option. It is unclear what date it has assumed the Price List is approved on.

63. If necessary, the Authority considers a start date later than 1 July can be accommodated through the Price List approval process. Western Power should liaise with the Authority and retailers to agree a start date acceptable to all parties. Dependant on the final start date, the average tariff increase may vary slightly from the 2 per cent plus CPI forecast to take account of the change occurring after 1 July 2013. However, the forecast revenue for the twelve months from 1 July and the increase in average charges (taking account of an initial period being charged at existing rates) for the twelve months should be in line with the forecast.

64. Appendix 1 of this Decision lists all of the sections in Western Power's access arrangement which have been amended as a result of the change to the recovery period for the deferred revenue. The following amendments have been made to the proposed changes included in the Authority's Issues Paper published on 17 May 2013:

- Sections 5.6.6, 5.7.6, 6.5.13 and 6.5.14 have been revised to reflect minor modelling corrections.
- Amendments in relation to the SSAM incentive rates have been removed reflecting the Authority's decision to retain current incentive rates.
- Sections 7.7.1 and 7.7.2 have been revised to show the value of deferred revenue in net present value terms consistent with the current access arrangement.
- Section 7.7.3 includes the opening asset lives at the beginning of the next access arrangement period.

Appendices

Appendix 1 Amendments to the Access Arrangement for the Western Power Network

Section 5.5.3 (a)

Remove “a ten year period” in section 5.5.3 (a) replace with “a 50 year period“.

Section 5.5.3 (b)

Remove “a ten year period” in section 5.5.3 (b) and replace with “a 42 year period“.

Section 5.5.4 Table 27

Replace the amounts to be added to the target revenue due to the recovery of deferred revenue ($ million real as at 30 June 2012) listed in Table 27 with the following amounts:

Financial year ending	30 June 2013	30 June 2014	30 June 2015	30 June 2016	30 June 2017
Transmission system	3.8	3.8	3.8	3.8	3.8
Distribution system	30.7	30.7	30.7	30.7	30.7

Section 5.6.6 Table 28

Replace the amounts of the cap for transmission service revenue to be used for calculating TR_t ($ million real as at 30 June 2012) listed in Table 28 with the following amounts:

Financial year ending	30 June 2013	30 June 2014	30 June 2015	30 June 2016	30 June 2017
TR_t	387.3	328.1	321.4	290.6	262.8

Section 5.7.6 Table 29

Replace the amounts of the cap for distribution service revenue to be used for calculating DR_t ($ million real as at 30 June 2012) listed in Table 29 with the following amounts:

Financial year ending	30 June 2013	30 June 2014	30 June 2015	30 June 2016	30 June 2017
DR_t	685.7	684.8	816.7	932.9	1,018.0

Section 6.5.13 Table 31

Replace the amounts for the annual percentage change in TR_t (defined as TX_t) used to constrain the maximum change in reference tariff revenue for the transmission system with the following amounts:

Financial year ending	30 June 2014	30 June 2015	30 June 2016	30 June 2017
TX_t	15.3%	2.0%	9.6%	9.6%

Section 6.5.14 Table 32

Replace the amounts for the annual percentage change in DR_t (defined as DX_t) used to constrain the maximum change in reference tariff revenue for the distribution system with the following amounts:

Financial year ending	30 June 2014	30 June 2015	30 June 2016	30 June 2017
DX_t	0.1%	-19.3%	-14.2%	-9.1%

Section 7.7.1

Remove “$300.2 million” in section 7.7.1 and replace with “$520.5 million”.

Section 7.7.2

Remove “$40.0 million” in section 7.7.2 and replace with “$70.5 million”.

Section 7.7.3

Replace this section with the following “The timeframe for recovering the deferred revenue amounts in section 7.7.1 will be 37 years and in section 7.7.2 will be 45 years.”