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Economic Regulation Authority

Sent to: <http://www.erawa.com.au/consultation>

## **Western Power AA5 Proposal – Response to ERA Issues Paper**

### **General Comments**

Western Power's AA5 proposal is a well-reasoned, professional set of documents that provide considerable detail on their plans for the coming five years. We commend Western Power staff for the level of explanation and detail provided in the proposal which has helped us to better understand its position. We also appreciate the opportunity that has been provided to meet with Western Power staff to discuss specific aspects of this proposal.

Perth Energy incurs network costs as both a retailer and as a generator. These must be recovered from our customers and our response is primarily driven by seeking the best for them. The focus of reform over the past few years has been the challenge of absorbing solar PV and other intermittent generation into the grid in a secure manner. This has overshadowed the previous focus on reducing the state's high electricity prices and we consider that this must now be restored. Because Western Power's costs form such a substantial proportion of total electricity costs, holding electricity costs stable or, hopefully, reducing them, can only be achieved if Western Power's costs are held to the minimum level required to provide its services.

We have made some general comments and have then followed the format established in the ERA's Issues Paper.

### ***Challenging Economic Conditions***

Electricity costs are a significant impost on both commercial and residential customers and are, to a significant extent, inelastic. Network costs are a major component of the total so Western Power's proposed Access Arrangement must be considered within the economic landscape expected for the coming five years.

Substantial changes are planned through the Government's Energy Transformation Project and some of these will see costs rise as new systems and processes are put in place. The AEMO AR6 proposal has sought an immediate increase in costs of around 30% to implement security constrained economic dispatch (SCED) along with new essential system services (ESS) markets. AEMO is also required to implement actions from the Government's distributed energy resource (DER) roadmap and expects substantial follow-on cost increases to accommodate the move to five-minute settlement (5MS).

Individual market participants also face the costs of developing trading systems to tie into the new SCED and ESS markets along with the requisite staff training and system commissioning costs.



While the overall longer-term economic outlook for Western Australia is generally positive many parts of the economy are still struggling with the impact of covid and the ensuing restrictions. Prices for many products have been rising and shortages of materials is hampering new construction as well as business operations. We are only just seeing the first impacts of the Russia-Ukraine situation which could have a major impact on fuel, food and other costs. There is also an expectation that interest rates may rise over the AA5 period.

Perth Energy notes that the impact of high electricity prices is starting to get some coverage in the local press. Significant price reductions have been achieved for large electricity consumers and for gas consumers through opening up these markets to competition. However, there is no indication that further deregulation will be put in place for other electricity customers any time soon. A large number of small electricity customers have achieved savings by investing in solar PV systems but this has required considerable capital outlay and is not a course of action open to all. Two thirds of residential customers do not have solar PV systems.

In reviewing this AA5 proposal from Western Power, the ERA has the opportunity to secure real economic benefits for the community. Our concern is that if this opportunity is missed, and further cost increases are baked in for the coming five years, the community will be further disadvantaged. There is also the real risk of community pressure for price reductions leading to ill thought-out responses from Government.

### ***Uncertainty for Western Power***

Developing an access arrangement for the coming five years is a particularly challenging task for Western Power because the detail of what it will be asked to accomplish is unclear. The first steps of the energy transformation process are well underway with significant investment in renewable energy systems both in front of and behind the meter. This is expected to continue apace but there is also the probability of many new storage systems being installed as well as increased numbers of electric vehicles. Depending on the outcome of Project Symphony, the AA5 period could well see independent suppliers orchestrating behind the meter systems for residential and commercial customers.

Western Power has also noted that additional funding may be required as a result of:

- New projects associated with the Whole of System Plan;
- Potential obligations in respect to private power poles;
- The new WHS Act; and
- The new Security of Critical Infrastructure Act.

Given these uncertainties, it is difficult for Western Power to establish its costs to a high degree of accuracy. On the other hand, network costs are very substantial – around 45% of the cost of supply to residential customers – so every effort should be made to identify costs in advance and stay within these estimates.

