

19 May 2006



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Dear Sir

Draft decision of the Economic Regulation Authority in relation to Western Power's Proposed Access Arrangement

Alinta Sales Pty Limited (**Alinta**) has reviewed the draft decision (**Draft Decision**) of the Economic Regulation Authority (**ERA**) in relation to Western Power Corporation's (**Western Power**) Proposed Access Arrangement (**Proposed Access Arrangement**) for the South West Interconnected Network (**SWIN**).

Alinta has a number of comments in relation to the Draft Decision, and these are set out in the following sections of this letter. These comments are made in response to a notice issued by the ERA on 21 March 2006 inviting interested persons to make submissions on the Draft Decision.

Alinta Limited has previously provided submissions (dated 10 November 2005) on the Proposed Access Arrangement (**Alinta Limited's Submissions**). Alinta notes that in a number of areas (e.g. "Introduction and Definitions", "Reference Services" and "Service Standard Benchmarks"), the ERA has adopted the views expressed by Alinta Limited in those earlier submissions. Alinta acknowledges and supports the approach taken by the ERA in this respect.

Alinta has chosen to comment on only certain issues arising from the Draft Decision, rather than providing a detailed discussion of the Draft Decision in its entirety. If there is no comment on an issue, that should not be taken to mean that Alinta supports, or does not support, the conclusion reached by the ERA on that issue.

Page numbers in brackets beside headings in this letter refer to the page in the Draft Decision at which the ERA's reasoning in relation to that issue begins. Unless otherwise stated, terms used in this letter have the meaning given in the *Electricity Networks Access Code 2004* (**Access Code**).

Alinta's comments on the Draft Decision are as follows.

1. Pricing Control (page 70) and Pricing Methods (page 177)

There are a number of issues under the headings "Price Control" and "Pricing Methods" that, in Alinta's view, require further consideration by the ERA.

(a) "Price shock"

Alinta recognises that the ERA has considered whether users will be faced with a "price shock" during the initial access arrangement period. Alinta comments on the proposed side constraints below.

In addition, however, Alinta is concerned about the risk of a price shock at the outset of the initial access arrangement period.

(i) Initial step increase in price

Alinta has undertaken a comparison between selected tariff components from the 2005-2006 price list contained in the C1 Schedule to Western Power's Pricing and Charging Paper, and the proposed 2006-2007 prices. This has indicated that, on the basis of the proposed tariffs, there will be some significant step increases between tariffs charged immediately prior to the access arrangement, and those charged once the access arrangement is in place.

The ERA stated in its Draft Decision (at paras [736]-[737]) that the proposed "smoothing factor" and side constraints, combined with the exclusion of accumulated capital contributions from the revenue requirement in the first year, would mean that "there will be no step increase in tariffs".

It is not immediately clear, however, whether that statement was intended to cover the risk of price shocks at the start of the access arrangement, or only during the course of the access arrangement. If the latter, then Alinta considers that insufficient attention has been paid to the potential for a significant step increase from existing tariffs to those charged at the start of the initial access arrangement period.

For this reason, Alinta considers that the ERA should request from Western Power a table of all reference tariff components, showing a comparison of the 2005-2006 and 2006-2007 prices (incorporating the amendments required by the ERA in the Draft Decision). This will allow the ERA (and users) to confirm that there will be no step increases in tariffs when the access arrangement commences.

If, contrary to the ERA's statement above, the figures demonstrate that a step increase is likely to occur when the access arrangement commences, Alinta submits that Western Power should be required to propose a mechanism to eliminate or minimise the likely price shock.

(ii) Side constraints (page 183)

The Proposed Access Arrangement contains side constraints, which provide that annual changes to tariff prices will not increase or decrease by more than CPI+2% in any year. Alinta notes that the proposed regime is different to the existing practice, whereby tariffs (and tariff components) cannot increase by more than CPI+2% per year, but decreases in tariffs are not restricted in that way.

Alinta submits that the ERA should ensure that it is satisfied that the advantages of the proposed approach outweigh the potential disadvantages of changing the status quo before approving the proposed side constraints.

(b) Technical rule changes (page 94)

Alinta supports an approach that will allow Western Power's target revenue to be adjusted at the end of an access arrangement period in order to take into account changes in costs associated with amendments to the technical rules. However, Alinta agrees with the ERA's view that the methodology set out in Appendix 7 to the Proposed Access Arrangement does not contain the necessary degree of transparency.

