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WESTERN POWER'S PROPOSED REVISED ACCESS ARRANGEMENT FOR THE PERIOD 2009/10 TO 2011/12

Alinta Sales Pty Limited (Alinta) appreciates the opportunity to comment on Western Power Corporation's (Western Power) proposed revisions to the current Access Arrangement (the Proposed Access Arrangement) for the South West Interconnected Network (SWIN).

Alinta's comments, which are set out in this letter and the attachment, are made in response to:

- Western Power's Proposed Access Arrangement and information provided to support the Proposed Access Arrangement, which were published by the Economic Regulation Authority (the Authority) on its website on 8 October 2008; and
- an Issues Paper on Western Power's Proposed Access Arrangement published by the Authority on 5 November 2008.

At this time, Alinta has commented only on certain issues arising from Western Power's Proposed Access Arrangement. The absence of a comment on any specific issue should not be taken to indicate that Alinta supports, or does not support, that particular aspect of Western Power's Proposed Access Arrangement.

Background

The objective of the *Western Australian Electricity Networks Access Code 2004* (the Code) is to promote the economically efficient investment in, and operation and use of networks and services of networks in Western Australia, in order to promote competition in markets upstream and downstream of the networks.

In its Issues Paper, the Authority indicated that if it were to accept Western Power's Proposed Access Arrangement as submitted:

- (real) transmission network charges would increase by 40 per cent in 2009/10 and 37.2 per cent in both 2010/11 and 2011/12; and
- (real) distribution network charges would increase by 40 per cent in 2009/10 and 30 per cent in both 2010/11 and 2011/12.

Alinta

Further, the Authority noted that the key drivers of the increase in Western Power's transmission and distribution network charges were:

- a 56 percent increase in (real) forecast non-capital (i.e. operating) costs over the actual costs incurred in the current access arrangement period;
- a 74 per cent increase in (real) forecast capital expenditure (i.e. new facilities investment) over that which occurred during the current arrangement period;
- an increase in the rate of return from 6.76 per cent (real, pre-tax) for the current access arrangement period to 8.95 per cent; and
- a change in the regulatory treatment of capital contributions that implies higher network prices in the short term than under the current treatment.

Alinta notes the Authority may approve Western Power's Proposed Access Arrangement only if it determines that the Code objective, and the requirements set out in Chapter 5 (and Chapter 9, if applicable), are satisfied.

Summary of Alinta's position

Alinta considers that Western Power's Proposed Access Arrangement does not currently meet the Code requirements…

Alinta appreciates that significant time and resources have gone into preparing Western Power's Proposed Access Arrangement and the information provided in supporting documentation.

However, Alinta considers that in a number of important areas the Proposed Access Arrangement appears either to not meet the requirements of the Code, or to be inconsistent with the requirements of the Code. These are summarised below and are discussed in more detail in the attachment.

- A number of clauses in the proposed Electricity Transfer Access Contract appear either not to be reasonable, or not sufficiently detailed and complete to form the basis of a commercially workable access contract or enable a user to determine the value represented by the reference service as the reference price (required by clause 5.3 of the Code).
- Additional information would be required in order to allow an assessment to be made that Western Power's proposed non-capital expenditure during the next access arrangement period is consistent with a service provider efficiently minimising costs (required under clause 6.40).
- Western Power has not separately identified new facilities investment during the current access arrangement period or the next access arrangement period that is to be added to the capital base under clause 6.51A(a) (new facilities investment that satisfies the new facilities investment test) or clause 6.51A(b) (new facilities investment that is to be approved by the Authority).
- Additional information would be required in order to allow an assessment to be made that the new facilities investment during the current access arrangement period, which Western Power proposes to add to the capital base under clause 6.51A(a), satisfies the new facilities investment test in clause 6.52.
- Additional information would be required in order to allow an assessment to be made that new facilities investment during the current access arrangement period which does not satisfy the new facilities investment test can be added to the capital base under clause 6.51A(b). Such information would include whether contributions made by network users reflected only the extent to which the new facilities investment test was not satisfied (required by clause 5.14).

- Given the significant increases in non-capital expenditure and new facilities investment, and the limited improvements in Western Power's proposed service standard benchmarks, it is not clear that the proposed benchmarks are either reasonable or sufficiently detailed and complete to enable a user or applicant to determine the value represented by the reference service at the reference tariff (required by clause 5.6).
- The proposed exclusion of non-reference services from the price control appears to be inconsistent with the requirements of the Code, which requires that the price control apply to covered services. Covered services in turn are defined to include both reference and non-reference services.
- The proposed gain sharing mechanism does not appear to meet the requirements of clause 6.22 as it does not describe the basis on which the surplus in clause 6.23 is to be determined.
- The proposed inclusion of a "D" factor scheme for adjusting target revenue in future access arrangement periods is not one of the adjustments to target revenue provided for in clause 6.4, and hence appears to be inconsistent with the Code.
- A number of the proposed amendments to the Application and Queuing Policy are not detailed enough to enable users and applicants to understand how the policy will operate.

…and does not achieve the Code objective…

Alinta considers that even if the requirements of the Code had been met, Western Power's Proposed Access Arrangement would not achieve the Code objective.

This is because the size of the increase in network reference tariffs that would result from Western Power's Proposed Access Arrangement, when combined with the fact that tariffs for certain contestable customers are capped below cost reflective levels, means that the Proposed Access Arrangement would not promote competition in markets upstream and downstream of the SWIN.

In fact, Alinta considers that the increase in network charges that would result from the Proposed Access Arrangement are very likely to be detrimental to the current level of competition in the electricity generation and retail market segments in Western Australia. This is for the following reasons.

- Higher network charges mean that electricity retailers' operating costs increase. Network charges make up a significant proportion of retailers' cost-to-serve.
- To the extent that retailers cannot pass through the increase in network charges to their retail customers, their financial position will deteriorate.
- While a proportion of retailers' contracts may allow a pass through of increases in network charges, the resultant increase in retail prices would substantially lessen the attractiveness of contracts offered by second tier retailers relative to Synergy's regulated tariffs (which the Office of Energy found are significantly below its cost-to-serve).
- As a result, the market share of the contestable customer segment held by second tier retailers is likely to fall (as Synergy is obliged to supply customers consuming less than 160 megawatt hours of electricity per annum at the regulated tariff where requested), while it is also possible that some second tier retailers may choose to exit the Western Australian retail market.
- The increases in Western Power's network charges would also result in the financial position of Verve Energy continuing to deteriorate through the netback pricing arrangements in the Vesting Contract between it and Synergy, which may impede its ability to effectively compete in the generation market.

…meaning the Proposed Access Arrangement should not be approved.

If Western Power's Proposed Access Arrangement does not satisfy the Code requirements and does not achieve the Code objective, it should not be approved.

Other issues

Change in economic conditions

Western Power has indicated that around $1.2 billion, or 67 per cent, of the increase in new facilities investment between the current access arrangement period and that forecast for the next access arrangement period is due to growth related investments.

However, the December 2008 survey of Western Australian business expectations undertaken by the Commonwealth Bank - Chamber of Commerce and Industry found that there had been a marked weakening in operating conditions in the State, with an increase in unused operating capacity and a significant fall in anticipated capital expenditure. Only 15 per cent of respondents intended to expand their capital stock in the year ahead, although the survey also found that businesses had benefitted from a significant fall in the cost of doing business.

It is likely that uncertainty stemming from the global financial crisis will continue to affect investment decisions in Western Australia well into the next access arrangement period. As Western Power's Proposed Access Arrangement was submitted in early October 2008, its forecast new facilities investment for the next access arrangement period is unlikely to reflect the full extent of this weakening in economic conditions.

Consequently, Alinta considers it would be appropriate for Western Power to review both its non-capital expenditure and its forecast new facilities investment for the next access arrangement period in light of this recent evidence on Western Australian economic conditions.

Tariff Equalisation Contribution

Alinta notes that unlike the current access arrangement, Western Power's Proposed Access Arrangement excludes the recovery from network users of the Tariff Equalisation Contribution, which totalled $71.6 million in 2007/08. As a result, the Proposed Access Arrangement understates the effective increase in network charges by the amount of the Tariff Equalisation Contribution, which is likely to exceed $200 million over the three years of the next access arrangement period.

Alinta supports the recommendation made by the Office of Energy in its draft Recommendations Report following its review of electricity tariff arrangements that the Tariff Equalisation Contribution be funded directly by Government through a community service obligation payment.