We note that much of the expenditure reduction compared to the AA4 period is due to the reduced rate of return and that Western Power has not yet finalised its WACC. The proposal notes that:



*“The WACC parameters will be updated to reflect the latest market conditions closer to the time of the AA5 decision”.*

There is much talk in the press of increasing inflation and interest rates so there is presumably a strong possibility that Western Power will face higher interest charges. Return on capital represents around 20% of proposed target revenue so changing the WACC will potentially have a significant impact on end-use tariffs.

### ***A restrained, flexible strategy***

Given the cost pressures elsewhere in the electricity industry, general community economic pressures and the uncertainty surrounding the task that Western Power faces during AA5, Perth Energy considers that a strategy of restraint and flexibility should be adopted.

We note that Western Power is planning further price increases even though the aim is to reduce their prices in real terms. Electricity is a critical price input for many of our commercial customers as well as being essential for residential users. It is very easy for a monopoly provider to consider that all of its proposed expenditure commitments are fully justified, especially where it sees these as supported by its community consultation. It is also difficult for an external party to challenge specific items in the proposed budget.

We would encourage Western Power to strenuously review and pare back its expenditures with the aim to avoid the requirement for any network price increases at least until customers start to gain the benefits of the transformation process. Western Power has indicated several areas where it may face unavoidable cost increases. We do not consider that these should automatically be passed through to customers by increasing tariffs.

Western Power has indicated that the \$182.6 Million deferred revenue from AA2, that is budgeted to be recovered through AA5, could be rolled forward, in full or in part, to provide room if additional unforeseen expenditure needs to be recovered. It could be fully recovered in AA6 rather than being split across both AA5 and AA6. Perth Energy supports this.

A second approach would be to prioritise proposed project expenditures such that these can be included or excluded as required to stay within its proposed price structure. It should ask itself what activities it would curtail if sufficient money were not available. If additional obligations are placed on Western Power through the AA5 period then other projects with lower rates of return should be reduced or deferred.

Perth Energy is not saying that Western Power is putting forward proposals that are not justified within its normal economic analysis processes. We are questioning whether they are a good use of the community’s resources given the present economic pressures, especially on some smaller businesses and on non-PV residential customers. Use of a higher, shadow, cost of capital may give a better indication of the value that the community places on proposed new investments.



## Questions for stakeholders

### **1. Is the network strategy Western Power has proposed to reconfigure and modernise the network, and the associated investment for AA5, reasonable, properly timed and based on sound cost estimates?**

Perth Energy supports the general approach adopted by Western Power to move away from a fully integrated grid to a more nuanced approach with a meshed central grid, micro-grids and stand-alone systems. Recent technology advances suggest that this will be the most economical method to provide reliable supply to customers. Increased efficiency for many electrical appliances, along with self-generation, has capped the rate of growth of electricity demand. Increased electrification and electric vehicles may well reverse this trend and Western Power needs to be alert to ensure that local restrictions do not arise through its modular grid.

Western Power plans to install some 1861 stand-alone power systems which would make it a substantial generation entity. This raises the question as to how these systems should be serviced and maintained. Should this continue to be a Western Power function, and does it have the necessary range of skills and resources, or would it be more economical to contract this out to private industry?

We note the proposed expenditure of around \$500 million on SCADA and the telecommunications network. Around 40% of this is stated as being required to replace equipment that is obsolete or unsupported. It is important that expenditure of the remaining \$300 million is task-driven rather than technology-driven. That is, this sum is necessary to continue providing long term cost reductions to customers rather than being nice-to-have.

The roll-out of five-minute capable meters, along with the associated communications and data management systems, will be essential if the full value of DER is to be achieved. Perth Energy is hopeful that residential customers, or at least those with behind-the-meter (BTM) facilities, will become contestable before the end of AA5 or AA6. Western Power's AMI will be essential to allow retailers or BTM providers to orchestrate residential users' BTM facilities. It is our understanding from discussions with Western Power that they are abreast of these needs.

