

Economic Regulation Authority

 WESTERN AUSTRALIA

Promoting fair prices, quality services and choice.



Roundtable Discussion:

Draft Decision on Proposed Revisions to the Access Arrangement for the South West Interconnected Network

Mr Lyndon Rowe, Chairman

Wednesday, 5 August 2009

Parmelia Hilton Perth (Stirling Room)

Overview

- To give interested parties an opportunity to discuss the draft decision on Western Power's proposed access arrangement revisions with the Economic Regulation Authority

Proposed Agenda

- Role of the Authority (5 mins)
- Key aspects of the draft decision (10 mins)
- Draft decision in more detail (30 mins)
- Assessment process – next steps (5 mins)
- Comments / Questions

The Economic Regulation Authority

Independence

- State's independent economic regulator
- Decisions are independent of industry, government and other interests

Functions

- Administers access to monopoly infrastructure
- Licenses service providers
- Monitors and regulates markets
- Conducts inquiries (referred by State Government)

Industries

- Electricity, gas, rail and water

Key Aspects of the Draft Decision (1/6)

Terminology to note

- AA1 period = first access arrangement period (2006/07 to 2008/09)
- AA2 period = second access arrangement period (2009/10 to 2011/12)
- Dollar amounts are real dollars of 30 June 2009, unless otherwise stated

Authority's Draft Decision

- Draft decision does not approve Western Power's proposed revisions
- 46 amendments required

Key Aspects of the Draft Decision (2/6)

Price Control

- Approved target revenue:

2009/10	2010/11	2011/12
\$795 m	\$941 m	\$1,115 m

- Real increase in network charges per year over the next three years (AA2 period):

Overall	Transmission	Distribution
8.5%	12.6%	6.1%

- Approved pre-tax real rate of return on the capital base of **7.06%**, compared with 8.95% proposed by Western Power and 6.76% approved for the AA1 period

Key Aspects of the Draft Decision (3/6)

Actual Capital Expenditure (AA1)

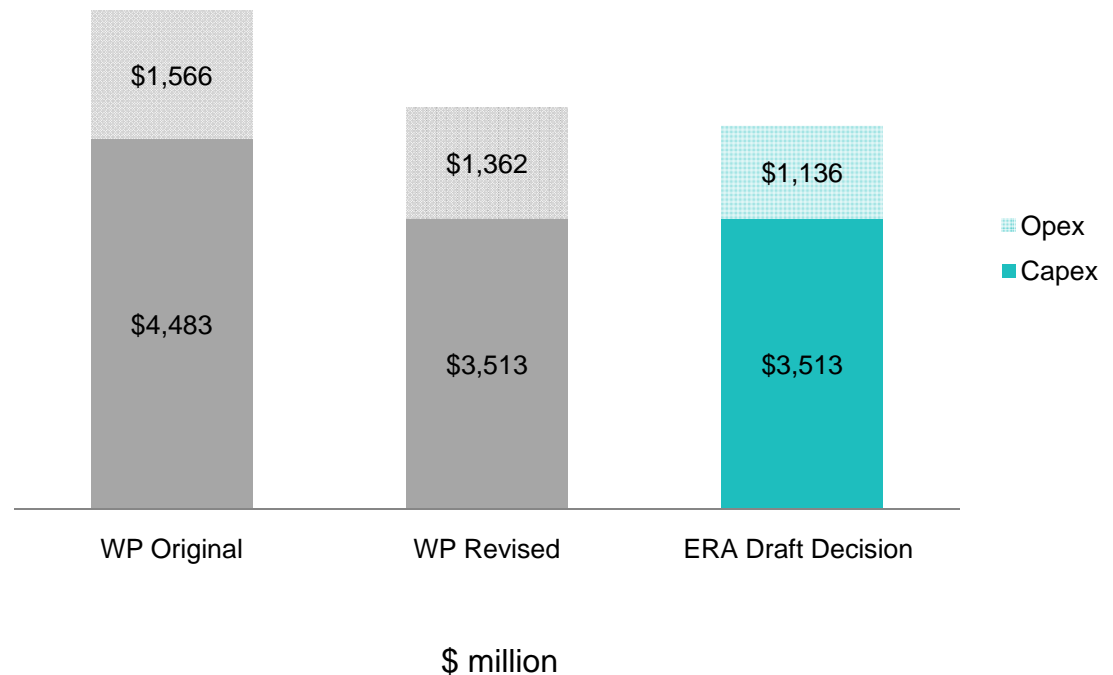
- \$474 million of capital investment undertaken during the AA1 period not approved for addition to the capital base
- Concerns that Western Power sought to earn a return on discontinued projects, had suffered cost overruns and had provided insufficient justification for cost increases
- Evidence of inefficiency in the management of capital works in the past