However, this report has not yet been finalised and the new Government is yet to formally respond to its recommendations. For these reasons, Alinta considers the Authority should adopt a conservative approach and assess Western Power's Proposed Access Arrangement on the basis that the existing policy will continue. That is, the Tariff Equalisation Contribution will continue to funded by users of the SWIN.

Need for regulated retail tariffs to be cost reflective

Alinta supports tariffs and charges for energy products and services, including in the retail, distribution and transmission segments of the market, being set at cost reflective levels. Cost reflective pricing is necessary to ensure that the Western Australian energy industry is placed on a sound commercial and economic foundation, which in turn supports ongoing investment in the industry, particularly by the private sector. However, the promotion of competition is also important as competition assists in maintaining downward pressure on prices, encourages improved service delivery, supports the development of innovative products and provides choice for consumers through a range of alternative price and service offerings.

Alinta notes that the Office of Energy's recent review of regulated retail electricity tariffs found that existing tariff caps were below cost. Where tariffs are capped below cost reflective levels, it is possible that tension may arise between setting cost reflective network charges and promoting competition at the retail level. As discussed earlier, the increase in network prices associated with Western Power's Proposed Access Arrangement is likely to be detrimental to the current level of competition in the electricity generation and retail market segments in Western Australia. A lessening of competition pressures would reduce the benefits that competition has already delivered for Western Australian electricity customers.

For these reasons, Alinta endorses the Office of Energy's recommendation that retail electricity tariffs for contestable customers in the SWIN increase to cost-reflective levels. While Alinta recognises that the Authority currently has no formal role in determining retail electricity tariffs, Alinta believes that the extent to which retail tariffs are cost reflective must have a bearing on the Authority's assessment of whether Western Power's Proposed Access Arrangement achieves the Code objective.

Should the Authority require further information on any of the above issues, or those discussed in the attachment, I can be contacted on 9486 3749.

Yours sincerely

Corey Dykstra
Manager Regulatory Affairs
Alinta Sales Pty Ltd

Att.

ATTACHMENT

WESTERN POWER'S PROPOSED REVISED ACCESS ARRANGEMENT FOR THE PERIOD 2009/10 TO 2011/12

Code objective and requirements

The objective of the *Western Australian Electricity Networks Access Code 2004* (the Code) is to promote the economically efficient investment in, and operation and use of networks and services of networks in Western Australia, in order to promote competition in markets upstream and downstream of the networks (clause 2.1).

Alinta notes the Authority may approve Western Power's Proposed Access Arrangement only if it determines that the Code objective, and the requirements set out in Chapter 5 (and Chapter 9, if applicable), are satisfied

Alinta has commented on a range of issues arising from Western Power's Proposed Access Arrangement. However, the absence of a comment on any specific issue should not be taken to indicate that Alinta supports, or does not support, that particular aspect of Western Power's Proposed Access Arrangement.

Summary of Alinta's position

Alinta considers that in a number of important areas Western Power's Proposed Access Arrangement appears to either not meet the requirements of the Code, or be inconsistent with the requirements of the Code. These are summarised below and discussed in more detail in the remainder of the attachment.

- A number of clauses in the proposed Electricity Transfer Access Contract appear either not to be reasonable, or not sufficiently detailed and complete to form the basis of a commercially workable access contract or enable a user to determine the value represented by the reference service as the reference price (required by clause 5.3 of the Code).
- Additional information would be required in order to allow an assessment to be made that Western Power's proposed non-capital expenditure during the next access arrangement period is consistent with a service provider efficiently minimising costs (required under clause 6.40).
- Western Power has not separately identified new facilities investment during the current access arrangement period or the next access arrangement period that is to be added to the capital base under clause 6.51A(a) (new facilities investment that satisfies the new facilities investment test) or clause 6.51A(b) (new facilities investment that is to be approved by the Authority).
- Additional information would be required in order to allow an assessment to be made that the new facilities investment during the current access arrangement period, which Western Power proposes to add to the capital base under clause 6.51A(a), satisfies the new facilities investment test in clause 6.52.

- Additional information would be required in order to allow an assessment to be made that new facilities investment during the current access arrangement period which does not satisfy the new facilities investment test can be added to the capital base under clause 6.51A(b). Such information would include whether contributions made by network users reflected only the extent to which the new facilities investment test was not satisfied (required by clause 5.14).
- Given the significant increases in non-capital expenditure and new facilities investment, and the limited improvements in Western Power's proposed service standard benchmarks, it is not clear that the proposed benchmarks are either reasonable or sufficiently detailed and complete to enable a user or applicant to determine the value represented by the reference service at the reference tariff (required by clause 5.6).
- The proposed exclusion of non-reference services from the price control appears to be inconsistent with the requirements of the Code, which requires that the price control apply to covered services. Covered services in turn are defined to include both reference and non-reference services.
- The proposed gain sharing mechanism does not appear to meet the requirements of clause 6.22 as it does not describe the basis on which the surplus in clause 6.23 is to be determined.
- The proposed inclusion of a "D" factor scheme for adjusting target revenue in future access arrangement periods is not one of the adjustments to target revenue provided for in clause 6.4, and hence appears to be inconsistent with the Code.
- A number of the proposed amendments to the Application and Queuing Policy are not detailed enough to enable users and applicants to understand how the policy will operate.

These issues, and a number of related matters, are discussed in more detail in the remainder of this attachment.

Standard Access Contract

Submissions are invited from interested parties on any practical issues and/or difficulties experienced with the electricity transfer access contract during the current access arrangement period, and whether interested parties foresee any potential issues arising from the revisions proposed by Western Power to the electricity transfer access contract for the second access arrangement period that:

- *may impact on a commercially workable access contract, or*
- *might present difficulties for a user or applicant in determining the value represented by the reference service at the reference tariff*

Proposed revised access arrangement

Alinta believes that the proposed standard Electricity Transfer Access Contract (ETAC), and accompanying information provided by Western Power as part of its Proposed Access Arrangement, is not currently sufficiently detailed to enable users or applicants to determine whether it:

- is reasonable [as required by clause 5.3(a)]; and
- is sufficiently detailed and complete to:
  - form the basis of a commercially workable access contract [as required by clause 5.3(b)(i)]; and

- enable a user or applicant to determine the value represented by the reference service at the reference tariff [as required by clause 5.3(b)(ii)].

The following sections detail the areas where Alinta considers the proposed standard ETAC does not meet the requirements of the Code.

Clause 3.1(d) Modified service

In principle, Alinta supports the standard ETAC being modified to enable Western Power to provide a modified service until a Reference Service is available.

Western Power proposes to revise the current standard ETAC by including clause 3.1(d) to allow it to provide a network user with a Modified Service until a specified date, or until certain specified events or works are completed to Western Power's satisfaction. Western Power would be able to continue to provide a Modified Service until the specified 'events or works' were completed to its satisfaction. The option for a network user to be provided with a Modified Service by Western Power ahead of a Reference Service being available may be commercially advantageous to that network user.

However, Alinta is concerned that the ability to provide a modified service may reduce the incentive for Western Power to ensure it provides the Reference Service requested by a network user in a timely fashion, and may impede the operation of a commercially workable access contract. The proposed clause 3.1(d) may also create uncertainty by giving Western Power the discretion to determine when the 'specified events or works' are satisfactorily completed (albeit that it is required to act as a reasonable and prudent person).

1. *Alinta requests the Authority consider whether clause 3.1(d) of the proposed standard ETAC satisfies the Code objective, and specifically whether the clause allows a commercially workable access contract to be formed as required by clause 5.3(b)(i) of the Code.*

Clause 3.8 Contracted capacity not utilised

Alinta does not support Western Power's proposal to revise the standard ETAC by including clause 3.8, which would allow it to unilaterally reduce a network user's Contracted Capacity and to determine the amount and timing of the reduction in capacity.

Western Power claims that its proposed clause 3.8.[1]

> *"promotes the Code objective of economically efficient investment in, and operation and use of, the network, and the improvement of competition in upstream and down stream markets. The purpose of the provision is to not allow user's to 'sit' indefinitely on unused capacity to the detriment of other potential users of that capacity."*

1 Western Power 2008, *Revised Access Arrangement Information for the Network of the South West Interconnected System*, 1 October 2008, Appendix 12, p.5.

Alinta has previously indicated that it believes "use-it-or-lose-it" provisions can be helpful in curbing anti-competitive behaviour, but that it believes the amendment is a very heavy handed approach. Wherever possible, Alinta supports market based approaches, and the proposed clause is likely to restrict opportunities for parties to come to bilateral agreements regarding the allocation of capacity on the network. Alinta also notes that substantial penalties also exist for firms and individuals that are guilty of anti-competitive behaviour under the Commonwealth *Trade Practices Act 1974*. Accordingly, existing competition law provides a reasonable and well-known approach to addresses any misuse of market power compared to that proposed by Western Power.

