

**Submission to the Economic  
Regulation Authority regarding ERA's  
Draft Decision Regarding Western  
Power's Access Arrangement Proposal  
(2018-2022)**

30<sup>th</sup> May 2018



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## Perth Energy Response to the ERA Draft Determination regarding Western Power's 4<sup>th</sup> Access Arrangement Proposal

### Executive Summary

Perth Energy welcomes the opportunity to provide comment in relation to the ERA's draft decision regarding Western Power's 4<sup>th</sup> Access Arrangement proposal (AA4). Perth Energy objects to several key elements of the ERA's draft determination. Perth Energy's submission is focused on sections of the draft determination which Perth Energy feels are in contravention of the objectives set out in the Network Access Code. The objectives set out in the Access Code are to promote:

- i) efficient investment in the network
- ii) competition upstream of the network
- iii) competition downstream of the network

Perth Energy believes the following aspects of the ERA's draft determination contravene the Access Code objectives above:

- 1) Unwillingness to revalue the Regulated Asset Base (RAB)
- 2) The price shock felt by transmission connected customers over the AA4 period.
- 3) Lack of accountability regarding metering services
- 4) Lack of appropriate reform regarding tariff structure



## Unwillingness to revalue the Regulated Asset Base (RAB)

In its initial submission to the ERA, Perth Energy questioned the decision to use the roll forward method of valuation for the Regulated Asset Base (RAB). Perth Energy is of the view this method is inconsistent with promoting efficient investment in the network. The ERA's response to this concern was found in paragraph 255 of its draft decision. The ERA states that it:

*"considers the roll-forward method is consistent with the access code" (para 255)*

Perth Energy is glad the ERA has made its position on valuation of the RAB known, but is disappointed with its lack of an explanation. Perth Energy is of the view that there are many valuation methods of the regulated asset base that are available, but a reason as to why:

- i) The roll-forward method is consistent the code objectives above, or
- ii) The roll-forward method is the best valuation method, given the alternatives.

given the price increase for transmission connected customers would be appreciated.

As per paragraph 253 of the ERA's draft determination, the ERA states:

*"the service providers target revenue only includes a regulatory depreciation allowance equal to (in real terms) the value of its initial capital investment." (para 253)*

Structuring the recovery of revenue in this way that is consistently linked to the historical cost of investment, creates an effective 'break-even' guarantee for Western Power for any asset included in the RAB, irrespective of its current value to the SWIS. Perth Energy would be interested in how the ERA came to the determination that providing a break-even guarantee for any investment carried out by Western Power is the most appropriate mechanism to 'promote efficient investment in the network'.

Perth Energy stands by its proposal in its initial submission that a more appropriate way to promote efficient investment in the network would be to revalue the RAB at the beginning of each Access Arrangement period and set the depreciation and return revenue amounts received in the Access Arrangement period based on the revalued asset amount, as opposed to historical cost. This would remove the guarantee Western Power currently receives with regards to its investment decisions and ensures customers are not paying more than they should with regards to network investment.



## The price shock felt by transmission connected customers over the AA4 period

### Cost Increases to Large Retail Customers

Increases to transmission costs by 12% year on year from 2018 to 2022 represent a material increase to the cost of delivering energy via the transmission network. Neither the ERA nor Western Power has made any representation to market participants that there are benefits associated with this increase. Section 6.4 (c) of the access code states that:

“The price control in an access arrangement must have the objectives of:

(c) Avoiding price shocks (that is, sudden material tariff adjustments between succeeding years)”

Perth Energy is of the view the ERA’s draft determination of transmission revenue increases of 57% over the AA4 period, which is approximately 12% per year would be considered a sudden material tariff adjustment between the AA3 period and the AA4 period. As such, In Perth Energy’s opinion the transmission price path over the AA4 period is considered to be a price shock and is therefore inconsistent with the requirements as set out in the Access Code.

As a result, Perth Energy and other retailers within the SWIS have been set the unfavourable task of notifying customers of significant price shocks to their transmission network costs over the AA4 period. This increase is particularly high for all customers on Reference Tariff 7 (RT7), Reference Tariff 8 (RT8), Transmission Reference Tariff 1 (TRT1) and Transmission Reference Tariff 2 (TRT2).