Key Aspects of the Draft Decision (4/6)

Forecast Capital and Operating Expenditure (AA2)

Key observations:

- Western Power's original forecasts (October 2008) compared to its anticipated revised forecasts (May 2009)
- Authority's draft decision compared with Western Power's original and revised forecasts

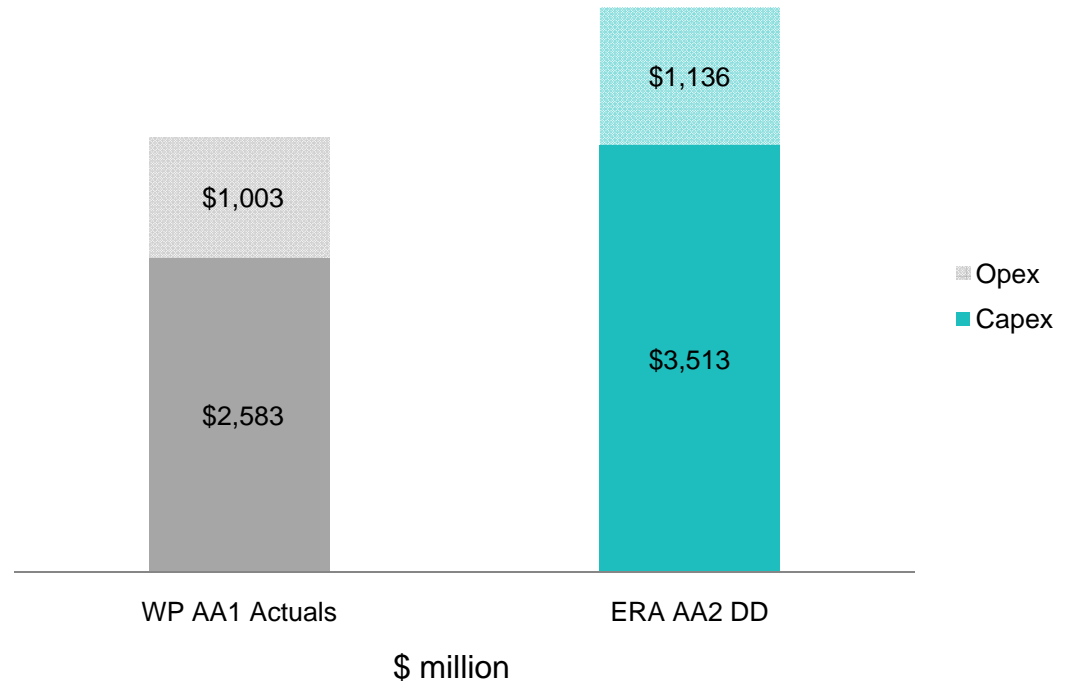


Key Aspects of the Draft Decision (5/6)

Draft Decision still allows for real increases in expenditure over the levels of expenditure incurred by Western Power during the AA1 period

Key observations:

- Real increase in network capital investment of \$931 million
- Real increase in operating costs of \$133 million



Key Aspects of the Draft Decision (6/6)

Incentive Arrangements

- Western Power's proposed service standard benchmarks approved, but additional benchmarks required
- Amended service standard adjustment mechanism to strengthen commercial incentives

Tariff Equalisation Contributions (TEC)

- Tariff equalisation contributions not included at present
- Government could require Western Power to collect \$403 million (nominal) in tariff equalisation contributions over the AA2 period
- Overall impact on average network charges... an increase in charges of around 17% a year