It is our understanding that the distribution system is unlikely to be able to support the mass roll-out of EV fast chargers. Western Power has proposed an EV charging tariff and would need to ensure that the revenue raised is sufficient to cover its full costs including distribution system upgrades where required. Western Power should consider tariffs that are related to the rate of charge to ensure appropriate recovery of costs.

As policies are developed to encourage EVs, by both state and local government, Western Power may need to become involved in the education process to ensure that EV charging does not impose unacceptable pressures on the grid.



**2. Are uncertainties about the future of the electricity system giving rise to a risk that Western Power’s network strategy and transformation initiatives could result in expenditure/assets that are not required or not fit for purpose?**

As noted above, there is considerable uncertainty about the actual task that Western Power will be expected to fulfil over AA5. There needs to be flexibility for Western Power to step away from some planned expenditures if circumstances change. In particular, we note that Western Power has not included costs to meet its obligations under Stage 2 of the Energy Transformation Strategy. This raises doubts as to whether it will be able to achieve its objective of avoiding real price increases.

**3. The ERA is seeking stakeholder views on Western Power’s proposed approaches to addressing climate change during AA5.**

It has been a challenging year for Western Power with floods, bushfires, high temperatures and a cyclone. However, none of these, with perhaps the exception of the steady high temperatures, are unprecedented so it is difficult to tie these back to “climate change”. It would be more appropriate to link the proposed system upgrades to the community’s requirement that Western Power be able to withstand these severe but infrequent events. It is more a reflection on the higher overall supply standards that are now expected.

That said, it is appropriate that Western Power should take measures to harden the system against infrequent extreme events where this can be justified. This determination should consider social as well as straight economic benefits. As a provider of stand-alone power systems (SPS) AGL does have a vested interest in these developments. However, it does appear that customers welcome the improved supply reliability and Western Power is reducing its costs. Perth Energy notes the age of much of the distribution network and plans to install substantial numbers of SPS appears economically sound.

Perth Energy also supports the undergrounding of distribution lines where this can be justified on a cost-benefit analysis. However, we see some of this as possibly non-essential expenditure that can potentially be deferred to allow prices to be held down. Expenditure on this program, and SPS installation, should be regularly reviewed to assess whether the capital outlays can be justified based on savings gained during the AA5 period. If the savings are more longer term then perhaps the programs should be slowed or deferred as part of holding down prices through the coming five years.

It would be good to see an estimate of what savings Western Power has achieved through undergrounding to date and how these have been appropriately taken into account within the proposed opex budget?

**4. The ERA is interested in stakeholder views on Western Power’s approach to safety, including any work practices it has adopted to ensure the safety of its workforce and the community.**

Pole top fires have caused supply interruptions to Perth Energy customers over the AA4 period. We note the change in practices associated with the application of silicone grease but stress that supply reliability, and response to interruptions, are key performance measures as far as customers are concerned. Comments made to us indicate that the timing of response to these fires is slower than customers consider to be reasonable.



Perth Energy notes the emphasis being placed on cyber security and supports this. The move to advanced metering means that cyber security will need to include protection of metering data being transferred from customers. The cyber implications of remotely curtailing output of domestic solar PV systems will also need to be considered.

However, we would not want “safety issues” to be used as justification for any over-expenditure. All expenditures should be based on the need to meet real issues and to comply with legislative obligations.

**5. The ERA is interested in stakeholder feedback on whether the revised access arrangement should incorporate measures focussed on reliability performance in specific areas of the network where reliability is below or tracking below the benchmark.**

Perth Energy agrees with the changes to performance measurements through which outages on the transmission system, as well as force majeure events, will be incorporated into distribution reliability statistics. We consider that this will give Western Power a broader measure of actual performance that will assist in justifying network upgrades or investment. We note that time lost because access is restricted by total fire bans or directions from emergency service will not be included in performance measures. We would encourage Western Power to still record this data as it can be used, again, for justification of upgrades or new investment.