Typically when material cost increases occur in any industry within the economy, the first response by those paying the increase is ‘what is the associated benefit from my increased expenditure?’ Unfortunately, neither the ERA nor Western Power has made any representation to market participants that there are any benefits associated with the increases to transmission revenue. Examples of improvements that customers and retailers may find palatable would be:

- Increased reliability standards for transmission connected customers
- Less network constraints on the transmission network
- Transmission network upgrades that will enable new generation
- Improvement of network readiness to accommodate new technologies

Unfortunately, none of these expected benefits that could be assumed to come about through increased revenue regarding the transmission network over the AA4 period have been communicated through the Access Arrangement process. Given the silence of any associated benefits regarding increased transmission network revenue, Perth Energy has come to the conclusion there is no benefit arising from the price shocks facing transmission connected customers.

Perth Energy notes that these substantial increases are being proposed at a time when all other participants in the electricity market are making stringent efforts to reduce prices to customers.



### Cost Increases to Power Generators

As the owner of a gas fired power station, Perth Energy finds itself in an unfortunate situation where it will have to accept a significant increase to transmission network costs during 2018 – 2021 for its power station with no mechanism in the current market rules to recover that drastic increase in cost.

For a market generator there are two avenues through which to recover the cost of generating power. The energy market and the capacity market. As the capacity price is set three years in advance, the transmission price shocks proposed throughout the AA4 period have not been factored into the capacity revenue a generator can expect to receive. The escalation factor in the calculation of the Benchmark Reserve Capacity Price with respect to Western Power transmission costs has been set at 0.4% for each year from 2018 through to 2021. Similarly, with respect to the energy market, power generators must bid at short run marginal cost. The ERA released guidelines on what costs would be considered short run marginal cost earlier this year. As network costs are deemed fixed costs, under the balancing submission guidelines released by the ERA, market generators are not able to recover this cost through changing their bids into the energy market. The price shocks proposed through the AA4 draft determination have created a situation where power generators will have to carry network losses as there is no mechanism to recover the transmission cost increases.

Perth Energy would challenge the ERA to:

- i) Reconcile how a 12% year on year price increase to transmission connected customers does not constitute a price shock over the AA4 period.
- ii) Clarify what tangible benefits transmission connected customers are receiving from the price shock that is a direct result of transmission price increases.
- iii) Reconcile how a transmission price increase with no improvement in service quality is consistent with access code objective of promoting competition downstream of the network
- iv) Reconcile how the ERA as an organisation have created the situation where significant cost increases are not recoverable by market generators with the access code objective of promoting competition upstream of the network.



## Lack of accountability regarding metering services

Last year the Public Utilities Office (PUO) set out the major reforms that the state government plans to undertake over the coming years. These include; improving access to the Western Power network through a constrained dispatch market, improving reserve capacity pricing signals and improving access to the Pilbara network. The PUO has not made electricity retail reform a priority and as such it is unlikely that any reform regarding competition for metering services is likely to take place.

Perth Energy would prefer metering to become a contestable business within the SWIS, but understands there is significant work required to the current regulatory framework to achieve that outcome. Given the focus of state government on other reform mechanisms Perth Energy is of the view that it is unlikely contestable metering would be introduced to the market prior to the end of the AA4 period.

In the interim, Perth Energy is of the view that the upgrade to 21<sup>st</sup> century technology for consumers' metering should not be put on hold. Western Power has demonstrated leadership in furthering the metering infrastructure within the SWIS through its Advanced Metering Infrastructure (AMI) project. The ERA has stated:

*“Western Power has not been able to demonstrate a positive net benefit, the proposed expenditure on the communications infrastructure is not reasonably likely to meet the requirements of the new facilities test.” (para 458)*

Perth Energy agrees that there is work still to be done regarding the most efficient manner in which communication investment can be carried out, however this should not result in removing the project from AA4 in its entirety. Perth Energy would challenge Western Power and the ERA to find a way to make this project work and value the intangible benefits that upgrading technology can bring.