Retail Tariffs

- Impact on retail tariffs is uncertain

Price Control (1/5)

Revenue Cap form of Price Control

- Sets an amount of revenue that Western Power may earn from network services during the course of the AA2 period
- Prices for network services are established annually, within the constraints of the revenue cap (Authority approves an annual “Price List”)
- Revenue cap is set based on a “building block” (cost of service) approach, which includes:
 - a return on the capital base (WACC)
 - a return of the capital base (depreciation)
 - a forecast of operating and maintenance costs

Price Control (2/5)

Opening Capital Base Value for AA2:

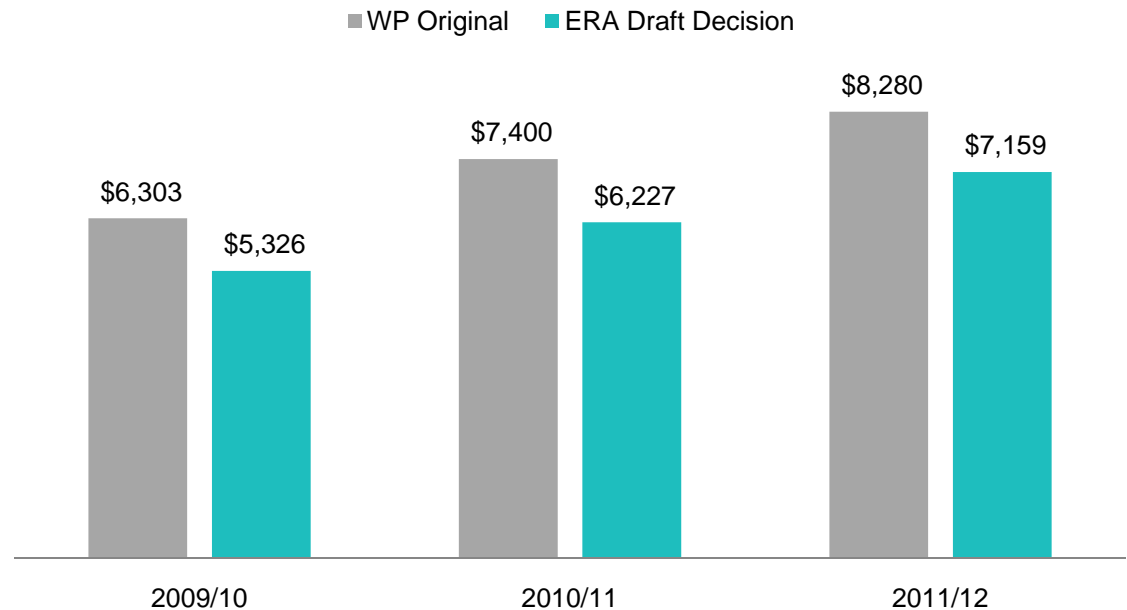
WP Proposed	ERA Draft Decision
\$5,327 million	\$4,851 million

Notional Capital Base Values for AA2:

Forecast amount of investment included (net of contributions):

- WP = \$3,719 million
- ERA = \$3,007 million

(closing asset base values)
\$ million



Price Control (3/5)

Rate of Return (Weighted Average Cost of Capital)

- Real pre-tax WACC:

