



5<sup>th</sup> December 2011

Mr Tyson Self  
Manager Projects Access  
Economic Regulation Authority  
PO Box 8469, PERTH BC WA 6849

Email: [publicsubmissions@erawa.com.au](mailto:publicsubmissions@erawa.com.au)

Dear Mr Self,

**RE: Second Round Submission for Midwest Energy Project NFIT**

APA Group (APA) supports the Midwest Energy Project. We welcome the opportunity to make a submission to the second round of the NFIT process.

APA believes the ERA draft decision was instructive. We also believe it was correct. The NFIT is nothing more than a *pre-approval* that the cost of an investment in new assets will be rolled into the asset base of the owner of the regulated network, once the investment is completed. The ERA has determined, that at this point in time, it cannot be reasonably assured that both the incremental revenue and the 'net benefits' from the Midwest Energy Project will materialise (the project's 'risk' in the regulatory sense). As a prudent economic regulator, it should not transfer this risk from Western Power to energy users<sup>1</sup>. In the opinion of APA, the ERA has not used unreasonable or overly conservative assumptions in reaching its draft decision.

The ERA has also made it clear that its draft decision does not preclude Western Power from progressing the Midwest Energy Project. In the absence of any further compelling evidence that changes the draft decision, APA believes that this is exactly what Western Power should now do. One of the main risks identified by the ERA is that of the proposed large loads either not eventuating, or not proving viable over the period required to make a return on the assets. Western Power is a large organisation with considerable financial and commercial expertise. It is dealing with prospective customers that are similarly commercially minded, with very large capital commitments to make in order to progress their mining operations. It is not beyond these organisations to manage the risks associated with the Midwest Energy Project through appropriate commercial arrangements and in the understanding that once constructed, it is likely that the ERA will allow the investment, or a significant portion of it, to be rolled into the asset base.

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<sup>1</sup> Incidentally, given that Western Power sources its funds from (and pays dividends on these funds to) the State, the ERA is also shielding WA taxpayers from this 'risk'.



Western Power gets paid a rate of return on its assets and investments commensurate with that of a prudent operator in a competitive market. That is, Western Power is being paid to take appropriate investment risk. Western Power has made it clear that its analysis suggests the risks associated with the Midwest Energy Project are prudent:

*Western Power believes that the project satisfies NFIT requirements in that the cost of the project is less than our estimates of the electricity market benefits - being in the order of \$94 million (greater than the project cost). The flow on benefits to the Mid West could be substantially larger<sup>2</sup>*

If Western Power is confident the project will ultimately satisfy the NFIT, then it should proceed. It is paid a rate of return to do so. If Western Power is confident the project will satisfy the NFIT but does not proceed, on the basis its Board deems the risk to its future revenue too great to bear, then it is not behaving as a prudent investor (and taking on an appropriate amount of risk), in which case the ERA should consider this risk aversion the next time it sets the regulated rate of return. If, despite its claims, Western Power is not confident enough of the project satisfying the NFIT to proceed without its pre-approval by the ERA, then it is attempting to transfer onto energy users<sup>3</sup> the downside risk of a project that, as a prudent investor, it deems too risky to undertake.

If the latter is the case and the project is deemed uneconomic in a regulatory sense, then, obvious issues of appropriateness aside, it does not mean that the Midwest Energy Project should be abandoned. An economic regulator must assess risk based on how a prudent operator would manage assets and investments in a competitive market. But economic regulation is often not conducive to determining the appropriateness of investments that are aligned with 'state development' objectives. Governments regularly make investments that would not stack up when measured solely on a restrictive definition of its economic viability. Put another way, governments often step into markets where private enterprise cannot justify investments in assets that are likely to provide a general benefit to society. This is commonly known as a market failure. The snowy hydro scheme and, closer to home, the Dampier to Bunbury Natural Gas Pipeline are good examples of energy assets that would have been unlikely to pass the purview of the economic regulator. In both cases, governments took on large risks using taxpayer funds and/or commitments in order to progress them. Yet both are examples of projects that have created immense benefit to society over a long period of time. This is one of the roles of prudent governments.

It is acknowledged that the Midwest Energy Project is important to opening up the Midwest region's mining potential. A similar infrastructure project in the region is the proposed Oakajee Port and Rail development. Both the State and Federal governments have allocated taxpayer funds to this project, with the remainder to be provided by private enterprise<sup>4</sup>. Additionally, for Stage 2 of the Midwest Energy Project, Western Power has

<sup>2</sup> [http://www.westernpower.com.au/networkprojects/substationPowerlineProjects/mid\\_west/mid\\_west\\_stage\\_1.html](http://www.westernpower.com.au/networkprojects/substationPowerlineProjects/mid_west/mid_west_stage_1.html)

<sup>3</sup> And taxpayers.

<sup>4</sup> It should be noted that any such monopoly infrastructure will have to abide by the relevant competition law and/or Part IIIA of the Trade Practices Act.



applied to the Federal Government for Infrastructure Australia (taxpayer) funds. If the Midwest Energy Project is deemed 'uneconomic' in a regulatory sense, the State Government must decide whether it believes if the State's taxpayers will benefit from the project progressing<sup>5</sup>. If it does, it should make funds available for Western Power to progress the project. In other words, as a state development asset, the project's 'risk' should be borne by the State and internalised by taxpayers as a function of the prudent operation of their government.

In summary, it is APA's opinion that the ERA has acted appropriately in arriving at its draft decision. If Western Power believes the Midwest Energy Project will ultimately satisfy the NFIT, then in the absence of compelling new evidence that will alter the draft decision of the ERA, it should enter into appropriate commercial arrangements with the major loads in the Midwest to share risk and continue to progress the project. If it is believed that the project is unlikely to be deemed economic in a regulatory sense, then the State must decide whether taxpayers will benefit from it progressing and if so, make the funds available for Western Power to progress the project.

APA continues to support the Midwest Energy Project and hopes it is able to progress in a timely manner.

Best Regards,



Shane Cremin  
Development Manager

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<sup>5</sup> Bearing in mind that even if deemed uneconomic in its entirety, it is likely that some portion will be allowed onto the regulated asset base.