Perth Energy also supports efforts to ensure that a high standard of reliability is delivered across the whole system. Any pockets of low performance need to be addressed so that all customers are receiving appropriate standards of supply.

One question is what actually happens to the reward/penalty money? In a private industry it would accrue to, or be lost to, shareholders. Will the expected \$32 million penalty from AA4 be taken from the Government [tax] revenue because it is the shareholder? Are some aspects of Western Power’s activities reduced or do customers have to make good this amount?

We note that Western Power’s consultants have developed estimates of the value of customer reliability as \$41.08 per kWh for the distribution system and \$48.10 per kWh for the transmission system. These are particularly difficult figures to estimate but the values developed by the consultant do appear to be reasonable.

**6. The ERA is interested in stakeholder views on:**

- **Western Power’s proposed approach to the cost uncertainties indicated in its proposal.**
- **How Western Power has responded to and is managing uncertainty about the market transformation.**

As noted in our general comments, this is one of the main areas of concern because the task that faces Western Power over the coming five years is unclear and there is considerable potential for changes driven either by market events or Government policy. Western Power needs to have flexibility within its AA5 programs. Western Power has proposed three mechanisms to address outstanding issues/uncertainties but these all result in the customer facing additional costs either:



- Immediately, because updated costs are provided in the final proposal; or
- During AA5 through re-opening of the access arrangement; or
- After AA5 by rolling extra costs into AA6.

With the level of cost pressures elsewhere in the electricity supply industry, and the generally difficult business environment within the state, Perth Energy considers that Western Power should be tailoring its activities to aim for zero-price increases. If some increase in prices is deemed to be essential, this should be locked in with Western Power's activities adjusted to ensure that the more critical/economic activities are undertaken with lower priority activities set aside. Only in an extreme situation should this agreed pricing be breached.

#### **7. The ERA is particularly interested in stakeholder views on:**

- **Whether Western Power's proposed changes to the connection provisions of the access arrangement adequately address requirements for the new market design.**
- **Any issues stakeholders have encountered when seeking connections that could be addressed by further amendments to the standard access contract, applications and queuing policy or contributions policy.**

The changes made to various standard documents to accommodate the changes occurring in the Wholesale Electricity Market appear to be well thought through.

We note the inclusion of an "indemnifier" within the new Electricity Transfer Access Contract which we assume will allow for new entities to connect who may not, on their own, have the requisite financial standing. We also note that Western Power has given itself the right to not consider an objection from an applicant whose application has not progressed for 12 months. Both changes appear likely to facilitate new applications and have Perth Energy's support.

Perth Energy also supports the concept of closing a Competing Access Group if there is only one valid application within it.

#### **8. The ERA is interested in stakeholder views and experience of how well Western Power communicates with customers and whether current service standards are adequate or any improvements are needed.**

In general our customers are happy with service levels. The one significant concern, however, is lack of information when outages occur. Customers have found it hard to know to whom they should talk to get a true picture of what is happening and how long any interruption will last. This last point is very important because if delays are likely to be prolonged then alternative arrangements can be made (eg hire a generator). If they are advised that any interruption will be of limited duration but it is then progressively extended the opportunity to make alternative arrangements is lost.





**9. Was stakeholder consultation on the proposed tariff structures adequate and were stakeholder views taken account of to ensure the proposed tariff structures accommodate the reasonable requirements of users and end-use customers?**

Perth Energy was not consulted on potential tariff changes

**10. The ERA is seeking:**

- **Stakeholder views on the proposed new tariffs and new tariff structures, including whether they will facilitate the connection of storage and electric vehicle charging stations and encourage demand patterns that will minimise the need for network augmentation.**
- **Stakeholder views on, and any information to assist in the review of, the tariff structure, future cost estimates, cost allocation and rebalancing of tariffs.**

Perth Energy repeats its point that planning any price increase, even a relatively low nominal increase in tariffs, is adding pressure to businesses and householders. We note, too, the very high increase in year 2 for RT4, RT16 and RT22 tariffs as part of restoring tariffs to being cost reflective. Consideration should be given to managing this over the four remaining years of AA5.