AA1 Approved	AA2 WP Proposed	AA2 ERA Draft Decision
6.76%	8.95%	7.06%

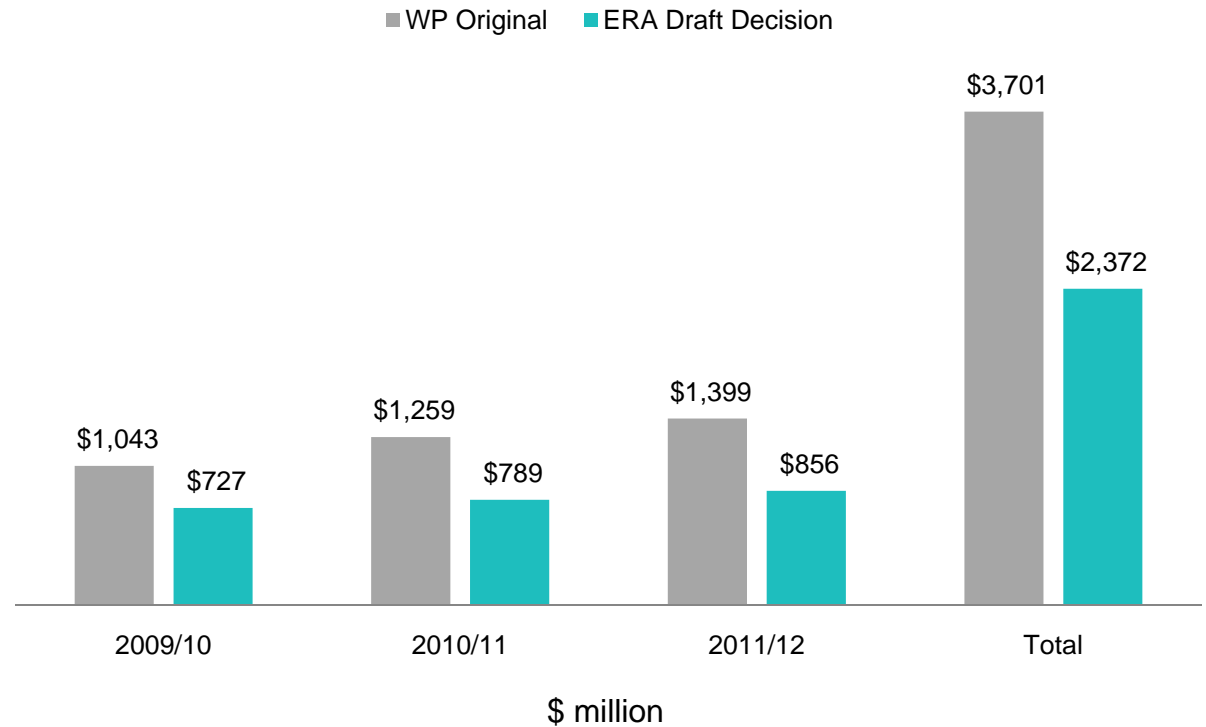
- Authority's amended WACC of 7.06% attributable to:
 - lower values ascribed by the Authority to the risk-free cost of funds and the cost of equity finance
 - a higher value ascribed to taxation imputation credits
- Based on the Authority's consideration of recent evidence from capital markets

Price Control (4/5)

Target Revenue (revenue cap)

Incorporates allowances for non-capital costs of:

- Western Power: \$1,566 million
- Authority: \$1,136 million



Price Control (5/5)

Effect on Network Charges (tariffs)

- Increases of:

Year	WP Proposed		ERA Draft Decision	
	Trans	Dist	Tran	Dist
2009/10	CPI + 42.2%	CPI + 42.2%	CPI + 12.6%	CPI + 6.1%
2010/11	CPI + 32.2%	CPI + 25%	CPI + 12.6%	CPI + 6.1%
2011/12	CPI + 32.2%	CPI + 25%	CPI + 12.6%	CPI + 6.1%

- Tariff equalisation contributions (TEC)
 - Tariff equalisation contributions not included, as the requirement has not been announced by the State Government
 - If TEC were included:
 - average distribution tariffs would increase approx. 26%
 - average network tariffs (dist and trans) would increase approx. 17%

Reference Services

- Access arrangement includes a range of transmission and distribution services as reference services, for which a reference tariff is specified
- Under Western Power’s proposed revisions, reference services comprise either “entry services” or “exit services”
- Authority’s draft decision:
 - requires that one or more reference services provide for a “bidirectional connection point”
 - bidirectional connection point required to cater for network services for small-scale renewable energy systems, and where electricity consumers participate in the State Government’s renewable energy buyback scheme

Standard Access Contracts

- Western Power’s standard access contract – the “*Electricity Transfer Access Contract*” (ETAC) – comprises a set of standard contractual terms on which reference services may be obtained
- Authority’s draft decision:
 - requires amendment of several provisions of the ETAC that were proposed by Western Power
 - required amendments take into account submissions from interested parties, and seek to ensure that the terms are reasonable and facilitate efficient use of the network and network services

