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10 November 2005

Dear Alistair

RESPONSE TO WESTERN POWER'S PROPOSED ACCESS ARRANGEMENT

Thank you for the ERA's invitation to comment on Western Power's proposed access arrangement.

As an existing retailer of electricity, the level of access prices and the contractual arrangements for access are extremely important in the operation of our business. While we consider that great progress has been made in applying network access uniformly across all retailers, we remain extremely concerned that elements of the access regime represent a material barrier to entry and that the proposed level of access pricing is not conducive to reducing the cost of electricity to the end-user.

We comment in detail as follows.

1. Appropriateness of demand forecasts

We note that the demand forecasts have not been reconciled to those produced by the same company for use by the Independent Market Operator. We trust it is self-evident that it is essential that the market have full confidence in the network service provider and that this state of affairs undermines that confidence.

2. Proposed price rises effective 1 July 2006

We note that Western Power proposes substantial price rises in network tariffs with effect from 1 July 2006. For example, the Time of Use Energy (Large) tariff, applicable to deregulated customers consuming less than 1,500kVA (Small to Medium Enterprises - SMEs) is proposed to increase by 16.8%. Given that the network charge is typically one third of the total electricity bill, this equates to a price increase of 5½%. Further, it should be noted that private retailers seeking to supply SMEs are primarily competing with gazetted tariffs. As there is a political commitment to cap gazetted tariffs at their present levels, private retailers in effect have to absorb the price rise, impairing the feasibility of participating in the electricity market.

It is therefore imperative that the ERA fully reviews the appropriateness of the proposed price outcome in addition to the merits of Western Power's justification for it. While Western Power is to be congratulated for proceeding via a well document and transparent process, the ERA should remain alert to the fact that the summation of component parts that of themselves are reasonable and prudent can nonetheless still lead to an improper outcome. In this case, if the process leads to substantially increased network prices that deter private retailers from entering the market, then the suitability of that outcome must itself be reviewed. For example, without limitation, we would note that while the debt-equity ratio of 60:40 utilised in the WACC has been proposed for consistency with other jurisdictions, the pricing outcome is very sensitive to this quantity and it could reasonably be set at the figure that would apply in the private sector - around 30:20. We anticipate that application of such lateral thinking could lead to a price reduction as opposed to the prospective large price rise.

3. Separate Electricity Transfer Contract, Connection Access Contract and Interconnection Works Agreement

We support the use of separate contracts in respect of Electricity Transfer, Connection and Interconnection Works. Their use is a constructive means of properly quarantining and allocating risks and responsibilities. However, we suggest that the ERA require Western Power to modify the approach to better reflect the circumstances of retailers, which do not themselves operate plant, either as consumers or producers of electricity. Further information is given below in response to Western Power's clause 18 of the Electricity Transfer Access Contract.

4. Electricity Transfer Access Contract

We comment on the Electricity Transfer Contract as follows.

Clause 6 (Compliance with connection provisions)

We understand this clause to require that every exit point supplied by a retailer must have a nominated Controller (clause 6.1) and that where the retailer is not the User, the retailer must ensure that the Controller complies with the obligations set out in the contract between Western Power and the retailer (clause 6.2). Further, if the Controller fails to comply with the obligations, then the retailer is in breach of the contract and is liable for and must indemnify Western Power against any consequent Direct Damage.

We note that The Model Standard Access Contract (MSAC) clause A3:36 b) provides for Western Power to propose circumstances (denoted by the parameter "x") in which a Controller must be nominated in respect of Exit Points. It therefore appears that Western Power has, in effect, proposed that "x" includes all circumstances, and thereby captures all customers no matter how small. This represents a major change from the present requirement in which nomination of a Controller is required for only large loads. Moreover, we note that clause A3.62 of the MSAC provides that if 3rd parties cause the User to breach the technical rules then, subject to the retailer not having been negligent and having behaved as a reasonable and prudent person, the

User is not in breach of the contract and is not liable for any breach of the technical rules.

