

Determination on the Proposed 2013/14 Price List for Western Power's Covered Electricity Network

Submitted by Western Power

26 June 2013

Economic Regulation Authority

WESTERN AUSTRALIA

This document is available from the Economic Regulation Authority's website at www.erawa.com.au. For further information, contact:

Economic Regulation Authority
Perth, Western Australia
Phone: (08) 6557 7900

© Economic Regulation Authority 2013

The copying of this document in whole or part for non-commercial purposes is permitted provided that appropriate acknowledgment is made of the Economic Regulation Authority and the State of Western Australia. Any other copying of this document is not permitted without the express written consent of the Authority.

Disclaimer

This document has been compiled in good faith by the Economic Regulation Authority (Authority). The document contains information supplied to the Authority from third parties. The Authority makes no representation or warranty, express or implied, as to the accuracy, completeness, reasonableness or reliability of the information supplied by those third parties.

This document is not a substitute for legal or technical advice. No person or organisation should act on the basis of any matter contained in this document without obtaining appropriate professional advice. The Authority and its staff members make no representation or warranty, expressed or implied, as to the accuracy, completeness, reasonableness or reliability of the information contained in this document, and accept no liability, jointly or severally, for any loss or expense of any nature whatsoever (including consequential loss) arising directly or indirectly from any making available of this document, or the inclusion in it or omission from it of any material, or anything done or not done in reliance on it, including in all cases, without limitation, loss due in whole or part to the negligence of the Authority and its employees.

This notice has effect subject to the *Competition & Consumer Act 2010* (Cwlth), the *Fair Trading Act 1987* (WA) and the *Fair Trading Act 2010* (WA), if applicable, and to the fullest extent permitted by law.

Any summaries of the legislation, regulations or licence provisions in this document do not contain all material terms of those laws or obligations. No attempt has been made in the summaries, definitions or other material to exhaustively identify and describe the rights, obligations and liabilities of any person under those laws or licence provisions.

Contents

DETERMINATION	1
REASONS	1
Access Code Requirements	1
Proposed Price List Submission	2
Compliance of the Proposed Price List with the Price Control	3
Specification of the Price Control under the Access Arrangement	3
Reference Service Revenue	3
Compliance of the Proposed Price List with the Pricing Methods	9

DETERMINATION

1. On 14 June 2013, Western Power submitted a proposed 2013/14 price list for its electricity network to the Economic Regulation Authority (**Authority**) for approval under Chapter 8 of the *Electricity Networks Access Code 2004* (**Access Code**).¹
2. Western Power's proposed price list has been submitted under terms of the amended access arrangement that applies to Western Power's electricity network for the third access arrangement period (2012/13 to 2016/17), which commenced on 1 February 2013, as amended by a mid period variation approved on 4 June 2013.^{2,3}
3. The Authority has assessed the proposed 2013/14 price list and considers that the proposed price list complies with the price control and pricing methods of the amended access arrangement.
4. The Authority also observes that section 6 of Western Power's proposed price list refers to a list of fees referred to as "application and queuing policy fees". This determination does not apply to these stated fees, as the Authority is not required to assess or approve such fees as part of its price list determination.
5. In accordance with the requirements of section 8.2 of the Access Code, the Authority approves the 2013/14 proposed price list and determines that this price list has effect from 1 September 2013. The Authority has published Western Power's proposed price list and price list information on its website.⁴

REASONS

Access Code Requirements

6. Chapter 8 of the Access Code sets out requirements for a service provider to submit proposed price lists, and for the Authority to approve and publish the proposed price lists and related price list information.

Approval of price lists if required

- 8.1 If a service provider's access arrangement requires it to submit price lists to the Authority for approval, the service provider must, at least 45 business days before the start of each pricing year (except for the first pricing year), submit to the Authority:
 - (a) a proposed price list to apply for the next pricing year; and
 - (b) price list information.

¹ 14 June 2013, Western Power, *2013/14 Price List and 2013/14 Price List Information*.

² November 2012, Western Power, *Amended Proposed Revisions to the Access Arrangement for the Western Power Network* (hereafter cited as "**amended access arrangement**"). The amended access arrangement was approved by the Authority on 29 November 2012, with a commencement date of 1 February 2013.