Service Standards

Service Standard Benchmarks

- Access arrangement includes specification of service standard benchmarks that specify the level of reliability of network services that may be expected by a user of the network
- Western Power's access arrangement specifies service standard benchmarks for four measures of reliability:

Transmission	Distribution
Circuit availability	SAIDI
System minutes interrupted	SAIFI

- Authority's draft decision approves the service standard benchmarks proposed by Western Power, but requires benchmarks to be included for additional measures of reliability for transmission services

Incentive Arrangements (1/2)

- Western Power's proposed revisions include mechanisms that create commercial incentives for Western Power to:
 - seek efficiencies in the operation of the network (the “GSM”)
 - achieve and improve upon the service standard benchmarks for the reliability of network services (the “SSAM”)

Gain Sharing Mechanism (GSM)

- Provides a reward to Western Power for out-performance of an efficiency and innovation benchmark in respect of operating expenditure in the AA2 period
- Authority's draft decision approves the proposed mechanism, but requires amendments to strengthen commercial incentives:
 - no rewards if service standard benchmarks not met

Incentive Arrangements (2/2)

Service Standard Adjustment Mechanism (SSAM)

- A mechanism detailing how Western Power's performance during the access arrangement period, against the service standard benchmarks, is to be treated by the Authority
- Provides for a penalty or reward to be determined for each year of the access arrangement period
- Authority's draft decision approves the proposed mechanism, but requires amendments to strengthen commercial incentives:
 - removal of dead-bands and limits around target values of service standards
 - increased value of incentive rates

Applications and Queuing Policy (1/2)

- Access arrangement includes a queuing policy (the “Applications and Queuing Policy”) that determines the priority that an applicant for a network service has over other applicants to obtain a service when capacity in the network is insufficient to meet all applications

“First-Come First-Served” Operation of Queue

- Substantial concern for many users of the network
- Authority’s draft decision:
 - recognises the concerns with the operation of the queue, but materially the same as queuing rules of the model AQP under the Access Code
 - notwithstanding the model AQP, the Authority considers that the queuing rules, in combination with structure of the wholesale electricity market and reserve capacity mechanism, do not serve to promote efficient investment in the network

Applications and Queuing Policy (2/2)

The solution to the Queue?

- Cannot be resolved through the queuing rules in the AQP alone
- Requires consideration in a broader review of regulatory arrangements for the electricity market
- Recommendation made by the Authority in the *2008 Wholesale Electricity Market Report* to the Minister that this issue be addressed
- Authority also cognisant of other activities that are addressing this and other related matters, for example, the AEMC's review of energy market frameworks in light of climate change policies

Contributions Policy

- Access arrangement includes a contributions policy, which is required to set out the principles and processes for determining when a contribution will be required from a user, including for a network augmentation, and for determining the amount of the contribution

Contributions

- Under the Access Code, contribution means a “capital contribution”, a “non-capital contribution” or a “headworks charge”
- Authority’s draft decision requires amendments to the contributions policy proposed by Western Power to ensure greater transparency for users in the calculation of contributions

Assessment Process (1/2)

Steps completed

- Western Power's proposed revisions submission – lodged 1 October 2008
- Public consultation (1st round) – 8 October 2008 to 17 December 2008
- Issues paper – published by Authority on 5 November 2008
- Public forum – held on 10 November 2008

Next steps...

Note: dates for “next steps” are indicative and are subject to extensions of time or suspensions of deadlines as permitted under the Access Code

Assessment Process (2/2)

Next steps

- Public consultation (2nd round) – 17 July 2009 to 13 August 2009
- Final Decision – by 24 September 2009
- *If required (i.e. final decision is to not approve):*
 - Additional submission from Western Power – by 23 October 2009
 - Further final decision – by 13 November 2009

Commencement of revised access arrangement

- At least 20 business days after the Authority's approval of the proposed access arrangement revisions

Comments / Questions

General Comments?

Questions?

- Matters directly relevant to the draft decision
- Review and assessment process