2. Transparency

Alinta supports the ERA's approach in requiring Western Power to provide additional, and more specific, information in a number of places throughout the Proposed Access Arrangement. In Alinta's view, the ERA's requirements in this regard will assist in creating an open and transparent regime in relation to the SWIN.

Alinta has set out below some particular areas where it agrees with the ERA's conclusions.

(a) Aggregate Annual Revenue Requirement (AARR) (page 84)

Alinta supports the ERA in its approach to this issue, and considers that the proposed amendments by the ERA should assist in achieving an appropriate degree of transparency in Western Power's calculations.

(b) Section 7.3 of the Access Code (page 179)

Alinta submits that the ERA should obtain sufficient information to satisfy itself that the revenue received from each reference tariff recovers the forward looking efficient costs of providing the reference services offered under each reference tariff, and that cross-subsidisation is not occurring.

(c) Metering (page 192)

Alinta supports the ERA's approach to the issue of charges for metering services. In Alinta's view the total cost of delivery for reference services should be included in the reference tariffs, with no additional costs to be imposed.

(d) Market Rules (page 212)

Alinta supports the ERA's requirement that Western Power provide details of System Management's costs.

3. Benchmarking and incentives

Alinta notes the requirement for "Regulatory Reporting Information" (page 214), and agrees that appropriate reporting is necessary in order to ensure a level of robustness in the administration of the Access Arrangement, and the achievement of targets.

However, in Alinta's view the reporting requirements proposed by the ERA will not, of themselves, be a sufficient incentive for Western Power to improve its service standards and efficiency, and to reduce costs. For this reason, Alinta submits that, contrary to the ERA's conclusions, the initial access arrangement should contain a gain sharing mechanism and efficiency and innovation benchmarks, and that Western Power should receive a financial incentive (or penalty) for achieving (or not achieving) its service standards targets.

Alinta does not accept that the limited empirical cost and performance data that is available is an insurmountable barrier to preparing an effective gain sharing mechanism and efficiency and innovation benchmarks. Other jurisdictions have been able to identify industry norms that can be applied for these purposes, and Alinta submits that the same can be done in Western Australia.

Alinta notes, however, that it should not be necessary for such benchmarking and gain sharing mechanisms to be assessed annually. Instead, Alinta submits that a review of the targets and achievements at the end of the access arrangement period should provide a sufficient incentive for Western Power, and will enable the ERA to receive a clearer indication of overall, long-term trends.

(a) Gain Sharing Mechanism (page 99)

In relation to the gain sharing mechanism, Alinta observes that if Western Power is incurring gains during the initial access arrangement period, these benefits should be returned to users (even if those returns are smaller than may be the case in subsequent access arrangement periods). Whilst Alinta recognises the concerns raised by Western Power, it is submitted that it would be beneficial to introduce a gain sharing mechanism now.

Alinta notes that section 6.20 of the Access Code provides that an access arrangement must contain a gain sharing mechanism unless the ERA determines that a gain sharing mechanism is not necessary to achieve the objective set out in section 6.4(a)(ii) of the Access Code (being to reward a service provider for efficiency gains and innovation beyond the efficiency and innovation benchmarks). Alinta maintains that Western Power has not established that a gain sharing mechanism is not necessary to achieve that objective.

(b) Efficiency and Innovation Benchmarks (page 175)

Alinta considers that by not including efficiency and innovation benchmarks in the Proposed Access Arrangement, Western Power will have no real incentive to reduce costs and increase efficiency. In Alinta's view this is not a reasonable outcome.

If, as Alinta has submitted above, a gain sharing mechanism should be included in the Proposed Access Arrangement, then efficiency and innovation benchmarks are also required.

(c) Service Standards Adjustment Mechanism (page 104)

Alinta is surprised that the ERA has adopted the approach of requiring Western Power to remove the proposed financial incentives (or penalties) from the Service Standards Adjustment Mechanism (**SSAM**). In Alinta's view, the better way to address this issue would be to focus on identifying appropriate targets for Western Power, while maintaining the financial incentive to achieve those targets.

Alinta submits that if the ERA is concerned about the risk of a windfall benefit to Western Power from such incentives, that issue can be adequately addressed by either proposing stricter standards, or by carefully limiting the level of payments available.