On this basis, we object to Western Power's proposals and request the ERA to require Western Power to adhere to the provisions of the access code, utilising a reasonable definition of "x". We propose that the definition of "x" should conform to existing practice.

Clause 9 (Security)

We note that the issue of security (credit support) has material consequences to the cost structure of small retailers, via the fact that it equates to a cash deposit, with the consequent adverse impact on working capital requirements and return on capital employed. Western Power's proposal would require a small retailer to deposit a cash amount to the value of up to around 1c/kWh supplied.

The MSAC provide as follows, in which the bold emphasis has been added.

Clause A3.51 provides that if the service provider (in this case Western Power)

> "determines that UserCo's technical or financial resources are such that a **reasonable and prudent person would consider there to be a material risk** that UserCo will be unable to meet its obligations under this contract, then service provider may, **subject to clause A3.52**, do ..... the following:
>
> a) require UserCo, at User Co's election, to:
> i) **pay in advance** the charges for **up to** 2 months services; or
> ii) provide a bank guarantee.....guaranteeing the charges for 2 months' services"

Clause A.3.52 provides:

> "If service provider requires UserCo to provide security under clause A3.51, then **UserCo may propose alternative arrangements** (for example, more frequent payment) to manage service provider's financial risk under this contract, and if so, **service provider and UserCo must negotiate as reasonable and prudent persons**, with a view to agreeing alternative arrangements which meet the following objectives:
>
> **a) minimising the extent to which the requirements of clause A3.51 constitute a barrier to UserCo's entry to a market; and**
> **b) not contravening section 115 of the {Electricity Industry Act 2005} and not otherwise hindering UserCo's ability to compete in upstream or downstream markets,**
>
> but also in the view of a reasonable and prudent person:
>
> c) **reasonably addressing** the risk to service provider that UserCo may be unable to meet its obligations under this contract; and
> d) being reasonably practicable for the service provider to administer."

(Section 115 of the Electricity Industry Act 2005 provides for Prohibitions on hindering or preventing access. Whilst commendable in its own right, we perceive it to be unnecessary to reproduce it here.)

Clause A3.53 provides:

> "If the parties fail to agree on alternative arrangements under clause A3.52, then:
>
> a) UserCo must comply with clause A3.51 unless the matter is subject of a dispute under clause A3.53(b); and
> b) **the matter may be the subject of a dispute** under this contract, in which case the dispute resolver may either:
> i) determine the terms of an appropriate alternative arrangement.....; or
> ii) determine that no alternative arrangement ....{is available}... in which case UserCo must comply with clause A3.51."

In summary, Networks is required to behave as a reasonable and prudent person, should only require credit support if it reasonably considers there is a material risk of default, should negotiate alternative arrangements that reasonably address Networks' risk and must not behave so as to create an entry barrier or hinder or prevent access.

In this context, we propose that Western Power should have proper regard to the fact that the retailer:

i) is not itself the end-consumer of the network capacity but is merely compelled to act as an intermediary between Western Power and its end-consumers. In effect, the retailer acts as Western Power's unpaid Account Manager, thereby greatly simplifying its contract management and customer relationships

ii) acts as Western Power's unpaid revenue collector in respect of the funds due to Western Power by its end-consumers

iii) bears the risk of financial default by Western Power's end-consumers without compensation from Western Power

From this perspective, we suggest it is unreasonable for Western Power to demand that the retailer further indemnifies Western Power, via the security, in respect of the risks that more properly belong to Western Power.

We further note that clause 9 a) iii) of Western Power's proposal provides for no interest to be paid on cash deposits, which is contrary to reasonable and prudent commercial practice and to the norms established in other aspects of the electricity market regulations.

Perth Energy has made a detailed commercial-in-confidence submission to Western Power on this matter and is willing to make it available in confidence to the ERA on request.

We perceive that Western Power's proposed clause 9 is a material barrier to entry for retailers and will unnecessarily increase costs for end-users. It also falls considerably short of the requirements of the MSAC and we request the ERA to require Western Power to adhere to the provisions of the access code.