There may also be sound commercial reasons for network users to hold contracted capacity in excess of immediate actual capacity requirements, including creating or maintaining valuable real options. Whether currently unutilised capacity is used in future is likely to depend on probabilities associated with a series of uncertain future events. Network users wishing to retain rights to capacity not current being used are still obliged to pay ongoing network charges, which constitutes a significant financial commitment. It is network users, not Western Power, that are best placed to determine whether the cost of creating and/or maintaining the real option (that is, the cost of the currently unused contracted capacity) is commercially prudent.

For example, on the SWIN, especially for edge-of-grid mining operations, electricity customers often have to pay significant capital contributions to connect. It is not uncommon that some of these operations may shut down for periods of a few months up to a few years for operational reasons or as a result of temporary dips in commodity prices. Alinta has previously indicated it considers it unreasonable that these customers could potentially lose their entitlements to connect to the SWIN and have to go through the entire connection/capacity increase process again when they are ready to resume operations. Instead, network users should be allowed to bilaterally trade their capacity for the period when it is not required provided they continue to pay Western Power the normal network charges associated with their contracted capacity.

Alinta also believes that there is no *a priori* evidence to support a view that transferring unused contracted capacity from one network user to another party will necessarily result in more economically efficient use of the network, or an improvement in competition in upstream or downstream markets as claimed by Western Power. This is especially the case if the transfer of the unused Contracted Capacity undermines network user's ability to undertake an expansion of its operations at a future time.

2. *Alinta requests the Authority consider whether clause 3.8 in the proposed standard ETAC satisfies the Code objective, and specifically whether the clause:*
    a. *is reasonable [as required by clause 5.3(a)];*
    b. *is sufficiently detailed and complete to form the basis of a commercially workable access contract [as required by clause 5.3(b)(i)]; and*
    c. *is sufficiently detailed and complete to enable a user or applicant to determine the value represented by the reference service at the reference tariff [as required by clause 5.3(b)(ii)].*

Clause 8.6 Under and over payments

Alinta supports the standard ETAC being consistent with existing wholesale and retail market rules with respect to the period for which adjustments to payments resulting from data errors are able to be made, which the amendments to clause 8.6 appear designed to achieve.

Western Power proposes to revise the current ETAC by including clause 8.6(d), which would give rise to a payment adjustment if notice of the error is given to the affected parties within 18 months unless the *payment* error resulted from a *data* error. A further additional clause, clause 8.6(e) would limit payment adjustments that can be made to payments resulting from data errors to 12 months from the date that notice of the error is given to the affected parties.

Western Power notes that the 12 month limitation for data errors aligns with a similar limitation under section 65 of the *Energy Operators (Powers) Act 1979* for errors in meter data,[2] which relates to adjustments to customer bills by retailers. Although it is not clear that the amendment proposed by Western Power would necessarily promote accuracy in the data information kept by both parties, Alinta notes that the settlement process for the Wholesale Electricity Market also provides for adjustment within 12 months.

<u>Clause 19.5 Limitation of liability</u>

Alinta notes that clause 19.5 of the revised standard ETAC imposes materially asymmetrical caps on the liability of each party to the contract.

Specifically, Western Power' maximum annual liability to any single network user is limited to $5 million in aggregate (other than with respect to personal injury). In contrast, the maximum annual aggregate liability of network users is the **sum** of:

- $20 million for each connection point at which generation plant (other than wind or solar powered generation) is connected at a voltage of 66 kV and above; and
- $5 million for each connection point at which consuming plant is connected at a voltage of 66 kV and above; and
- $1 million for every 100 connection points at which consuming plant is connected at a voltage below 66 kV.

3. *Alinta requests the Authority consider whether clause 19.5 of the proposed standard ETAC satisfies the Code objective and specifically whether the clause is reasonable as required by clause 5.3(a) of the Code.*

2 Western Power 2008, *Revised Access Arrangement Information for the Network of the South West Interconnected System*, 1 October 2008, Appendix 12, p.5.

Service Standards

Submissions are invited from interested parties on Western Power's proposed revisions to the service standard benchmarks, including: • *the level of service standard benchmarks proposed by Western Power for the second access arrangement period;* • *the proposed exclusions for the measures of SAIDI, SAIFI and circuit availability; and* • *whether the supporting information provided by Western Power is sufficiently detailed to enable users or applicants to determine the value represented by the reference service at the reference tariff.* *Submissions are also invited on whether Western Power's service standards are reasonable, given the levels of actual and forecast expenditures for the current and second access arrangement periods.*

Alinta considers that the information provided by Western Power in its Proposed Access Arrangement, and accompanying information, is not currently sufficiently detailed to enable users or applicants to determine:

- whether a service standard benchmark for a reference service is reasonable [clause 5.6(a)]; or
- the value represented by the reference service at the reference tariff [clause 5.6(b)].

The following sections detail the areas where Alinta considers the requirements of the Code may not be met.

Proposed exclusions for the measures of SAIDI, SAIFI and circuit availability

Alinta understands that there are likely to be differing views amongst major SWIN-connected electricity customers concerning the performance of the SWIN, and that such views are likely to be location specific. As an example, one customer has advised Alinta that it has incurred material financial costs due to distribution network instability in the Geraldton and Eneabba areas. Energy 'flicks' on the distribution network, which may last for as short a period as a few seconds up to a minute, trip its operating plant, which then requires around two to three hours to be brought back online. The customer has indicated that it considers the stability of the network has deteriorated in the past three years.

Importantly, the short term nature of such network instability problems will not be reflected in Western Power's network performance benchmarks as both the definitions of System Average Interruption Duration Index (SAIDI) and the System Average Interruption Frequency Index (SAIFI) exclude interruptions of less than one minute. Nevertheless, for customers, the commercial implications of such short duration interruptions are no different to that resulting from outages of substantially greater lengths. For this reason, an improvement in SAIDI and SAIFI will not necessarily reflect the provision of a 'better' service to SWIN-connected electricity customers.

Transmission service standard benchmarks

Western Power claims that the underlying performance of the transmission network is appropriate and should be maintained (refer Table 1). It also notes that there are no significant drivers to either improve or relax current transmission service performance standards.

Nevertheless, the information provided by Western Power also indicates that transmission network capital expenditure attributed to 'improvement in service' is expected to increase from $27 million during the current access arrangement to almost $70 million in the next access arrangement period, an increase of almost 160 per cent (Table 25, p.76).

Table 1 Service standards benchmarks for transmission reference services

	First access arrangement			Second access arrangement		
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
	Actual	*Actual*	*Estimate*	*Forecast*	*Forecast*	*Forecast*
Circuit availability (% of total time)	98.0 (98.2)	98.2 (98.2)	na	98.0	98.0	98.0
System Minutes interrupted (meshed network)	14.2 (7.8)	8.7 (7.8)	na	9.3	9.3	9.3
System Minutes interrupted (radial network)	1.4 (3.9)	1.8 (3.9)	na	1.4	1.4	1.4

Note: Numbers in brackets reflect previous benchmark targets.

Source: Western Power 2008, *Access Arrangement Service Standard Report for the financial year ending June 2008*, 4 November 2008 and Western Power 2008, *Revised Access Arrangement Information for the Network of the South West Interconnected System*, 1 October 2008, p.162

The information provided by Western Power also indicates that 'preventative routine' and 'preventative condition' operating (i.e. non-capital) expenditure (excluding corrective deferred) is forecast to increase from $62.26 million over the current access arrangement to $114.35 million in the next access agreement, an increase almost 84 per cent (Table 28, p.84).

Western Power argues that preventative maintenance needs to be carried out to reduce the probability of failure, or degradation in performance of the transmission network assets, and that there would be an unacceptable increase in the risk of deterioration of the reliability performance of the transmission network over the medium term if there was a reduction in the level of transmission operating expenditure. However, it also notes that it has not been able to address the backlog issues in preventative maintenance because of the need to prioritise work programs to address the immediate needs of new generation and load connections (p.80).

Alinta notes that Figures 16, 17 and 18 (pp.45-46) of Western Power's Proposed Access Arrangement information indicates that the percentage of System Minutes Interrupted attributed to equipment causes has remained relatively consistent since 2004/05, implying that the inability to address the preventative maintenance backlog has not adversely affected service standards.

