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CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

17 December 2008

Access Arrangements Review
Electricity Access
Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

electricityaccessreview@era.wa.gov.au

Dear Chairman

PROPOSED REVISIONS TO THE ACCESS ARRANGEMENT FOR THE SOUTH WEST INTERCONNECTED NETWORK

The Chamber of Commerce and Industry of Western Australia (CCI) is pleased to provide a submission to the Economic Regulation Authority (the Authority) regarding Western Power's proposed revisions to the Access Arrangement for the South West Interconnected Network (SWIN).

Proposal to Allow Reduction of Contracted Capacity

CCI notes Western Power's proposal to introduce provisions that allow unilateral reduction to a user's contracted capacity at a connection point, conditional upon the contracted capacity not being used and where Western Power considers the contracted capacity is unlikely to be used.

CCI continues to strongly oppose this proposed provision as set out in our submission to the Authority, dated 21 February 2007.

In the February 2007 submission, CCI asserted that in our view Western Power is not appropriately equipped to assess whether a market participant will be likely to use unutilised capacity at any point. The Chamber strongly believes that a customer who has contracted and paid for capacity should not be subject to the provider revoking that capacity based upon an arbitrary assessment of the customer's use.

We maintain that the primary concern of Western Power should be to recover investment and operational costs, as contemplated under the Access Code. Regulatory functions, such as the withdrawal of network capacity, should remain the responsibility of an independent regulator, such as the Economic Regulation Authority, or equivalent body. Alternatively, it may be appropriate for the rules governing the electricity market to be amended to more explicitly state how and when a disconnection may occur.

Proposed Target Revenues and Reference Tariffs

CCI notes that Western Power has proposed significant increases in target revenues and reference tariffs, resulting in network charge increases of 40 percent from 2008/09 to 2009/10 for both transmission and distribution charges, and subsequent annual real increases in 2010/11 and 2011/12 of 37.2 percent for transmission charges and 30 percent for distribution charges. CCI recognises the additional costs that will flow through the supply chain as a result of Western Power price increases and the consequent impact this may have on business. However, CCI fully supports tariff adjustments that achieve full cost recovery, as noted below.

Reference Tariffs and the Price Control

CCI strongly believes that enterprises must be allowed to set prices that are cost reflective, including allowance for a reasonable return on investment. CCI strongly supports any proposals to modify the Access Arrangement to ensure that cost-reflective pricing is achieved.

CCI understands that there was significant underinvestment in the SWIN for many years, across successive governments, while the electricity transmission utility was under public ownership. This has resulted in a significant number of assets approaching end of life and consequently require upgrading and/or replacing.

CCI notes that Western Power is proposing to increase all reference tariffs, including for the residential market. However, current government policy imposes a cap on retail pricing in the non-contestable market sector, which we understand primarily benefits residential customers. We further note that under the vesting contract, the generator (Verve Energy) incurs the cost differential.

CCI believes that the State Government must allow the State's electricity generator to move towards cost reflective pricing as a matter of priority so that new investment can be encouraged in the generating sector.

Capital Investment

The Western Australian business sector is facing significant cost pressures brought about by volatility in the global economic environment and the consequent impact on the local economy. Electricity demand forecasts have the potential for significant change over the three-year period governed by the next Access Arrangement. Fluctuations in total electricity demand will impact upon the operating costs, and potentially the capital expenditure requirements, of Western Power.

The Chamber notes that power generation costs are also increasing, and there is potential for further price increases should the Federal Government proceed with the implementation of a Carbon Pollution Reduction Scheme, which will result in an additional carbon cost being factored into pricing models.

Given this uncertainty CCI recommends that the Authority review the tariff increases proposed by Western Power. It is imperative that the proposed price levels reflect efficient use of funds for both capital and recurrent expenditure, commensurate with expenditure that would exist within a competitive market framework, as stated by section 6.4(a)(i) of the Access Code.

CCI recommends that the Authority should examine whether Western Power will meet forecasts with respect to planned capital investment in new facilities. CCI notes that Western Power is

forecasting 81 percent of transmission network capital expenditure will be driven by growth related work hence much of the tariff uplift is driven by the proposed new capital works.

CCI believes that the Authority must examine the facilities invested in by Western Power during the first access arrangement period, to ensure the capital base is set at an appropriate level. CCI understands that a key aspect of the Authority's role is to ensure Western Power's on-going compliance with the new facilities investment test.

Capital Contributions

CCI recognises that the SWIN is an ageing network that is experiencing significant demand growth. This has resulted in the need for capital expenditure to both augment and/or replace old assets and also to expand the total reach of the SWIN.

CCI believes that Western Power should be entitled to set prices such that will ensure necessary capital upgrades. CCI considers that the Authority should examine Western Power's proposed capital works program to ensure that it is appropriate, achievable and efficient, particularly given the changing economic environment which may impact overall levels of demand and the delivery costs of capital projects.

The Chamber notes the proposed change with respect to the method adopted for treatment of capital contributions. CCI is concerned that the proposed treatment may result in a significant short-term cost to industry participants through an estimated 17 percent cost increase in transmission services and 28 percent cost increase in distribution services, which are proposed to be incorporated into higher revised reference tariffs.

CCI urges the Authority to consider whether it is necessary to change the method of calculating capital contributions. As both the current and proposed methods result in the same outcome for the present value of the assets over their lifetimes, we are concerned that a change in capital contributions methodology may be unwarranted because the short-run price spike that would result from a change to the capital contributions methodology presents a significant financial risk to end-users.

Rate of Return Calculations

CCI notes that while the methodology adopted for calculating the revised weighted average cost of capital is reasonable, the input variables potentially may have changed in line with changes across the macroeconomic environment. CCI recommends that the Authority review these parameters to ensure the proposed rate of return is appropriate.

Price Controls

CCI notes the proposed revisions to the reference tariffs establish a three-year glide path for Western Power to achieve cost-reflective pricing. CCI believes such an approach is helpful, in that it insulates customers from a large-scale price change in a single year.

With respect to the quantum of the changes, CCI believes these are a function of the full tariff calculation, and can only be assessed once a full analysis of the complete Access Arrangement revisions has been undertaken by the Authority.

Conclusion

CCI supports the need for Western Power to set tariffs at a rate commensurate with the investment made in the network, while also offering a reasonable rate of return. CCI strongly endorses cost-reflective pricing as a means to achieving this objective.

However, CCI is aware of the financial impact that any price increase will have on downstream electricity consumers and therefore recommends that the Authority consider the proposed Access Arrangement revisions, to ensure that the variations appropriately compensate Western Power for the investments made, while not penalising customers through the imposition of unnecessarily high tariffs.

CCI notes that the aim of the Access Code is to ensure that Western Power operates as it would within in a competitive market, and so we believe that only Access Arrangement revisions that are in line with this principle should be endorsed by the Authority.

Furthermore, CCI considers that this review of the Access Arrangements highlights the need for the State Government to review its policy with respect to electricity tariff caps, to better enable the market to operate transparently.

CCI's Senior Adviser, Industry Policy, Andrew Canion would be pleased to provide further information on this submission and can be contacted on (08) 9365 7688 or email andrew.canion@cciwa.com.

Yours sincerely

Trevor Lovelle
Executive Director, Industry Policy