³ 4 June 2013, Economic Regulation Authority, *Decision: Variation to Western Power's Access Arrangement for 2012/13 to 2016/17*.

⁴ See Economic Regulation Authority website: <http://www.erawa.com.au/access/electricity-access/price-list-determinations/>

- 8.2 If the Authority considers that a service provider's proposed price list complies with:
- (a) the price control in the service provider's access arrangement; and
 - (b) the pricing methods in the service provider's access arrangement,
- then the Authority must:
- (c) approve and publish the service provider's proposed price list which has effect from a date specified by the Authority; and
 - (d) publish the service provider's price list information.
- 8.3 The Authority must not approve a service provider's proposed price list if the proposed price list does not comply with sections 8.2(a) and 8.2(b), and must notify the service provider that it does not approve the proposed price list and provide reasons.
- 8.4 If a service provider is notified under section 8.3 that the Authority does not approve a proposed price list submitted by the service provider, the service provider may at any time submit a revised proposed price list to the Authority.
- 8.5 If the Authority:
- (a) notifies a service provider under section 8.3 that it does not approve a proposed price list submitted by the service provider; and
 - (b) has not approved a revised proposed price list,
- then the price list most recently in effect continues in effect until the Authority approves a revised proposed price list submitted by the service provider under section 8.4.
- 8.6 If the Authority has not notified a service provider that it does not approve a proposed price list within 15 business days after receiving either:
- (a) the proposed price list; or
 - (b) any further information the Authority has requested in relation to the proposed price list,
- (whichever is later), then the Authority is to be taken to have approved the price list.

Publication of price lists if approval not required

- 8.7 If a service provider's access arrangement does not require it to submit price lists to the Authority for approval, the service provider must, at least 25 business days before the start of each pricing year (except for the first pricing year), submit to the Authority a copy of:
- (a) a price list to apply in respect of the next pricing year which complies with:
 - (i) the price control in the service provider's access arrangement; and
 - (ii) the pricing methods in the service provider's access arrangement;
- and
- (b) price list information.
- 8.8 Where a service provider submits a price list and price list information to the Authority under section 8.7, the Authority must publish the price list and price list information.

Proposed Price List Submission

7. Clause 6.4.3 of Western Power's amended access arrangement requires it to submit to the Authority a proposed price list, together with price list information, at

least 45 business days before the start of each pricing year (except for the first pricing year).

8. Western Power submitted a proposed 2013/14 price list to the Authority on 26 April 2013. The Authority published a decision not to approve the proposed price list on 4 June 2013 on the basis that it did not comply with the price control of the approved access arrangement as amended by a mid period variation on 4 June 2013.
9. On 14 June 2013, Western Power submitted a revised proposed 2013/14 price list and price list information to the Authority as permitted under section 8.4 of the Access Code. Western Power has also provided the Authority with confidential spreadsheets containing additional supporting information and calculations to indicate the forecast of revenue associated with the proposed price list.

Compliance of the Proposed Price List with the Price Control

Specification of the Price Control under the Access Arrangement

10. Under the Access Code, “price control” refers to the provisions of an access arrangement that determine the target revenue to be earned by the service provider, enable users to predict likely annual changes in target revenue during the access arrangement period, and aim to avoid price shocks (material tariff adjustments between succeeding years).
11. Section 5 of the amended access arrangement establishes revenue cap price controls for each of the transmission and distribution networks. The operation of these price controls within an access arrangement period is set out in clauses 5.6.1 to 5.6.8 and 5.7.1 to 5.7.8 of the amended access arrangement.
12. Related to the price control is a “side constraint” that limits the extent to which component charges of reference tariffs may be increased from one pricing year of the access arrangement period to the next. Clauses 6.5.13 and 6.5.14 of the amended access arrangement specify the method to calculate side constraints on price changes for transmission and distribution, which for the 2013/14 pricing year will constrain reference tariff charges to:
 - 10.31 percentage points for the transmission network; and
 - 41.67 percentage points for the distribution network.