Given the significant increase in capital and non-capital expenditure (and the economies of scale inherent in electricity networks), it would not be unreasonable to expect that transmission network service standards should be increasing over time (rather than remaining relatively static).

For these reasons, Alinta considers that the information provided by Western Power is not sufficiently detailed to enable users or applicants to determine the value represented by the reference service at the reference tariff, as required by clause 5.6(b) of the Code. In addition, Alinta considers that the information provided by Western Power does not allow network users to determine the additional value provided by the increase in the reference tariff for each reference service.

Distribution service standard benchmarks for the second access arrangement period

Table 3 and Table 4 summarise Western Power's actual performance in terms of SAIDI and SAIFI and the benchmarks proposed for the second access arrangement period.

Table 2 SAIDI service standards

	First access arrangement			Second access arrangement		
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
	Actual	Actual	Estimate	Forecast	Forecast	Forecast
SWIN total	229	230	230	225	210	201
CBD	33	51	na	38	38	38
Urban	145	165	na	161	150	142
Rural Short	333	260	na	253	233	222
Rural long	625	611	na	599	567	548

Table 3 SAIFI service standards

	First access arrangement			Second access arrangement		
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
	Actual	Actual	Estimate	Forecast	Forecast	Forecast
SWIN total	2.52	2.5	2.5	2.44	2.29	2.18
CBD	0.26	0.23	na	0.24	0.24	0.24
Urban	1.83	1.91	na	1.88	1.76	1.67
Rural Short	3.84	3.13	na	3.05	2.83	2.7
Rural long	4.73	4.99	na	4.89	4.64	4.47

Alinta notes that Western Power's proposed SAIDI and SAIFI service standard benchmarks differ to comparable electricity network businesses. For instance, it is understood that Energex and ESTA Utilities must use best endeavours to achieve a CBD (equivalent) SAIDI target of 15 and 25 minutes, respectively. Western Power's SAIDI target sits well above these targets. For urban (equivalent) SAIDI targets, the comparable benchmark targets for Energex, ETSA Utilities and Ergon Energy comparable targets are 95, 115, and 142 minutes, respectively.

Reference Tariffs and the Price Control

Submissions are invited from interested parties on the level of actual non-capital costs for the current access arrangement period, and whether or not the actual costs are consistent with a service provider efficiently minimising costs.

Alinta considers that it is not clear that Western Power's estimated actual non-capital costs during the current access arrangement period include only those non-capital costs that would have been incurred by a service provider efficiently minimising costs, as required by clause 6.40.

Alinta notes that estimated actual non-capital costs incurred in respect of Western Power's transmission network under the three years of the existing access arrangement is expected to be \$225.3 million, marginally below that forecast (\$226.9 million).

In contrast, the estimated actual non-capital costs incurred by Western Power with respect to the distribution network was $776.5 million, more than 22 per cent above the $634.5 million that was approved by the Authority for the three years of the existing access arrangement.

Clause 6.4(a)(i) of the Access Code implies that the level of non-capital costs approved by the Authority in March 2007 as part of the current access arrangement (i.e. $634.5 million) represented the (then) efficient non-capital cost of providing covered distribution network services during the access arrangement.

Western Power does not appear to have provided as part of its Proposed Access Arrangement or supporting information:

- information on the key drivers for the increase in actual non-capital distribution network costs (i.e. $142 million) during the current access arrangement compared with that forecast for the current access arrangement; or
- information (for example, benchmark comparisons) to support a conclusion that its estimated actual non-capital distribution (or transmission) expenditure is consistent with it efficiently minimising costs.

Alinta notes that revenue proposals submitted to the Australian Energy Regulator (AER) by transmission and distribution system network service providers in the National Electricity Market (NEM) either included substantially greater information on whether their actual non-capital expenditures are consistent with a service provider efficiently minimising costs, or that the regulator undertook extensive analysis to determine whether this was the case.

For example, as part of TransGrid's 2009–2014 revenue proposal submitted to the AER, it engaged consultants to provide an overall assessment of its operating efficiency (using a repeatable methodology with valid comparisons) by comparing its performance to twelve other comparable transmission businesses, including four based in Australia. Key performance indicators that were considered to provide an insight into relative operational efficiency included:

- Operations and Maintenance (O&M) cost per kilometre (km) of line;
- O&M cost per regulated asset base;
- O&M cost per gigawatt hour (GWh) of electricity delivered
- O&M cost per full time employee (FTE); and
- km of line per FTE.

TransGrid also noted that it participated in the International Transmission Operations and Maintenance Study (ITOMS). ITOMS is a benchmarking study that its consultants noted is held in high regard by market participants as it uses normalisation factors that have been developed over an extended period of time. TransGrid's consultants considered that the ITOMS benchmarking study provided a reasonable insight into the relative efficiency of the study participants. In part, the ITOMS benchmarking was relied on by the AER in concluding that TransGrid's (and Transend, another NEM transmission company) past non-capital expenditure was efficient.

Similarly, as part of its draft determinations for the New South Wales distribution network service providers (DNSPs) for the period 2009–14, the AER engaged a consultant to assist it in assessing whether forecast non-capital costs reasonably reflected the efficient costs a prudent operator in the circumstances of each DNSP would incur. The consultant employed both a top-down and a bottom-up approach, which the AER considered was an appropriate approach to the assessment of efficient costs because in combination the assessments ensure that the relevant issues were considered comprehensively.

The issues considered by the consultant, many of which appear equally relevant in respect of Western Power's Proposed Access Arrangement, included:

- the appropriateness of the forecasting methods and procedures;
- the efficiency of the base year non-capital expenditure;
- escalations to the base year non-capital expenditure;
- step changes in non-capital expenditure, the rationale for those changes and the associated efficiency benefits;
- the scope for capital and non-capital trade offs; and
- the increase in non-capital expenditure over the next regulatory control period relative to comparable businesses.

Alinta believes further information is required in order to be able to make an assessment as to whether the actual level of non-capital costs for the current access arrangement period is consistent with Western Power efficiently minimising costs as required by the Code.

Submissions are also invited from interested parties on the forecast non-capital costs, and the adequacy of Western Power's supporting information for this forecast

Alinta considers that it is not clear that Western Power's forecast non-capital costs for the next access arrangement period include only those non-capital costs that would be incurred by a service provider efficiently minimising costs, as required by clause 6.40 of the Code.

Alinta notes that non-capital costs in respect of Western Power's transmission network for the three years of the next access arrangement are forecast to be $319.6 million, which is almost 42 per cent ($94.3 million) higher than the estimated actual non-capital expenditure for the current access arrangement period ($225.3 million).

In addition, distribution non-capital expenditure for the next access arrangement period is forecast to be $1,246.85 million, which is:

- $470.4 million, or 60.6 per cent, higher than the actual estimated actual non-capital expenditure for the current access arrangement period ($776.5 million); and
- nearly 100 per cent, or $612.3 million, higher than the efficient level of non-capital costs approved by the Authority for the three years of the existing access arrangement.

Western Power has provided supporting information on the key drivers for the significant increase in non-capital network costs (i.e. $564.7 million) during the current access arrangement compared with that forecast for the current access arrangement.

However, Alinta believes that the information provided by Western Power is in itself not sufficiently detailed to enable network users to conclude whether forecast non-capital expenditure for the next access arrangement period is consistent with Western Power efficiently minimising costs as required by the Code.

As noted in the preceding section, revenue proposals submitted to the AER by transmission and distribution system network providers have included substantially greater information on whether their non-capital expenditures were consistent with the efficient minimising costs.

Consequently, Alinta believes that further information is required in order to be able to make an assessment as to whether the forecast level of non-capital costs for the next access arrangement period is consistent with Western Power efficiently minimising costs as required by the Code.

Submissions are invited from interested parties on the substantial increases in new facilities investment recorded by Western Power for the current access arrangement period (as actual investment over forecasts for the period), and for the second access arrangement period (as forecast investment over actual investment for the current access arrangement period).

New facilities investment during the current access arrangement period

Alinta notes that estimated actual new facilities investment incurred in respect of Western Power's transmission network in the three years of the existing access arrangement is expected to total $1,067.5 million, which is more than $393.6 million, or 58.4 per cent, higher than that which was approved by the Authority in March 2007 for the three years of the existing access arrangement ($673.9 million). Similarly, estimated actual distribution network new facilities investment is expected to be $1,512.2 million, more than $535.4 million, or 54.8 per cent, higher than that approved by the Authority ($976.8 million).

