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Mr Ignatius Chin
Assistant Director Electricity Market Surveillance
Economic Regulation Authority
6th floor, Governor Stirling Tower
197 St Georges Terrace
PERTH WA 6000

Dear Ignatius

Alinta submission on System Management's allowable revenue application

System Management makes the following comments in response to matters raised in Alinta's submission on System Management's allowable revenue application for the period 1 July 2007 to 30 June 2010.

Appropriateness of labour cost allocation

Alinta questions the increase of staff numbers from 14 FTEs in 2006/07 to 19.1 in the review period.

Alinta also makes the point that "…additional functions proposed to be undertaken by System Management appear to be labour intensive initial costs to setup System Management, rather than an ongoing requirement…".

The additional functions System Management included in section 5.2.1 of the allowable revenue application are ongoing. Importantly, when System Management allocated 14 FTEs in the 2006/07 budget, this was done in the absence of any experience in market operations, and when the Market Rules themselves were in a far from settled state. Now that System Management has experience of the requirements and demands of the Market Rules, a better picture exists of the functions and the resources required to comply with these functions. In particular, ongoing compliance and reporting, as well as extensive outage planning requirements, represent significant demands which were not fully appreciated in April 2006, when the 2006/07 budget was prepared.

Whilst the allowable revenue application of 30 November 2006 provides further information, System Management would encourage the Authority to inquire further if questions remain concerning either the extent of System Management's functions or the derivation of the labour allocation during the review period.

For example, to assist the Authority in understanding the nature and scope of outage planning (one of the key functions conferred upon System Management in the Market Rules), it is noted that approximately 375 market related proposed outage plans were accepted or approved under the Market Rules in the three month period between 21 September and 21 December 2006 (approximately 1500 are expected annually).

System Management's experience is that the ongoing maintenance of procedures, as well as significant new reporting and compliance requirements, require adequate resources for which no provision has been made in the 2006/07 budget.

Labour cost escalation

Alinta asked the Authority to consider whether the forecast labour cost escalation (6% per annum) was "overstated", given that the IMO forecasted a 4% increase.

In response, System Management states that the labour escalation allocation represents our expectation of labour cost increases during the review period, and provides System Management with sufficient salary flexibility to retain skilled and experienced staff in a competitive labour market environment.

Further, it is noted that Western Power in February 2005 negotiated a Certified Agreement with the Australian Services Union for a three-year period ending in February 2009. The agreement is applicable to Western Power's "salaried" staff (i.e. Semi-professionals, Engineers, Administrative Staff, Technical officers etc.).

Within the agreement wage rates were negotiated to increase each year by a fixed percentage. These rates have been locked in and are not negotiable until the end of the life of the agreement. The table below summarises the wage increases:

Percentage Increase	Increase Applicable From
6%	December 2005
6%	March 2007
5%	March 2008

The 6% annual increase for labour costs in the allowable revenue application also takes into account labour market movements and conditions. The Wage Price Index (**WPI**) reported in the ABS catalogue 6345.0 – 'Labour Price Index' reports that for a period of one year ending in September 2006 the WPI for the Electricity, Water & Gas sector had an increase of 6.1%. (The WPI measures the changes in the price of wages).

Compare this to Western Australia's WPI for all sectors of 4.3% for the same period. Western Power also competes with the resource sectors for labour – the Mining sector for the same period also had an increase to the WPI of 6%.

Given the fixed increase to the cost of wages and the current market conditions that Western Power faces it would be unrealistic to suggest that costs in labour should only rise by 4% each year of the review period.

Again, System Management stands by its decision to increase labour costs by 6% as we believe it is justifiable given the current conditions faced by the organisation.

Appropriateness of functional cost and legal costs

Alinta queries System Management's proposed 10% annual escalation of legal costs, arguing that the rate is well above expectations on CPI movement and System Management's own expectations regarding the increase in labour costs.

System Management contends that there is no connection between expected CPI movements, or labour cost escalation, and annual legal cost increases.

While the amount of legal expenditure is uncertain, as acknowledged in the Authority's issues paper, an increase in the relevant allocation by 10% in each year of the review period is prudent to cater for expected increases in the need for legal advice (as market participants become more sophisticated and disputes are considered more likely to increase) and reasonable pre-estimates of likely increases to our legal advisors per unit rate.

Self insurance

Alinta poses a number of queries regarding the proposed self-insurance premium.

System Management notes that it is working with its risk advisors to obtain insurance premium estimates commensurate with System Management's exposure and liabilities in the wholesale electricity market. It is expected that, should it be able to identify a suitable insurance policy, this process will be concluded by the end of February.

Depreciation method of phase 1 IT costs

Alinta does not object to System Management's depreciating phase 1 IT costs over three years, rather than five years. Although for accuracy it is noted that System Management proposed a revised depreciation period of two and a half years.

Work program

Alinta requested that the Authority satisfy itself that any costs recovered as System Management costs are not also recovered under the Access Arrangement.

System Management has assured both the Authority and market participants of this in the allowable revenue submission. Audit by the IMO during the annual budget process, and the Authority's "effectiveness" monitoring under clause 2.16 of the Market Rules, will provide assurance that there is no double-recovery.

Operating expenditure

System Management notes that Alinta makes no comment upon the proposed IT operating expenditure.

Economic incentive scheme

System Management's allowable revenue submission detailed the forecast costs of market operations for the three year period commencing 1 July 2007. System Management did not propose an economic incentive scheme to apply during the review period.

Other issues

If you have any further questions about the derivation of the forecast costs applying to System Management's wholesale electricity market functions from 1 July 2007, please do not hesitate to contact me on 9427 5787.

Yours sincerely

[Signed]

Alistair Butcher
Market Strategic Development Manager