Clause 18.5 (Limitation of liability)

We note that clause 18.5 requires retailers to accept various levels of liability associated with generators and customers under contract to them. At the extreme, retailers contracted with a Generator connected at 132 kV are required to accept and insure for a liability capped at $50 million annually.

This is contrary to clause A3.62 of the MSAC which provides that if 3rd parties cause the User to breach the technical rules, then provided that the User has acted as a reasonable and prudent person and has not been negligent, then the User is not in breach and is not liable for any breach of the technical rules. Moreover, a retailer is not licensed to operate generators or loads and has no control over the entities contracted to it. It is therefore unreasonable to require it to bear the liability, especially as there exists a separate Connection Contract where these liabilities more properly sit. We are also sympathetic to the view that the market would be best served by Western Power itself insuring the maximum feasible liability with a view to minimising the overall cost and passing through this cost on a user-pays basis.

We request the ERA to require Western Power to allocate these liabilities to the entities to which they naturally belong. Further, we request that the actual liability caps be thoroughly reviewed as they appear to have been established arbitrarily without proper consideration.

Clause 28 (Disputes)

We note that while clause 28 is not necessarily contrary to the MSAC, it does not provide for the concept of the dispute resolver referred to in A3.53. Given that Western Power has a culture and tradition of unfettered market dominance, we request that further to clause A3.99 of the MSAC, the ERA should require provision for "....mediation, conciliation or other alternative resolution method rather than commencing an action to resolve the dispute through litigation." Otherwise, small retailers risk the continuation of gouging by Western Power without a cost-effective remedy. This is a barrier to market entry.

5. Supplementary Matters

Standby

In section 10.5 of the Access Arrangement, Western Power correctly states that the concept of Standby does not exist in the prospective Wholesale Electricity Market. However, it is more accurate to say that it is replaced by the concept of Reserve Capacity. It is, of course, important that Western Power maintains an orderly transition from the current practice of Standby to the practice of Reserve Margin, in

which case any delay to market commencement would make it necessary for the MSAC to provide for it in the same manner as the current access contract.

6. Price Application Policy

a) Reasonableness

We request the ERA to require Western Power to implement the Price Application Policy as a reasonable and prudent person as some aspects of it are unnecessarily prescriptive and there is a danger that Western Power will abuse its authority (as it currently does with the new communications rules). For example, Western Power usually performs extremely well in respect of implementing changes to DSOC, CMD, and network tariffs. Indeed, it is often feasible for these to be implemented retrospectively and Western Power often does so at the User's request. Western Power also currently permits "fine tuning" the capacity reservations of new facilities. However, clauses such as 3.4, 3.7, 6.2 and 6.3 risk eliminating this service for no good reason. We therefore request the ERA to require Western Power to interpret the respective timescales as setting minimum performance standards rather which it should seek to exceed wherever it reasonably can.

b) Clause 3.8 (Frequency of tariff nominations)

We object to Western Power imposing the requirement that the retailer shall ensure that that the nominated network tariff is best suited to their customer. Western Power has no such authority and, indeed even if it did, this document is not the instrument for its exercise.

c) Clause 13 (Metering)

We have previously filed with the ERA our objections to Western Power's requirement for the retailer to pay for meter upgrades – letter dated 29 August 2005, copy attached. In summary, we note that Western Power is basically in the business of investing in capital assets and then leasing them to end-users. Their current practice of requiring the initial private retailer to purchase an asset for Western Power to own and for subsequent retailers to use at no upfront cost is inequitable and a barrier to entry. In particular, this requirement does not apply to Western Power Retail and Western Power has been given ample funds to allocate at its discretion, to the point of spending them on customers that don't require meter upgrades while forcing private retailers to fund customers that do. Further details are provided in the attached letter.

Yours sincerely

Steve Gould

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DIRECTOR

Perth Energy

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29 August 2005

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Dear Alistair

CONCERNS ON THE PROPOSED ELECTRICITY METERING CODE

It has recently come to our attention that the schedule for introduction of the electricity Metering Code ("Code") does not provide for formal public consultation but that the ERA will otherwise be considering the Code in the next few days.