Alinta is concerned at the material increase in new facilities investment during the current access arrangement period compared to the amount that the Authority determined in March 2007 would reasonably be expected to satisfy the new facilities investment test or the test in clause 6.56 [which is similar to new clause 6.51A(b)]. Western Power does not appear to have provided information on the key drivers for the increase in new facilities investment.

Alinta considers it is not unexpected that there would be some variation between forecast new facilities investment and actual new facilities investment where such variation results predominantly from unforseen reasons, which might include:

- unanticipated growth in electricity demand;
- unanticipated changes in safety, health and environmental regulations; and/or
- unanticipated increases in labour and material costs.

However, given total network new facilities investment during the current access arrangement period is $929 million, or 56 per cent, higher than that approved by the Authority (and that the approved amount had also already increased substantially over the period taken to approve the current access arrangement), Alinta finds it difficult to accept that majority of the increase could be attributed to unforseen events.

Alinta considers that the access arrangements could be greatly improved by improving the transparency of new facilities investment information that is required to be provided by Western Power. In particular, Alinta would encourage the Authority to enhance the current regulatory reporting regime by requiring Western Power to provide the following.

- Forecast levels of physical activity expected to be delivered by the forecast new facilities investment, for example:
  - length of cable by cable type to be installed;
  - number of distribution transformers to be installed;
  - number of high voltage substations to be built; and
  - the contribution of the new facilities investment to service quality outcomes as measured by average duration and frequency of interruptions.
- An annual reconciliation between forecasts and actual outcomes across expenditure, physical and service quality outcomes.

As discussed in more detail in the following section, Alinta considers that the information provided by Western Power with respect to its actual new facilities investment expenditure, raises significant doubts as to whether new facilities investment in the first access arrangement period which Western Power is proposing to add to the capital base satisfies the requirements of the Code to be added to the capital base.

Given the significant variation between new facilities investment during the current access arrangement period and that approved by the Authority, Alinta expects that the Authority will rigorously assess whether Western Power has adequately demonstrated that new facilities investment in the first access arrangement period meets the requirements of the Access Code to be added to the capital base.

In this regard, the Authority's recent Draft Determination on the extent to which Western Power's proposed 66/11kV medical centre zone substation expansion and voltage conversion of the distribution network satisfied the new facilities investment test raises significant questions on the application of the new facilities investment test by Western Power. In that case, the Authority's Draft Determination was that:

- the proposed project cost exceeded the amount that would be invested by a service provider efficiently minimising costs; and
- a significantly greater proportion of the efficient project cost satisfied the 'second leg' of the new facilities investment test than was claimed by Western Power.

[Further comments on the application of the new facilities investment test and the test under clause 6.51A(b) are provided in the following section.]

Alinta is also concerned with the apparent unconstrained ability of Western Power to undertake new facilities investment, provided the new facilities investment is found to satisfy the new facilities investment test.

As commented later in this submission, an implicit conclusion that may be drawn from Western Power's proposal to defer a portion of target revenue from the next access arrangement period to a later access arrangement period is that the magnitude of the increase in network charges that would otherwise be required is inconsistent with the Code objective. The same logic holds for the current access arrangement period – the apparent inability of the Code to limit the amount of new facilities investment with a reasonable degree of certainty may result in an outcome that could, in hindsight, be found to be inconsistent with the Code objective. That is, the Authority would not have concluded that the current Access Arrangement satisfied the Code objective had it known the full extent of new facilities investment that would be undertaken by Western Power.

New facilities investment during the next access arrangement period

Western Power's Proposed Access Arrangement is for:

- transmission network forecast capital expenditure (i.e. new facilities investment) in the next access arrangement period to be $2,193.7 million, which is:
  - $1,126.2 million, or 105 per cent, higher than the estimated actual new facilities investment during the current arrangement period; and
  - $1,519.8 million, or 225 per cent, higher than the new facilities investment that was approved by the Authority for the current arrangement period;
- distribution network forecast capital expenditure (i.e. new facilities investment) in the next access arrangement period to be $2,289.7 million, which is:
  - $777.5 million, or 51 per cent, higher than the estimated actual new facilities investment during the current arrangement period; and
  - $1,312.9 million, or 134 per cent, higher than the new facilities investment that was approved by the Authority for the current arrangement period.

Western Power has indicated that around $1.2 billion, or 67 per cent, of the increase in new facilities investment between the current access arrangement period and that forecast for the next access arrangement period is due to growth related investments.

However, the December 2008 survey of Western Australian business expectations undertaken by the Commonwealth Bank - Chamber of Commerce and Industry found that there had been a marked weakening in operating conditions in the State, with an increase in unused operating capacity and a significant fall in anticipated capital expenditure. Only 15 per cent of respondents intended to expand their capital stock in the year ahead, although the survey also found that businesses had benefitted from a significant fall in the cost of doing business.

It is likely that uncertainty stemming from the global financial crisis will continue to affect investment decisions in Western Australia well into the next access arrangement period. As Western Power's Proposed Access Arrangement was submitted in early October 2008, its forecast new facilities investment for the next access arrangement period is unlikely to reflect the full extent of this weakening in economic conditions.

Consequently, Alinta considers it would be appropriate for Western Power to review both its non-capital expenditure and its forecast new facilities investment for the next access arrangement period in light of this recent evidence on Western Australian economic conditions.

Submissions are invited from interested parties on Western Power's calculation of the capital base values at the start of the second access arrangement period and, in particular, on whether Western Power has adequately demonstrated that new facilities invested in the first access arrangement period meets the requirements of the Access Code to be added to the capital base.

The Code draws a distinction between new facilities investment that may be added to the capital base where:

- the new facilities investment test is satisfied [i.e. new facilities investment is added to the capital base under clause 6.51A(a)]; **or**
- the Authority has approved the new facilities investment being added to the capital base [i.e. the new facilities investment is added under clause 6.51A(b)].

Western Power's application of these tests is considered in the following sections.

New facilities investment test

Clause 6.51A(a) of the Code allows new facilities investment undertaken during the current access arrangement period to be added to the asset base to the extent the new facilities investment **satisfies both**:

- the 'first leg' of the new facilities investment test in clause 6.52(a) of the Code: **and**
- one or more of the three criteria set out in the 'second leg' of the new facilities investment test set out in clause 6.52(b).

Western Power has indicated it does not believe that the Code provisions relating to the new facilities investment test necessitate after-the-event reviews of capital expenditure. In fact, Western Power's consultants claim that (Section 2, Appendix 5):

> *…the costs of conducting a regulatory review of these investment decisions would not be offset by any benefits of improved investment decision making. In effect, any regulatory review of these investment decisions would simply expose Western Power to unnecessary stranded asset risk."*

Alinta does not agree with this conclusion, and notes the Authority commented in its final decision on the Access Arrangement for current access arrangement period that:

> *… a binding determination on whether the forecast new facilities investment meets the new facilities investment test and is able to be added to the capital base…will be made by the Authority either at the time of undertaking an assessment of proposed revisions to the access arrangement or, under section 6.71 of the Access Code, at a time requested by Western Power [at 337, p.99].*

In any event Western Power engaged two consultants to demonstrate that capital expenditure (i.e. new facilities investment) during the current access arrangement period satisfied the new facilities investment test.

- Harding-Katz advised on the application of the new facilities investment test to Western Power's capital expenditure (i.e. new facilities investment) during the current access arrangement period.
- PB was engaged to demonstrate that Western Power's capital expenditure during the current access arrangement satisfied the requirements of the new facilities investment test (refer Appendix 5 of Western Power's Revised Access Arrangement Information).

Alinta notes that BP reviewed just four capital expenditure projects that represented expenditure of $65 million, or around 2.6 per cent, of Western Power's total capital expenditure during the current access arrangement of $2.5 billion. However, the information provided by Western Power with respect to its new facilities investment and PB's assessment, raises significant doubts as to whether the new facilities investment in the first access arrangement period which Western Power is proposing to add to the capital base satisfies the requirements of the Code to be added to the capital base.

These concerns are echoed in the Authority's recent Draft Determination on the extent to which Western Power's proposed 66/11kV medical centre zone substation expansion and voltage conversion of the distribution network satisfied the new facilities investment test, which also raises significant questions on the application of the new facilities investment test by Western Power.

These concerns are discussed in more detail in the following two sections.