On the ERA's proposed approach, Alinta is concerned that Western Power will have no real incentive to reach its targets. In Alinta's view, just because the Access Code does not necessarily require the inclusion of a financial component in the SSAM, the ERA should not opt out of giving this issue full consideration.

However, Alinta does support the position of the ERA on the issue of transparency, and the question of whether improvements in service standards are attributable to access arrangement funded strategies or to Western Power's own network management initiatives. In Alinta's view the SSAM must promote the necessary level of transparency for users.

Alinta also has some concerns about the aspect of the SSAM proposed in clauses 5.12(b) and 5.13(b). In Alinta's view, it would be preferable for the applicable reward or penalty to be calculated across the whole of the access arrangement period, rather than for each individual year. This is because optimal results may be achieved by acting outside of targets for one year, in order to achieve longer-term improvements. The SSAM as currently proposed may not encourage this sort of forward planning.

4. Trigger events (page 203)

Alinta supports the ERA's requirement that clauses 8.1(a) and (b) of the proposed trigger event mechanism be deleted.

In relation to clause 8.1(c), Alinta submits that the words "materially adverse impact" should be replaced with "material impact". This amendment would ensure that the trigger events mechanism applies in the same way to events that decrease Western Power's costs as to those that increase costs. In Alinta's view, this is an equitable and reasonable way to approach the issue of trigger events.

5. **Proposed Capital Contributions Policy (page 352)**

Alinta considers that the approach taken by the ERA to Western Power's proposed Capital Contributions Policy (**Proposed CCP**) constitutes an improvement to the initial proposed provisions. In particular, Alinta supports the ERA's conclusions in relation to the sections on "Application of Proposed CCP", "Lowest sustainable cost", "Calculation of contribution", "Amount of forecast costs", "Connection assets", "Non-capital costs", "Consumers consuming less than 50MWh per year", and "Matter of contribution".

However, there are still a number of areas where Alinta has concerns in relation to the Proposed CCP, and these are discussed below.

(a) **Transmission-connected generators: "shallow vs. deep approach" (clause 9 of the Proposed CCP)**

Alinta is disappointed that the ERA has not taken the opportunity to bring the Proposed CCP in line with the approach taken in other jurisdictions (nationally and internationally), by adopting a "shallow approach" to connection charges for all new generating plant seeking connection to the network.

Alinta considers that the ERA's views raise a broader policy issue in relation to the role of capital contributions in the access regime. In Alinta's view, the position adopted in the Access Code (and by the ERA to date) is unsupportable when reference is had to the position taken by other regulators, and to the advantages inherent in a "shallow" charging approach. To this end, Alinta notes the concerns set out in Alinta Limited's Submissions, and supports them. Some of Alinta's key concerns about the "deep" charging approach are briefly summarised below.

- Alinta is concerned that the approach to capital contributions that is adopted under the Access Code and the Model Capital Contributions Policy (**Model CCP**) will effectively result in barriers to entry in markets upstream and downstream of the network, which will have a negative impact on competition on those markets and potentially result in non-compliance with the Code objective.
- In Alinta's view, it is fundamental that there should be recognition of the net benefit to users provided through the connection of new generating plant to the network, and accordingly that the capital contributions of new generating plant should be limited to the forecast costs of dedicated connection assets only. In many (if not all) cases, it is not reasonable to require an applicant to contribute to augmentation of the wider network, and therefore a shallow approach to connection charges should be applied generally in relation to the network.
- Capital contributions can impose a significant financial burden on new generating plants. If consumer demand is sufficient to justify a new generating plant, then the costs associated with reactive power works should be shared among all network users. Moving the cost of shared assets into common infrastructure benefits competition in generation, because it removes some of the risk associated with sharing assets. This makes it easier for generators to enter and exit the market, and simplifies charging arrangements.
- Shallow charging is also advantageous because a new user can readily identify the connection assets and hence costs. This means that shallow charging is ultimately more transparent.

In addition to the above comments, Alinta asks the ERA to clarify the phrase "net benefit to users", as used in paragraph [1838] of the Draft Decision. Alinta notes that one limb of the

New Facilities Investment Test set out in section 6.52 of the Access Code requires that the new facility provide "a net benefit in the covered network". Alinta is unsure whether that is the requirement that the ERA was referring to in paragraph [1838].