Perth Energy has participated in the Metering Code development process, mainly via the contributions of Shona Guilfoyle and Lisa Gagiero. We have a number of material concerns that we have highlighted consistently throughout the process and have until now not pursued outside the process in the perception that a public consultation was planned. Given our revised understanding of the process, we now wish to notify the ERA that we **perceive the Code's requirements for upfront capital charges in respect of meter upgrades and the installation of remote communications to be materially inequitable and a barrier to market entry.**

Specifically, the Code requires customers transferring to private retailers to have 30-minute interval metering and remote communication equipment installed at a cost of approximately $750 per item - $1,500 per customer load. The State Government has recognised that this is a barrier to entry for "Small Use Customers" (being customers that consume less than 160MWh per year) and has made funds available for the necessary capital investment over the next two years. In effect, retailers that supply such Small Use Customers have to fund only that portion of the upfront capital in excess of the average cost of such upgrades (the excess cost being zero in most cases).

While this is a valuable recognition of the importance of the issue, we have the following concerns:

i) Western Power Retail is not subject to these capital imposts and is thereby given a competitive advantage.

ii) The subsidy applies only to Small Use Customers. Customers that consume, for example, 161MWh per year are ineligible for the subsidy. In this case, the customer would have an annual bill of around $25,000, of which the capital costs are around 6%.

iii) The subsidy ceases next year, or earlier if the money runs out before then.

iv) A program of customer upgrades is in progress irrespective of whether they are actually intending to transfer to a new retailer. Indeed, towards the end of the previous financial year we suffered delays in the upgrade of meters for customers awaiting connection because Western Power's staff were fully allocated in getting the budget spent (as an alternative to forfeiting the money).

v) Most electricity supply agreements commit customers to take supply for around 2 years. In effect, the first retailer to supply the customer is required to pay the full amount of the upgrade, even if the customer subsequently changes to another retailer.

vi) Even though the retailer funds the upgrade, Western Power owns the equipment and the retailer cannot include it as part of its asset inventory.

vii) The method of requiring an upfront capital payment is at variance with the ethos of the network access philosophy according to which the network owner invests in the provision of long term assets which it then leases at regulated rates to the prevailing user.

viii) The technical basis for requiring the upgrade of the metering is highly questionable for certain classes of customer.

ix) We question the proposed costs, perceiving that they are high in comparison with eastern states' practice and recent reductions in equipment price.

Though it isn't directly relevant to the Code, these upfront costs should also be regarded in the context of the other upfront charges to which private retailers are subject, as follows:

a) Approximately $100 per customer for network access application

b) $540 per bill modification fee (for any number of customers)

c) A bank guarantee security deposit in the region of 1c/kWh for network access (approximately $1,600 for a 160MWh customer).

Consequently, a private retailer faces an upfront capital charge of ~$3700 in order to commence supply to a customer with an annual bill of around $25,000 (15% of the annual bill). And when the government subsidy expires, supply to customers with annual bills of around $15,000 will incur a cost of $2,600 (18% of the annual bill).

Our position is that upgrade capital costs ought to be part of WPC Networks' core business; Networks ought to fund them and then charge the appropriate "leasing fee" to the incumbent retailer. We would also advise that this does not create a requirement for large additional network expenditure; all that is necessary is to fund the upgrades associated with customers that actually transfer to private retailers. Moreover, the

government funds spent on the current indiscriminate upgrade program could be put to use in the manner we propose without any additional funding being required for some years.

I would also take this opportunity to advise you that we perceive the proposed Service Level Agreement of the Code to be inappropriate. Metering is currently covered in a half-page clause of the Network Access Agreement and we contend that it is appropriate to upgrade that clause rather than to develop a completely new and cumbersome contract, complete with separate invoicing arrangements, with what is, after all, the same legal entity.

Yours sincerely

Steve Gould

DR STEVE GOULD
DIRECTOR