<u>Leg 1 - Efficiently minimising costs [clause 6.52(a)]</u>

The first 'leg' of the new facilities investment test, set out in section 6.52(a), requires that in order for the new facilities investment to be added to the capital base the new facilities investment must not exceed the amount that would be invested by a service provider efficiently minimising costs. The Code defines 'efficiently minimising costs' as incurring no more costs than would be incurred by a prudent service provider:

- acting efficiently;
- in accordance with good electricity industry practice;
- seeking to achieve the lowest sustainable cost of delivering covered services; and
- without reducing service standards below the service standard benchmarks set for each covered service in the access arrangement or access contract.

Based on the approach adopted by the Victorian Essential Services Commission (ESC) in relation to gas distributors in that State, Harding-Katz commented that it was (Section 2, Appendix 5):

> *"…reasonable to infer that Western Power's actual and forecast capital expenditure during the first access arrangement period is prudent and efficient – and therefore can be added to the capital base – where Western Power has a commercial incentive to invest in a prudent and efficient manner.*
>
> [and claimed that]…
>
> *Western Power … faces strong incentives to minimise its capital expenditure in all expenditure categories that are not subject to the Investment Adjustment Mechanism; and*
>
> *It is therefore reasonable to infer that all actual and forecast capital expenditure for the first access arrangement period in those categories not subject to the Investment Adjustment Mechanism is efficient and prudent, and meets the requirements of the NFIT.*

Alinta notes that the gas distribution system in Victoria is owned by Envestra, Multinet and SP Ausnet, which are public companies that are either directly, or indirectly, listed on the Australian Stock Exchange. As a wholly government-owned statutory corporation, Western Power's board and management is not likely to be subject to the same capital market incentives and/or disciplines that exist for the gas distributors in Victoria.

As a result, Alinta considers there is no *a priori* basis for concluding that capital expenditure (i.e. new facilities investment) by Western Power during the current access arrangement period was necessarily prudent and efficient simply because the expenditure was incurred.

In addition, PB also concluded that Western Power's business processes and related governance arrangements act to drive efficient investment and to facilitate investment decision making and outcomes that are aligned with the requirements of clause 6.52(a) of the Code.

Alinta notes that, in considering whether the new facilities investment satisfies clause 6.52(a), PB comments that the development of **technical options** for both the Kewdale and Joondalup substations were conducted using Western Power's standard processes. However, it is not clear that Western Power's processes address the matter of whether the cost of a specific technical option do not exceed the amount that would be invested by a service provider efficiently minimising costs.

Alinta notes that the Authority's Draft Determination on the New Facilities Investment Test for a 66/11 kV Medical Centre Zone Substation Expansion and Voltage Conversion of the Distribution Network found that although the proposed substation represented an efficient choice of project, it was not satisfied that the design of the proposed substation was consistent with **technical efficiency** for the project. Specifically, the Authority concluded that:

- 66kV switchgear was available with the required fault rating, and that Western Power had not demonstrated that upgrading the substation to 132kV was sufficiently planned to justify the additional expense of 132kV equipment;
- The number of incoming lines and transformers should be reduced from three to two; and

- Environmental and land management costs were excessive given the substation was to be located adjacent to an existing substation.

Similarly, Alinta considers that while PB's assessment may confirm the efficiency of Western Power's project choice, it does not adequately demonstrate that the selected option is the most technically efficient.

Therefore, in Alinta's view the information provided by Western Power is not sufficient to support a conclusion with respect to the four projects assessed by BP that Western Power's new facilities investment does not exceed the amount that would be invested by a service provider efficiently minimising costs.

<u>Leg 2 [clause 6.52(b)]</u>

The second 'leg' of the new facilities investment test, set out in section 6.52(b), requires that in order for the amount of new facilities investment that satisfies the 'first leg' to be added to the capital base:

- the anticipated incremental revenue for the new facility must be expected to at least recover the new facilities investment [clause 6.52(b)(i)]; **or**
- the new facility must provide a net benefit in the covered network over a reasonable period of time that justifies the approval of higher reference tariffs [clause 6.52(b)(ii); **or**
- the new facility must be necessary to maintain the safety or reliability of the covered network or its ability to provide contracted covered services [clause 6.52(b)(iii).

Alinta has a number of concerns about the application of the second leg of the new facilities investment test by Western Power.

Firstly, the information provided by Western Power indicates it treats capital contributions as 'revenue' for the purposes of determining whether new facilities investment satisfies clause 6.52(b)(i) of the Code (refer p.33 of Appendix 5).

However, clause 5.14 of the Code restricts Western Power from requiring a capital contribution where new facilities investment satisfies the new facilities investment test [i.e clauses 6.52(a) **and** 6.52(b)]. The implication of the Code appears to be as follows.

- New facilities investment can only be the subject of a capital contribution if the new facilities investment test is **not** satisfied [i.e. it fails clause 6.52(b) given clause 6.52(a) must still be met in order for the new facilities investment to be added to the capital base under clause 6.51A(b)].
- In this case, the new facilities investment can only be added to the capital base if approved by the Authority under clause 6.51A(b) (**not** 6.51A(a) as implied by Western Power). Further comments on application of this test are provided in a subsequent section.

Secondly, the Authority's Issues Paper on the New Facilities Investment Test for a 66/11 kV Medical Centre Zone Substation Expansion and Voltage Conversion of the Distribution Network indicates that the second leg of the new facilities investment test requires **each** of the following questions to be addressed (in order).

- Is the **value** of any part of the new facilities investment that is necessary to maintain safety and reliability of the network or its ability to provide covered services equal to the new facility investment? (This value is equal to 'z').
- Is the **value** of any net benefits that justify higher reference tariffs greater than or equal to the value of the new facility investment – z ? (This value is equal to 'y').
- Is the anticipated incremental revenue for the new facility greater than or equal to the value of the new facility investment – y – z? (This value is equal to 'x')

In each of the above cases, the amount of new facilities investment is assumed to be equal to the new facilities investment that would be invested by a service provider efficiently minimising costs. The amount of new facilities investment that may be added to the capital base is the amount given by x + y +z, subject to this amount being no greater than the amount of new facilities investment that would be invested by a service provider efficiently minimising costs.

Alinta makes the following observation on the application of the second leg of the new facilities investment test by Western Power.

- The new facilities investment for the Kewdale and Joondalup substations is justified on the basis that the investment are necessary to maintain the operation of the network within the technical rules and is therefore aligned with the safety and reliability criteria in clause 6.52(b)(iii).

  However, Western Power has not identified whether the **value** of the new facilities investment that is necessary to maintain safety and reliability of the network or its ability to provide covered services **is at least equal to** the amount of new facilities investment.

- The new facilities investment for the Bluewaters Substation Stage 2 is justified on the basis that the anticipated incremental revenue is greater than or equal to the value of the new facility investment under clause 6.52(b)(i).

  However, the information provided by Western Power does not identify the amount of incremental revenue associated with the facility, and hence it is not clear that the requirements of clause 6.52(b)(i) have been satisfied.

- The new facilities investment for the Binningup Desalination Plant is separated into shared assets and dedicated connection assets.

  PB states that (p.44, Appendix 5):

  > *A capital contribution for the dedicated connection asset has been calculated as equal to the total cost of the asset in accordance with Western Power's Capital Contributions Policy.*

  As noted above, clause 5.14 of the Code restricts Western Power from requiring a capital contribution where new facilities investment satisfies the new facilities investment test.

  However, the information provided by Western Power does not indicate whether the new facilities investment for the Binningup Desalination Plant dedicated connection assets fails to satisfy, in its entirety, any of the three tests in clause 6.52(b).

> Further, the full cost of the shared assets associated with the connection of the Binningup Desalination Plant are justified on the basis that the investment are necessary to maintain the operation of the network within the technical rules and is therefore aligned with the reliability leg of clause 6.52(b)(iii).
>
> However, Western Power has not identified whether the **value** of the new facilities investment that is necessary to maintain safety and reliability of the network or its ability to provide covered services **is at least equal to** the amount of new facilities investment.

Alinta notes that none of the new facilities investment reviewed by BP were deemed to satisfy (or partially satisfy) the new facilities investment test under clause 6.52(b)(ii), where the new facility is expected to provide a net benefit over a reasonable period of time that justifies the approval of higher reference tariffs. In each case, PB comments that (e.g. p.40, Appendix 5):

> *It has not been determined whether the project would offer net benefits to the network user that would justify higher tariffs. Therefore, leg (ii) of the Part (b) of the NFIT [new facilities investment test] is not used to justify the project.*

Alinta notes that Western Power similarly did not consider whether the 66/11 kV medical centre zone substation expansion and voltage conversion of the distribution network provided net benefits, but that the Authority's Draft Determination concluded that a substantial proportion of the efficient new facilities investment could be justified under this element of the second leg of the new facilities investment test. This finding, along with other adjustments made by the Authority in the Draft Determination, will have a material impact on the quantum of the capital contribution that Western Power could require to be made towards the project if upheld in the final determination.

