



CONSULTATION

New Facilities Investment Test Application for the Mid West Energy Project (Southern Section)

DRAFT DETERMINATION

The Economic Regulation Authority has released its [draft determination](#) on Western Power's application for a new facilities investment test for the Mid West Energy Project (Southern Section). The application was submitted under section 6.71 of the *Electricity Networks Access Code 2004*.

Western Power's pre-approval application is for a total amount of forecast new facilities investment for the proposed works of \$383.4 million. Western Power submits that the entire proposed investment of \$383.4 million meets the test of section 6.51A of the Access Code, by virtue of satisfying the new facilities investment test of section 6.52 of the Access Code.

Western Power's application claims that the total proposed expenditure is met by a combination of incremental revenue and net benefits and is not proposing to require any contributions from specific customers or any other means of financing. Western Power has estimated the net present value of incremental revenue over the next 40 years will amount to \$206 million and the net present value of other benefits (predominantly linked with an assumed increase in wind generation) will amount to \$271 million.

The Authority has reviewed the proposed expenditure of \$383.4 million. Generally the proposed expenditure does not exceed the amount that would be invested by a service provider efficiently minimising costs, with the exception of \$16.7 million (4.4 per cent of the total proposed expenditure) which the Authority considers to be potentially inefficient.

However, the Authority has significant concerns in relation to the second part of the new facilities investment test. After consideration of Western Power's new facilities investment test application and independent advice, the Authority's draft determination is that it cannot give pre-approval at this stage for the total proposed expenditure of \$383.4 million to be rolled into the regulated capital base. The Authority considers that to do so would lead to existing customers being exposed to an unacceptable risk of increased charges, with potentially no commensurate benefit.

The Authority recognises that the proposed augmentation could enable significant amounts of new load and generation capacity to be connected to the network, which could bring increased revenues to Western Power. However, the majority of the proposed new incremental revenue relates to two new mining operations, one of which has yet to achieve Final Investment Decision. Given the inherent uncertainties in mining investment, the Authority is concerned that existing customers should not be left exposed to the risk of the other project not going ahead, resulting in the forecast incremental revenue not being realised and exposing existing customers to increases in charges.

The Authority also recognises there could be other significant potential benefits resulting from the proposed augmentation which could justify an increase in charges to customers. However, the Authority considers a number of the benefits claimed by Western Power in this context (particularly in relation to additional wind generation capacity) are uncertain and based on overly optimistic assumptions. Again, the Authority is concerned therefore that

existing customers could be exposed to increased charges with no commensurate benefit.

Without the proposed major new mining loads and new generating capacity in the Mid West, a much lower cost solution could be adopted to accommodate natural load growth in the region. The Authority is concerned that the scenarios adopted by Western Power in support of its application are uncertain. An outcome of including the investments in the capital base at this stage would be to transfer the ex-ante risks associated with achieving a return on the new investments – from Western Power to existing customers. The Authority's view is that these risks are borne best by the new loads that would benefit from the new assets, or by Western Power, rather than by existing customers.

The Authority notes that satisfaction of the new facilities investment test is not a prerequisite for a service provider to proceed with an investment. Western Power is free to continue with the project and to either obtain contributions from new loads through commercial negotiation, or else to place the investment into a speculative fund. With the speculative fund, as additional loads are connected, Western Power would be eligible to seek approval to include the additional capacity within the capital base, with a retrospective return. In this way, Western Power would bear the risk of future demand eventuating, not existing customers.

Interested parties are invited to make submissions on the draft determination which is available, with other related documents, on the ERA [website](#) by **4:00 pm (WST) on Monday, 12 December 2011**.

Submissions should be marked to the attention of Manager Projects Access.

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Confidentiality

In general, all submissions from interested parties will be treated as being in the public domain and placed on the Authority's website. Where an interested party wishes to make a submission in confidence, it should clearly indicate the parts of the submission for which confidentiality is claimed, and specify in reasonable detail the basis for the claim. Any claim of confidentiality will be considered in accordance with the provisions of sections 14.12 to 14.15 of the Access Code.

The publication of a submission on the Authority's website shall not be taken as indicating that the Authority has knowledge either actual or constructive of the contents of a particular submission and, in particular, whether the submission in whole or part contains information of a confidential nature and no duty of confidence will arise for the Authority.

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