

Community Electricity

Submission in Response to ERA Public Consultation

Allowable Revenue and Forecast Capital Expenditure for the Independent Market Operator and System Management 2013/14 to 2015/16

Standing

Community Electricity (“Community”) is a member of the IMO’s Market Advisory Committee (MAC) and the ERA’s Technical Rules Committee.

Community has no commercial interest in the Authority’s determination.

General

Community acknowledges that the new Balancing and Load Following Ancillary Services (LFAS) Markets that commenced on 1 July 2012 were major undertakings that imposed significant costs and organisational challenges on both the IMO and System Management. Although the new markets are less than a year old, the Balancing Market is delivering prices towards the ‘optimistic’ extreme of the spectrum of expectations. While the LFAS market has regrettably delivered outcomes towards the ‘pessimistic’ extreme, there are signs of improving efficiency and recent reductions in prices towards more credible levels.

In terms of organisational performance, Community considers that the IMO managed the conception, design and implementation of the new markets according to a ‘business as usual’ culture, resulting in an outstanding achievement. Similarly, we consider that System Management, being a unit of Western Power, performed extremely well in adapting to the new requirements in both its operations, and just as importantly, its culture. In particular, we note that System Management has established a new team of committed professionals who are responding to the new challenges in appropriate and innovative ways. The level of consultation and participant participation is especially welcome.

Community considers that in assessing the Allowable Revenues for both organisations, it should be born in mind that the respective costs are an infinitesimal proportion of the total cost of supply to an end-user, and a very small proportion of the net reductions achieved via the two new markets. Consequently, it is important that the costs of the new responsibilities should be properly funded with an emphasis on encouraging fit-for-purpose innovation, rather than impeding it through ‘penny pinching’.

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Submissions are invited from interested parties on the process that the Authority intends to follow in making a determination on Allowable Revenue and in approving Forecast Capital Expenditure for the IMO and System Management.

Community supports the ERA's proposed approach in determining the allowable revenues. In particular, we support benchmarking against previous years and making allowance for 'trend changes' in traditional costs and 'step changes' in costs associated with new activities.

Submissions are invited from interested parties on the key assumptions indicated by the IMO to have been applied in deriving its proposed Allowable Revenue for the third Review Period.

Community supports the key assumptions proposed by the IMO.

Submissions are invited from interested parties on the proposed capital projects and the associated capital requirements indicated by the IMO to have been included in deriving the Forecast Capital Expenditure for the third Review Period and the five-year depreciation model it applied across all components of capital projects.

Community supports the capital requirements proposed by the IMO.

Submissions are invited from interested parties on System Management's building block approach to revenue determination, the inclusion of the return on investment based on estimated real post-tax weighted average costs, and key assumptions indicated by System Management to have been applied in deriving its proposed Allowable Revenue for the third Review Period.

Community notes the ERA's comments that System Management has used a novel approach to determining its proposed Allowable Revenue, and that this approach differs markedly from both that used previously and the approach used by the ERA in assessing the proposal. Furthermore, Western Power has not explained the reasons for the changes.

While Community is open to the possibility that significant changes could be merited by the new structure and the new circumstances posed by the two new markets, we consider it self-evident that a professional organisation overseen by a regulator should properly and proactively explain the reasons for the changes. Furthermore, we note that Western Power has proposed new payments in respect of tax payments made and a Return on Capital Employed. In response, we would reiterate the ERA's advice that:

“The Allowable Revenue and Forecast Capital Expenditure must include only costs that would be incurred by a prudent provider of the services, acting efficiently, seeking to achieve the lowest practically sustainable cost of delivering the services in accordance with the Market Rules, while effectively promoting the wholesale market objectives.”

On this basis, we would advocate that Western Power should be properly compensated in accordance with the applicable regulations for only the fit-for-purpose costs that it incurs. In particular, we are concerned that the new proposal for payment of a Return on Capital is an attempt to grasp unwarranted funding according to the bidding of its parent,

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Western Power. Furthermore, notwithstanding the inappropriateness of the proposal, we are disturbed that a WACC of 6.66% is proposed instead of the 3.60% that was approved by the ERA in Western Power's Access Arrangement 3. We therefore propose that Western Power's proposal should be denied in respect of Return on Capital and the tax payment. [We would also add that insofar as Western Power was to be successful in this claim, we would then propose that instead the money be saved by removing System Management from the cultural clutches of its parent and locating it under the IMO.]

Community also notes a zero insurance cost in the current review period has increased to \$1.2million in the prospective period. We propose that the ERA should carefully review the appropriateness of this claim. [We attempted to download Western Power's 204 page submission, but were unable to due to its size (65Mb in comparison to the IMO's 2Mb).

Community otherwise supports the proposed budgets, with particular emphasis on IT Support, Business Support, Functional, and Labour.

Submissions are invited from interested parties on the proposed capital projects indicated by System Management to have been included in deriving of the Forecast Capital Expenditure for the third Review Period and the economic life it assumed for the asset groups for depreciation purposes.

Community supports in good faith System Management's proposed capital investment program for the purpose of delivering system operation services.

Contact

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