(b) Options for payment (clauses 6.1, 6.2 and 6.3 of the Proposed CCP)

Alinta supports the ERA's approach in maintaining the ability for users to make their contributions "in-kind", or by means of periodic payments. In particular, Alinta agrees that the threshold for periodic payments should be lower, because it is likely that the users who are required to make contributions at the smaller end of the scale will be the same entities that will need the option of periodic payments.

However, for the reasons given below in relation to the Electricity Transfer Access Contract, Alinta does not consider it appropriate for the variables in relation to the terms and amount of periodic payment (clause 6.3 of the Proposed CCP) to be left open for negotiation between the parties.

(c) Rebates and recoupment (clause 7 of the Proposed CCP)

For the reasons given below in relation to the Electricity Transfer Access Contract, Alinta does not consider it appropriate for the variables in the rebates and recoupment clause of the Proposed CCP to be left open for negotiation between the parties.

6. Tariff Equalisation Contribution (pages 71 and 178)

Alinta acknowledges the need for a Tariff Equalisation Contribution (TEC). However, Alinta is concerned to ensure that any ongoing price volatility resulting from the inclusion of a TEC is minimised. This is particularly important given that users do not currently know what the final figure for the first year of the access arrangement period will be, nor how that figure will change from year to year.

Accordingly, Alinta submits that the ERA should carefully consider whether the proposed smoothing factor and side constraints (discussed above) will be sufficient to manage any increases (or decreases) in tariffs resulting from a change in the TEC.

7. Interim arrangements (page 199)

Generally Alinta is comfortable with the idea that, in the event that the commencement of the Wholesale Electricity Market is delayed, Western Power's existing working practices will continue.

However, Alinta submits that a mechanism should be included in clauses 10.8 and 10.9 of the Proposed Access Arrangement to ensure that if Western Power wishes to change any of those "existing working practices" during the interim period, particularly tariffs, then a suitable consultation and approval process will be implemented.

8. Regulatory test (page 200)

Alinta supports the potential expediting, modification or waiver of the application of the regulatory test for major augmentations, and waits to see Western Power's submissions in this regard.

9. Standard Access Contracts (page 216)

Generally, Alinta is supportive of the ERA's amendments to the Standard Access Contract. However, Alinta's key concerns in relation to the Connection Access Contract and the Electricity Access Contract are outlined in this section.

(a) **Connection Access Contract (page 286)**

Alinta agrees with the ERA that the Connection Access Contract should not be a Standard Access Contract, but only because Western Power has not proposed a connection service as a reference service in the Proposed Access Arrangements. However, Alinta reiterates the concern stated in section 3.4 of Alinta Limited's Submissions, that Western Power's access arrangement should include a connection service as a reference service.

Section 5.2(b) of the Access Code requires an access arrangement to specify a reference service for each covered service that is likely to be sought by either or both of:

- (i) a significant number of users and applicants; or
- (ii) a substantial portion of the market for services in the SWIN.

The ERA stated in paragraph [1369] of the Draft Decision that it does not have sufficient information regarding the demand for a stand alone connection service to determine whether or not it would meet the tests in section 5.2(b) of the Access Code. Alinta considers that a connection service is a covered service that is likely to be sought by a significant number of users and applicants or a substantial portion of the market for services in the SWIN. A connection service provides the user with a right to physically connect facilities and equipment to the SWIN. Alinta considers that it is reasonable to assume that any generator of a reasonable capacity would require a connection service. Alinta considers that the ERA should require Western Power to include a connection service as a reference service in the access arrangement.

(b) **Electricity Transfer Access Contract (page 217)**

(i) **Clause 18.5(b) – Maximum Liability Amount**

In the Draft Decision, the ERA considers that Western Power should amend clause 18.5 of the Electricity Transfer Access Contract (**Transfer Contract**) to delete the specified limitations of liability amounts for Western Power and users. The ERA considers that each user should be entitled to negotiate the relevant liability provisions in accordance with their individual requirements.

Alinta is disappointed that the ERA did not utilise its discretion under the Access Code to prescribe specific caps on the liability of Western Power and users under the Transfer Contract. The limits on a user's and Western Power's liability are very important to users. It will provide certainty to users if the ERA specifies those limits or, if that is not possible, it will provide some guidance as to how the limits of liability will be determined.