Reference Service Revenue

13. Western Power has set out its determination of maximum transmission reference service revenue (MTR_t) and maximum distribution reference service revenue (MDR_d) in sections 1.3.1 and 1.3.2 of the price list information respectively.

Transmission Services

14. Western Power’s derivation of the reference service revenue for transmission services is indicated in Table 1 below.

Table 1 Western Power's determination of maximum transmission regulated revenue for 2013/14

Calculation Parameter	Value (\$ million)	Source
Revenue cap ($TR_{2013/14}$, dollar values of 30 June 2012)	328.1	Amended Access Arrangement, clause 5.6.6
Correction factor ($TK_{2013/14}$, dollar values of 30 June 2012)	27.4	2013/14 Price List Information, section 1.3.1 (Table 2)
Maximum regulated transmission revenue ($MTR_{2013/14}$, dollar values of 30 June 2012)	355.5	
<i>Inflation factor</i>	1.042	2013/14 Price List Information, section 1.3.3 (Table 6)
Maximum regulated transmission revenue ($MTR_{2013/14}$, nominal dollar values)	370.6	
$MTR_{2013/14}$ July-August	67.0	2013/14 Price List Information, section 1.3.1 (Table 3)
$MTR_{2013/14}$ September-June	303.6	2013/14 Price List Information, section 1.3.1 (Table 3)

15. Western Power has provided to the Authority on a confidential basis a model containing the calculations used to derive the correction factor (K).⁵
16. The correction factor for transmission (TK_t) is calculated from required and collected revenues from the 2012/13 pricing year and is indicated in Table 2 below. The correction factors were derived by applying a weighted average cost of capital (WACC) of 3.6 per cent real post-tax, as approved in the amended access arrangement for the third access arrangement period.⁶

⁵ 24 April 2013, Western Power, K Factor Model (confidential).

⁶ November 2012, Western Power, *Amended Access Arrangement*, clause 5.4.1.

Table 2 Western Power's determination of the correction factor (TK_t) for 2012/13 for the determination of maximum regulated transmission revenue

Calculation Parameter	2012/13
Maximum Transmission Revenue, MTR_t	413.8
<i>minus</i> Actual Transmission Revenue (ATR_t)	387.3 (forecast)
(Over)/Under Revenue Collection $_t$	26.4
Multiplied by (1 + WACC)	27.4

17. As Western Power has proposed the Price List should take effect from 1 September 2013, the 12 month maximum regulated revenue has been allocated between the two months prior to the new prices coming into effect and the ten months after the new prices come into effect. The allocation assumes constant volumes during the year. The Authority considers this allocation to be reasonable for the purposes of setting tariffs for the 2013/14 year and is consistent with the approach adopted in the past when price changes have occurred part way through the year.

Distribution Services

18. Western Power's derivation of the reference service revenue for distribution services is indicated in Table 3 below.

Table 3 Western Power's determination of maximum distribution regulated revenue for 2013/14

Calculation Parameter	Value (\$ million)	Source
Revenue cap ($DR_{2013/14}$, dollar values of 30 June 2012)	684.8	Amended Access Arrangement, clause 5.7.6
Correction factor ($DK_{2013/14}$, dollar values of 30 June 2012)	69.2	2013/14 Price List Information, section 1.3.2 (Table 4)
Maximum regulated distribution revenue excluding TEC_t ($MDR_{2013/14}$, dollar values of 30 June 2012)	754.0	
<i>Inflation factor</i>	1.042	2013/14 Price List Information, section 1.3.3 (Table 6)
Maximum regulated distribution revenue excluding TEC_t ($MDR_{2013/14}$, nominal dollar values)	786.1	
Tariff equalisation contribution ($TEC_{2013/14}$, nominal dollar values)	209.0	2013/14 Price List Information, section 1.3.2 (Table 4)
Maximum regulated distribution revenue including TEC_t ($MDR_{2013/14}$, nominal dollar values)	995.1	
$MDR_{2013/14}$ July-August	151.4	2013/14 Price List Information, section 1.3.3 (Table 5)
$MDR_{2013/14}$ September-June	843.7	2013/14 Price List Information, section 1.3.3 (Table 5)