Perth Energy supported this decision by Western Power, as the ability to offer more innovative products and give customers the power to better manage their electricity cost is dependent on the introduction of more robust metering technologies. In the absence of a contestable metering market being introduced in the near term, Perth Energy feels it is appropriate for Western Power to take the leadership in ensuring the metering infrastructure is reflective of the modern economy. The ability to offer more innovative products will assist Western Power in achieving the network access code objective of promoting competition downstream of the network.



## Lack of appropriate reform regarding tariff structure

A range of market participants, including Perth Energy have noted that the current Western Power Tariff structure is not conducive for customers to optimise their use of the network. For any customer on a demand based reference tariff (Reference Tariff 5-8), their costs to Western Power are fixed for 12 months regardless of their behaviour and use of the network.

The ERA have stated in the draft determination that:

*“matters raised in submission have merit, however, as discussed above, the Access Code does not provide for the ERA to approve structures of reference tariffs to the level of detail that would enable the ERA to impose particular tariff structures such as those proposed in submissions” (para 867).*

Perth Energy is of the opinion that the tariff structure proposed by Western Power is a barrier to investment in behind the meter energy solutions such as batteries and solar. As such, this barrier is in direct contravention of the Access Code objective to promote competition downstream of the network. Given the tariff structure is inhibiting the objective of the Access Code; Perth Energy is of the view that the ERA has sufficient remit to make determinations on the structure of reference tariffs, contrary to its statement above.

Payment of network services that is reflective of a customer’s network usage, will help facilitate appropriate price signals and drive more informed decisions by customers in regards to alternative energy solutions. Decisions to invest in behind the meter generation (i.e. solar), to invest in energy storage technologies (i.e. batteries) or participate in peer to peer energy products are dependent on having accurate and timely pricing signals with respect to network costs. Without accurate pricing signals these investments will not go ahead because customers will continue to pay for a network they will not be using.

In the case of a customer on a reference tariff 5 or 6, they will not see any reduction in their Western Power cost for a minimum of 12 months after making a decision to invest in behind the meter energy solutions. The lack of a timely pay off in respect of lower network costs after investment, is worsening the investment case for these alternative energy solutions.

Perth Energy would like the ERA to reconcile how the current tariff structure provided by Western Power for reference Tariffs 5 to 8 is not in direct contravention of the access code objective to promote competition downstream of the network given it is a clear barrier to investment downstream of the network.

Perth Energy reiterates its belief that a “thin” connection should be offered by Western Power as a reference tariff. The ERA noted that

*“such a service may be required. However, evidence that this is a service likely to be sought by a significant number of users is currently lacking and would be needed for the ERA to require Western Power to offer the service as a reference service”. (Para 730)*





In response Perth Energy notes that there are already some 230,000 customers who have installed solar systems and could be considered as potential users of such a tariff over the term of AA4. We say this because of several driving factors:

- The price of batteries is reducing and already they are being perceived as another “standard” item for homes in the same way that air-conditioning became “standard” and solar PV is becoming “standard”;
- The system instability issues caused by high solar usage, and high solar export to the grid, that AEMO have publicly highlighted are likely to lead to financial or regulatory incentives for the installation of batteries behind the meter; and
- Retailers are actively considering the development of “virtual power plants” which will drive further investment in behind the meter storage.

On a broader view, Government is currently encouraging an increase in housing density in locations that are close to public transport facilities. It is noticeable, even in relatively recent suburbs, that houses are being demolished and replaced by two or three units on the same site. If these new dwellings, or other existing dwellings, have access to a “thin” connection then they defer or potentially eliminate the need to strengthen the distribution system which would otherwise be required. This cost saving should be identified by Western Power and credited as part of the “thin” tariff structure in accordance with the “causer pays” principle.

Perth Energy notes and supports the move to separately identify the cost of metering rather than rolling it into the reference supply charge. This is economically efficient and we consider that adequately identifying savings to Western Power that would result from a thin connection is a parallel improvement.



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