Further, the ERA states in paragraph [1262] of the Draft Decision that if Western Power and a user cannot agree on each party's limit of liability, the limits will be determined by an arbitrated award under the dispute resolution provisions of the Access Code. Alinta considers that it would reduce the need for the parties to invoke the dispute resolution provisions if the ERA specified the limits on liability or provides guidance on the limits.

Alinta notes that Western Power has historically had near (if not absolute) monopoly power in the Western Australian electricity transmission market, and today continues to exercise a significant degree of market power. This means that if the limitation of liability amounts are not specified in the Transfer Contract, users will be left in the difficult position of having to agree terms and conditions with an entity in a much stronger bargaining position than the users. In Alinta's view, this is contrary to the expectation of users that the Access Arrangement (and particularly the Transfer Contract) will allow them to enter into a standard term contract with Western Power on reasonable terms that have been approved by the ERA.

(ii) **Clause 24.4 – User must comply with curtailment**

The ERA did not review clause 24.4 of the Transfer Contract as the ERA considered that the clause is consistent with section 5.5(a) of the Access Code. Section 5.5(a) provides that the ERA must determine that a standard access contract is consistent with the relevant Access Code requirements to the extent that it reproduces, without material omission or variation, the Model Standard Access Contract (**MAC**).

Alinta queries whether clause 24.4 reproduces clause A3.30 of the MAC, the equivalent provision in the MAC, without material omission or variation. Clause 24.4 of the Transfer Contract provides that if Western Power notifies the user of a curtailment, the user must comply or "procure compliance" with any reasonable requirements concerning the curtailment. However, clause A3.30 of the MAC does not require the user to "procure" such compliance by others. Alinta considers that the contractual obligation to procure third parties to comply with requirements concerning curtailment is an additional, unreasonable obligation that materially differs from the MAC. Alinta considers that clause 24.4 of the Transfer Contract should be amended so that a user is only required to use "reasonable endeavours" to procure compliance with curtailment requirements.

10. **Applications and Queuing Policy (page 298)**

Alinta supports the approach taken by the ERA to the issues raised under the proposed Applications and Queuing Policy.

Alinta agrees with the ERA's comments in paragraph [1484] of the Draft Decision in relation to users being able to make minor amendments to changes in capacity by utilising the capacity increase notice mechanism under the Model Applications and Queuing Policy (**Model AQP**). Clauses A2.30 to A2.40 of the Model AQP are the relevant provisions of the Model AQP relating to capacity increase notices. However, Alinta notes that in the Draft Decision the ERA does not require Western Power to amend its proposed Applications and Queuing Policy to include clauses A2.30 to A2.40 of the Model AQP without material variation or omission.

Alinta notes that the ERA requires Western Power to amend clause 3.6 of the Transfer Contract to include clauses A3.15 to A3.17 of the MAC in relation to capacity increases. The ERA stated, in paragraph [1034] of the Draft Decision, that it is the intention of the Access Code to provide a streamlined process in both the MAC and the Model AQP in respect of capacity increases. Alinta queries whether Western Power should be required to insert clauses A2.30 to A2.40 of the Model AQP into the Applications and Queuing Policy in order to facilitate the streamlined process in respect of capacity increase notices in the MAC and the AQP.

11. **Transfer and Relocation Policy (page 391)**

Alinta supports the approach taken by the ERA to the issues raised under the proposed Transfer and Relocation Policy (**TRP**).

In relation to the issue of capacity at the destination point (clause 6.2 of the proposed TRP), Alinta observes that Western Power is the entity that is in a position to determine the question of available capacity. Accordingly, Western Power should be required to advise the relevant user about this on request.

12. **Prior contractual rights**

Alinta notes that, despite the comment (at para [47] of the Draft Decision) that the ERA is required to recognise certain prior contractual rights, there does not appear to be any discussion in the Draft Decision about the application of sections 4.34 and 4.35 of the Access Code. Alinta considers that existing users should be provided with a degree of comfort in relation to the impact of the access arrangement on their existing contractual arrangements (and particularly on tariff structures).

13. **Further information**

If you have any questions in relation to Alinta's position on the issues set out in this letter, please do not hesitate to contact Mr Geoff Hobley on 9486 3234.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D MacKenzie', with a stylized, cursive script.

Donald MacKenzie
General Manager Energy Markets