New facilities investment approved by the Authority [clause 6.51A(b)]

As noted earlier, the Code also allows new facilities investment that does not meet the new facilities investment test to be added to the capital base **if** approved by the Authority under clause 6.51A(b). The new facilities investment that would fall into this category are new facilities investment that do not satisfy the 'second leg' of the new facilities investment test, and toward which a network user has made a contribution.

Alinta has two key concerns about the manner in which Western Power appears to have treated new facilities investment towards which contributions have been made.

Firstly, although the Regulatory Statements provided by Western Power for the 2007/08 financial year indicate that it received more than $155 million in capital contributions in that year alone, it does not appear to have separately identified the amount of new facilities investment that is to be added to the capital base under clause 6.51A(b).

Consequently, Alinta considers that Western Power should be required to provide information on the amount and nature of new facilities investment that is to be added to the capital base under clause 6.51A(b) of the Code, in order to allow the Authority to approve that amount of new facilities investment to be added to the capital base for the next access arrangement period following an assessment as to whether the amount of meets the requirements of clause 6.51A(b).

Secondly, and as discussed in preceding sections, the information provided by Western Power in support of its Proposed Access Arrangement raises questions as to whether it is determining the required amount of capital contributions by applying the new facilities investment test as required by clause 5.14 of the Code. A case in point is the information provided in respect of the future connection of the Binningup Desalination Plant, which makes no reference to the new facilities investment test having been undertaken for the dedicated network connection asset.

Similarly, the adjustments made by the Authority in its Draft Determination on whether the 66/11 kV medical centre zone substation expansion and voltage conversion of the distribution network provided satisfied the new facilities investment test would have a material impact on the quantum of the capital contribution that Western Power could require to be made towards the project if upheld in the final determination.

For these reasons, and as discussed in more detail in the section on the current capital contributions policy, Alinta is concerned that where Western Power requires a capital contribution from an applicant, in many cases it has not demonstrated that the contribution reflects only the extent to which the new facilities investment does not meet the new facilities investments test as required by the Code.

Summary

Network users are entitled to be assured that Western Power is complying with the requirements of the Code. Given the relative newness of the Code, Alinta believes it is now opportune for the Authority to undertake a detailed review of a representative sample of Western Power's new facilities investment during the current access arrangement period (say around 15 to 20 per cent in aggregate) in order to determine whether the amount of new facilities investment that Western Power proposes to add to the capital base meets the requirements of the Code to be added to the capital base.

Submissions are invited from interested parties on whether information provided by Western Power in the revised access arrangement information is sufficient for the Authority to be satisfied that the forecast new facilities investment may be reasonably expected to either meet the new facilities investment test, or the test under section 6.51A(b) of the Access Code where the new facilities investment has been financed by contributions.

Western Power provides a detailed overview of its forecast capital expenditure (i.e. forecast new facilities investment) in Appendix 1. However, Alinta considers that the issues raised in the preceding section with respect to new facilities investment undertaken in the current access arrangement period are equally applicable in the context of the Authority considering Western Power forecast new facilities for the next access arrangement period.

Firstly, Western Power does not appear to have separately identified:

- the amount of forecast new facilities investment that it considers may be reasonably expected to meet the new facilities investment test [clause 6.51A(a)]; and
- the amount of new facilities investment that it is seeking the Authority approve under clause 6.51A(b) of the Access Code.

Secondly, for forecast new facilities investment that Western Power reasonably expects will satisfy the new facilities investment test, and hence wishes to add to the capital base under clause 6.51A(a), Alinta makes the following observations.

- It is not clear that Western Power's forecast new facilities investment does not exceed the amount that would be invested by a service provider efficiently minimising costs [as required by clause 6.52(a), the 'first leg' of the new facilities investment test].
- Western Power does not appear to have identified to what extent the forecast new facilities investment is justified under each of the three elements of the second leg of the new facilities investment test:
  - If some or all of the new facilities investment is justified under the incremental revenue test of the second leg of the new facilities investment test [i.e. clause 6.52(b)(i)], the information provided by Western Power will need to identief the amount of incremental revenue associated with the facility, and hence demonstrate the requirements of clause 6.52(b)(i) may be reasonably expected to be satisfied.
  - If some or all of the new facilities investment is justified under the net benefit element of the second leg of the new facilities investment test [i.e. clause 6.52(b)(ii)], Western Power will need to demonstrate that the value of the net benefit is reasonably expected to be at least equal to the amount of new facilities investment.
  - If some or all of the new facilities investment is justified under the safety and reliability element of the second leg of the new facilities investment test [i.e. clause 6.52(b)(iii)], Western Power will need to demonstrate that the value of the new facilities investment that is necessary to maintain safety and reliability of the network or its ability to provide covered services is reasonably expected to be at least equal to the amount of new facilities investment.

As a result, Alinta considers that the information provided by Western Power does not demonstrate that proposed new facilities investment during the next access arrangement period meet the requirements of the Code to be added to the capital base under either clause 6.51A(a) (the new facilities investment test) or the test under clause 6.51A(b) where the new facilities investment has been financed by contributions.

Submissions are invited from interested parties on the change in treatment of capital contributions that is proposed by Western Power.

Alinta does not support Western Power's proposal to change the manner in which is treats capital contributions.

For the current access arrangement period, Western Power elected to add capital contributions to its capital base and deduct the amount of the contribution from the target revenue amount. For the next access arrangement period, Western Power proposes to <u>exclude</u> the amount of the capital contribution from its capital base and to also <u>not</u> adjust the amount of target revenue to account for the amount of the contribution.

Alinta notes that the Authority estimated that the change in treatment of capital contributions increases the target revenue (in present value terms) for the period covered by the proposed revised access arrangement over the full amount of target revenue under the previous treatment of capital contributions by approximately 15 per cent for transmission services and 17 per cent for distribution services.

Alinta has in the past expressed its concern that Western Power's current treatment of capital contributions would give rise to cross-subsidies between present and future users of the network. For example, a network user that is about to retire plant is likely to experience improved performance from the system due to the new investment, and also benefit from lower network charges in the year the capital contribution was made. These lower network charges would be offset by future network users paying higher network charges that arise from the higher capital base.

It is Alinta's view that Western Power should not have elected to treat capital contributions in the manner it presently does. Nevertheless, having elected to adopt a particular treatment for capital contributions, Alinta considers that Western Power should not be allowed to unilaterally change the manner in which capital contribution are treated, particularly given doing so would result in a material increase in network charges and has a neutral financial effect on Western Power.

Alinta notes that Western Power's proposal to change the manner in which is treats capital contributions results in a substantial price shock, requiring a sudden material adjustment in network charges between successive years, which appears inconsistent with the Code objective and requirements.

Western Power indicates that its proposal to change the manner in which is treats capital contributions follows advice from its economic consultants, NERA. Alinta considers that given the effect that the proposal would have on network prices, the Authority should require Western Power to make NERA's report public.

In addition, Alinta considers that Western Power should be required to demonstrate that its proposal to change the manner in which is treats capital contributions better achieves the Code objective when compared to the status quo, and support its analysis with a rigorous cost benefit assessment (including the identification of transfers between affected parties).

(Although discussed further below, it is relevant to note here that Alinta also considers that Western Power's proposal to defer a portion of target revenue resulting from the change in the treatment of capital contributions is not permitted under the Code.)

Submissions are invited from interested parties on the rate of return (WACC), and various parameters, proposed by Western Power.

Alinta does not support Western Power's proposal to keep confidential the agreed date and sampling period over which the values of capital market parameters (the number of trading days over which the average values of the risk free rate and debt margins) are to be determined.

Firstly, as noted by the Authority, there is no provision within the Code that provides for this information to be kept confidential. Secondly, Alinta does not consider Western Power would be commercially disadvantaged if this information were public. Alinta believes that ensuring this information is public would promote transparency in the price setting process.

Alinta also notes that the values of the parameters used by Western Power to derive its WACC differ markedly from that used by the AER in its draft revenue proposal determinations for TransGrid and Transend, which were published in late October and November 2008 respective (refer Table 4).