Western Power has emphasised throughout its submission the significant costs associated with the energy transformation process. The financial benefits of this are not, however, passed through to all consumers. Approximately one third of residential customers have solar PV systems but two thirds do not with a significant number of these unlikely to install such systems. House design or location, multi-person dwellings, financial capability and rental properties will limit the eventual take-up of solar.

Perth Energy questions whether the costs and benefits are appropriately reflected within Western Power's tariffs. We consider that the "causer pays" principle used elsewhere in the energy market should be applied here. The costs of stabilising distribution voltages and resolution of similar issues should be back charged, as far as possible, to those who are causing these issues rather than being smeared across all customers. We note also that until residential contestability levels fall the vast bulk of benefits accrue to Synergy customers whereas all customers fund these costs.

It is really important that the storage and EV charging tariffs are established in a cost reflective form now while the number of such installations is low. Making changes when usage has increases substantially will be unpopular and potentially politically impossible. Western Power should strongly resist any pressure to set tariffs which include subsidies to encourage either storage or EVs as it will be very hard to unwind these in the future. This would repeat the issues now being experienced with solar PV tariffs.

Perth Energy supports the super off-peak tariff designed to encourage energy use to move to current low demand period in the middle of the day. It is a sound initiative.





**11. The ERA is interested in stakeholder views on Western Power’s proposed operating and indirect expenditure and any information stakeholders may have to inform the ERA’s assessment of the efficiency of the proposed expenditure.**

We note that almost one quarter of opex is identified as “Corporate” costs. We consider that the ERA should review these in some detail to ensure that corporate activities and structures are appropriate. Western Power should have processes in place to undertake their own regular reviews of these costs and be able to provide this evidence to the ERA.

**12. The ERA is interested in stakeholder views on the proposed capital expenditure and any information stakeholders may have to inform the ERA’s assessment of the efficiency of the proposed expenditure.**

A 30% increase in capital expenditure is proposed. Without detailed information we cannot comment on how much of this is essential due to Government edict, critical operating requirements or safety. Nor can we identify what is financially justified. We go back to our position that Western Power should adjust its capital projects to ensure that tariff increases are avoided.

**13. The ERA invites submissions on Western Power’s proposed alternative cost of debt approach.**

**14. The ERA invites submissions on Western Power’s proposed change from a 5-year to a 10-year term for the risk free rate for equity.**

**15. The ERA is seeking stakeholder views on the asset lives proposed by Western Power.**

Perth Energy has no specific comments in response to questions 13, 14 & 15.

**16. The ERA is interested in stakeholder views on the revenue path proposed by Western Power and the treatment of deferred revenue in the access arrangement review process.**

Perth Energy is concerned that several network tariffs will have a substantial increase in the second year of the Access Arrangement. While we understand the desire to transition tariffs to a more cost-reflective basis this will impose a shock onto customers. Consideration should be given to making the adjustment over the full AA5 timeframe.

**Summary**

Western Power has provided a very professional set of information in its proposals and has also showed great willingness to explain its position. Perth Energy appreciates this. We also appreciate the critical role of Western Power within the energy transformation process in addition to its on-going supply obligations.

However, given the cost pressures in the electricity industry, and in the community in general, plus the possibility of additional costs being incurred that are currently unforeseen, Perth Energy does not support tariff rises even if these are nominal rather than real increases. We consider that every effort should be made to hold prices at no higher than current levels.



Should you have any questions in relation to this submission please contact me on [REDACTED] or at [REDACTED]

Kind regards,

[REDACTED]

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