19. As is the case with transmission services, the correction factor for distribution (DK_t) is calculated from required and collected revenues from previous pricing years and is indicated in Table 4 below. The correction factors were derived by applying a WACC of 3.6 per cent real post-tax, as approved in the amended access arrangement for the third access arrangement period.⁷

⁷ November 2012, Western Power, *Amended Access Arrangement*, clause 5.4.1

Table 4 Western Power's determination of the correction factor (DK_t) for 2012/13 for the determination of maximum regulated distribution revenue

Calculation Parameter	2012/13
Maximum Distribution Revenue, MDR_t	885.5
<i>minus</i> Actual Distribution Revenue (ADR_t)	818.7 (forecast)
(Over)/Under Revenue Collection $_t$	66.8
Multiplied by (1 + WACC)	69.2

20. As is the case for transmission, the 12 month maximum regulated revenue has been allocated between the two months prior to the new prices coming into effect and the ten months after the new prices come into effect. The allocation assumes constant volumes during the year. The Authority considers this allocation to be reasonable for the purposes of setting tariffs for the 2013/14 year and is consistent with the approach adopted in the past when price changes have occurred part way through the year.

Inflation Factor

21. Western Power indicates in section 1.3.3 of the price list information that the inflation factor, used to calculate the required revenue from reference services in nominal dollar values, is derived from actual inflation for the annual period December 2011 to December 2012 (2.2 per cent) and a forecast of inflation for the period December 2012 to December 2013 (2.0 per cent). Western Power has sourced its forecast of inflation for the annual period to December 2013 from the Reserve Bank of Australia's May 2013 Statement on Monetary Policy publication. The Authority considers this estimate to be reasonable for this purpose and notes that future price lists will include a correction for differences in forecast and realised (actual) inflation.

Forecast Revenue

22. Table 7 of the Price List Information sets out the expected revenue to be collected from the component charges of reference tariffs based on the proposed new tariffs. The total values of expected revenue compared with maximum target revenue are shown in Table 5 below.

Table 5 Western Power’s forecast revenue to be collected from reference services for the period September 2013 – June 2014

Revenue Component	Value (\$ million)
Transmission Revenue	
Forecast revenue from transmission tariffs (inclusive of non-reference standby access charges of \$3.4 million)	303.6
Target services revenue (from Table 1 of this determination)	303.6
Forecast over/(under) recovery	0
Distribution Revenue	
Forecast revenue from distribution reference tariffs	843.7
Target revenue (from Table 3 of this determination)	843.7
Forecast over/(under) recovery	0

23. The expected revenues for both transmission and distribution are in line with the respective target revenue caps approved under the amended access arrangement.
24. Clauses 6.5.13 and 6.5.14 of the amended access arrangement set out the side constraints that apply to increases in network charges for the transmission and distribution network. The side constraint formula allows for a reference tariff to be increased such that the proportional increase in nominal revenue from the reference tariff from the previous year is less than or equal to the proportional increase from:
- inflation escalation;
 - the year to year change in target revenue that was determined in the financial model for the access arrangement;
 - adjustments to target revenue that result from carry-over and cost pass-through mechanisms under the price control, as well as the tariff equalisation contribution for distribution charges; and
 - a further two per cent.
- For this purpose, inflation is the percentage increase in the CPI (weighted average for eight capital cities) for the most recent December quarter compared to the December quarter in the previous year.
25. The side constraints applying to increases in charges from 2012/13 to 2013/14 is 10.31 per cent for transmission charges and 41.67 per cent for distribution charges. In order to calculate the side constraints the following parameters were used:
- a forecast of CPI inflation of 2.0 per cent;
 - year to year change in target revenue of -2.0 per cent for transmission charges and 19.3 per cent for distribution charges;

- an increase of 8.35 per cent for transmission charges and 17.99 per cent for distribution charges which reflect adjustments to target revenue;
 - a further two per cent.
26. Section 8.1 of the price list information indicates the percentage changes in reference tariffs from 2012/13 to the proposed 2013/14 price list. The percentage changes are within the bounds established by the side constraints and range between:
- reductions in transmission tariffs of between 14 and 4 per cent; and
 - increases in distribution tariffs of between 0 and 18 per cent.
27. Western Power notes in sections 1.2.5 and 8.2 of the Price List Information that, during the second access arrangement period, rather than adjusting individual tariffs by different amounts, the decision was made (in order to reduce price shock to individual customer groups) to increase all network tariffs by the same amount each year. This resulted in charges for some reference tariffs deviating slightly from the “optimal” level. Western Power intends to rectify this by re-balancing tariffs as allowed by the side constraints during the third access arrangement period.
28. Section 8.2 of the Price List Information notes that the tariffs with the most significant variations from the average price movements are RT9 (street lighting) and RT4 (time of use business). Western Power notes that the RT9 distribution tariff has not increased by as much as the average distribution increase due to the majority of the related cost pool being for asset maintenance only. Western Power notes the business time of use tariff is increasing more than the average due to the tariff having deviated from its optimal level resulting in the need to recover more revenue to be cost reflective.
29. The Authority notes that tariffs have been uniformly increased over a significant period of time, whereas the numbers of customers and energy used by each tariff group has changed by different amounts during that time. The Authority considers this is likely to have led to a divergence between the costs allocated to a specific customer group and the revenue collected from that customer group.
30. The Authority has reviewed the information provided by Western Power in relation to rebalancing and considers it to be reasonable. The Authority notes that the tariff changes meet the requirements of the side constraint and that the forecast revenue for each tariff class falls within the incremental and stand-alone cost as required by section 7.3 of the Access Code.
31. Taking into account the derivation of required revenues from reference services, the forecast revenue to be collected, and the changes in reference tariff charges relative to the side constraint, the Authority is satisfied that the proposed 2013/14 price list complies with the price control set out in the amended access arrangement.

Compliance of the Proposed Price List with the Pricing Methods

32. “Pricing methods” under the Access Code refer to the structure of reference tariffs included in the access arrangement, which determines how the maximum revenue is allocated across and within reference services.

33. Clauses 6.1.1 to 6.3.3 and Clauses 6.5.1 to Clauses 6.7.3 of the amended access arrangement detail the pricing methods applied by Western Power. The overview of pricing methods, at clause 6.3.1, states that reference tariffs are derived from an amount of required revenue for a pricing year by a method of cost allocation.
- 6.3.1 Reference tariffs are derived from an analysis of the cost of reference service provision which entails:
- a) identifying the costs of providing revenue cap services;
 - b) determining the expected non-reference service revenue within the costs of providing revenue cap services;
 - c) deducting the expected non-reference service revenue from the costs of providing revenue cap services to determine the costs of providing reference services;
 - d) allocating the costs of providing reference services to particular reference service customer groups;
 - e) translating the costs of serving particular reference service customer groups to the costs of providing reference tariffs; and
 - f) determining a structure of reference tariffs in a manner that reflects the underlying cost structure, in accordance with section 7.6 of the Code.
34. The pricing methods set out in the approved access arrangement also require:
- reference tariffs should be set between the incremental and stand-alone cost of service provision;
 - charges paid by different users of a reference service should differ only to the extent necessary to reflect differences in the average cost of service provisions to the users;
 - the structure of tariffs should reasonably accommodate the requirements of users collectively; and
 - the incremental cost of service should be recovered by tariff components that vary with usage and the costs in excess of the incremental cost of service should be recovered through tariff components that do not vary with usage.
35. Western Power's proposed Price List Information for 2013/14 sets out how it has complied with the requirements of its approved access arrangement.
36. The Authority has reviewed the Price List Information together with additional information provided on a confidential basis to verify that the requirements of the approved access arrangement have been complied with. In assessing compliance with the pricing methods, the Authority notes that the objectives of the pricing methods under sections 7.3 and 7.4 of the Access Code are broad. These objectives require that the reference tariffs recover the forward-looking efficient costs of providing reference services and that the reference tariff applying to a user recovers an amount of revenue that is greater than the incremental cost of service provision and less than the stand-alone cost of service provision.
37. Taking these matters into account, the Authority considers that the proposed 2013/14 price list complies with the pricing methods established under the amended access arrangement.