Table 4 Transmission WACC parameters

	TransGrid's proposal	AER draft determination	Transend's proposal	AER draft determination	Western Power Proposed
Date	26 Jun 08	**31 Oct 08**	31 May 2008	**21 Nov 08**	8 Oct 2008
Risk-free rate (nominal)	5.70%	**5.46%**	6.37%	**5.27%**	6.45%
Risk-free rate (real)	3.10%	**2.84%**			3.62%
Expected inflation rate	2.52%	**2.55%**	2.54%	**2.55%**	2.73%
Debt risk premium	1.75%	**3.27%**	3.13%	**3.28%**	3.366%-3.658%
Market risk premium	6.00%	**6.00%**	6.00%	**6.00%**	6.00-7.00%
Gearing	60%	**60%**	60%	**60%**	60%
Equity beta	1	**1**	1	**1**	0.9-1.1
Value of imputation credits	0.5	**0.5**	0.5	**0.5**	0-0.5

Source: AER 2008, *TransGrid transmission determination 2009–10 to 2013–14*, Draft decision, 31 October 2008, p.xix and AER 2008, *Transend transmission determination 2009–10 to 2013–14*, Draft decision, 21 November 2008, pp.14-15.

Using the values parameters proposed by Western Power generates possible (pre-tax Officer) WACC values ranging from 8.5 per cent to 11.1 per cent. However, if the values determined by the AER in its most recent draft revenue proposal determination for Transend were used instead, Alinta estimates that the (real pre-tax Officer) WACC would instead be 7.7 per cent.

Given the significant changes in the economic environment, Alinta expects the Authority will review the value of the WACC input parameters used by Western Power in calculating the proposed WACC.

Alinta also expects that the Authority will have regard to the AER's recent review of WACC parameters, which relied on information gained from fourteen submissions to an Issues Paper published in August 2008, and comments made during a 'round table' of finance experts where the AER clarified specific matters in consultant reports submitted by the industry associations to the Issues Paper.

Alinta notes that as a result of the review, the AER is proposing to retain a market risk premium of six percent, but to reduce the equity beta to 0.8, increase the credit rating (used to calculate the debt risk premium) from BBB^+ to A^-, and increase the value of imputation credits ('gamma') to 0.65. Ignoring the effect of the change in credit rating, the reduction in the equity beta and the value of imputation credits ('gamma') alone would decrease the (real pre-tax Officer) WACC calculated by the AER for Transend to 6.9 per cent.

Alinta notes that a (real pre-tax Officer) WACC of 6.9 per cent would still represent an increase to Western Power's existing WACC of 6.76 per cent.

Price control

Submissions are invited from interested parties on changes proposed by Western Power to the price control, including:

- *application of the price control only to revenue from reference services; and*
- *the revised side constraint on year-to-year changes in reference tariff charges.*

Form of price control

The form of price control in Western Power's Proposed Access Arrangement sets a smoothed target revenue amount for each year of the next access arrangement period, with the present value of the revenue stream being set equal to present value of its costs over the next access arrangement period.

As noted earlier, Alinta believes that the information provided by Western Power as part of its Proposed Access does not currently enable an assessment to be made as to whether:

- the actual level of non-capital costs for the current access arrangement period is consistent with Western Power efficiently minimising costs as required by the Code; or
- the amount of new facilities investment during the current access arrangement period satisfies the requirements of either clause 6.52(b) or 6.56 of the Code.

While the Authority should assess in detail whether Western Powers non-capital expenditure and new facilities investment are consistent with the Code requirements, it faces significant information asymmetries in doing so.

In addition, Alinta notes that the overall revenue cap form of price control proposed by Western Power is the same as that which applied during the current access arrangement period, which appears to have provided no explicit incentive for it to efficiently reduce costs. Alinta considers it would not be unreasonable to conclude that the failure of the current form of price control is reflected in the increase in Western Power's estimated actual non-capital network costs of around $140 million during the current access arrangement compared with that approved by the Authority in March 2007.

Alinta considers that applying a 'CPI-X' form of price control, with the 'X' component providing an incentive for efficiency savings, may be more effective in achieving the Code objective. Under this approach, a smoothed target revenue amount could be determined for each year of the next access arrangement period, where the net present value of the smoothed target revenue would be below the present value of Western Power's total costs. This form of price control would be consistent with clause 6.2 (as the target revenue is set with reference to Western Power's total costs), but Alinta believes it would better incentivise Western Power to achieve dynamic efficiencies in the delivery of reference services.

Alinta considers that the proposed inclusion of a gain sharing mechanism in the Proposed Access Arrangement for the next access arrangement period does not reduce the need for Western Power to be appropriately incentivised to achieve efficiency savings through applying a 'CPI-X' form of price control to target revenue.

Application of price control

Alinta does not support Western Power's proposal to exclude non-reference services from the revenue cap price control, as it considers this approach is not consistent with the requirements of the Code.

Specifically, clause 6.2 of the Code requires that, whatever its form, the price control must set the amount of target revenue, which is defined in clause 6.4(a)(i) as the revenue that meets the forward-looking and efficient costs of providing "covered services". In turn, "covered services" are defined as including "non-reference services". The effect of the Code provisions appears to be that revenue from non-reference services must be included in target revenue, which in turn must be set through a price control.

Alinta considers that the "price control" Western Power suggests would apply to non-reference services in the next access arrangement period (that is, its criteria for determining charges for non-reference services in clause 5.1(b) of its access arrangement) does not satisfy the Code requirements for price controls, which are detailed in clause 6.2 of the Code.

Adjustments to target revenue in the next Access Arrangement Period

Submissions are invited from interested parties on proposed revisions to the access arrangement to allow adjustments to target revenue in the next access arrangement period, including by:

- *the proposed gain sharing mechanism;*
- *the proposed service standards adjustment mechanism;*
- *the deferral of revenue; and*
- *the "D factor Scheme".*

Gain sharing mechanism

In principle, Alinta supports the inclusion of a gain sharing mechanism in the access arrangement for the next access period provided it establishes an incentive for Western Power to reduce costs and/or otherwise improve its productivity.

However, Alinta is concerned that there appear to be a number of ambiguities in the Code with respect to the gain sharing mechanism that should be considered and clarified by the Authority. For example, the Code establishes:

- an amount that results from innovation and efficiency gains in excess of specified efficiency and innovation benchmarks (clause 6.21); and
- a 'surplus' that reflects the extent to which returns actually achieved from the sale of covered services during the previous access arrangement period exceeded that forecast (clause 6.23).

Clause 6.25 of the Code then requires the Authority to determine how much (if any) of the 'surplus' (defined in clause 6.23) results from efficiency gains or innovation by the service provider in excess of the efficiency and innovation benchmarks (the amount determined by clause 6.21) in the previous access arrangement (with the determined amount referred to as the 'above-benchmark surplus').

Clause 6.27 of the Code requires that the Authority apply the gain sharing mechanism to determine how much (if anything) is to be added to the target revenue in order to enable Western Power to continue to share in the benefits of the efficiency gains or innovations which gave rise to the 'surplus'.

The Code appears to be unclear with respect to the amount that is to be available to Western Power under the gain sharing mechanism. It appears it could be at least either:

- the amount by which innovation and efficiency gains exceed the efficiency and innovation benchmarks (i.e. the clause 6.21 amount, which is the interpretation that appears to have been applied by Western Power in its proposed Access Arrangement); or
- the 'above-benchmark surplus' that is to be determined by the Authority (i.e. the clause 6.25 amount, which may be less than the clause 6.23 amount).

Alinta's view is that the latter approach is consistent with the requirements of the Code as it recognises that Western Power's performance with respect to the specified efficiency and innovation benchmarks may be influenced by factors other than its own efforts (and therefore links the surplus available to the overall level of covered services provided by Western Power).

For example, under the gain sharing mechanisms proposed by Western Power, the amount available to Western Power may not reflect only the amount by which the efficiency and innovation benchmarks were exceeded due to its efforts. Specifically, it would appear that a decline in economic activity that leads to lower electricity demand, and hence lower operating and maintenance costs (without impacting on service levels), may give rise to a benefit to Western Power under the proposed gain sharing mechanism (which would then lead to an increase in the target revenue in future access arrangement periods).

In any event, Alinta considers that Western Power's proposed gain sharing mechanism does not meet the requirements of clause 6.22 as it is does not prescribe the basis on which returns in clause 6.23 are to be determined.

Service Standards Adjustment Mechanism

Alinta does not support the Service Standards Adjustment Mechanism (SSAM) as proposed by Western Power in its proposed Access Arrangement.

Western Power claims that there is:

> *Limited scope to improve performance beyond target levels…[and that] in these circumstances the function of SSAM is to provide a means for ensuring Western Power makes a tangible financial commitment to delivering the target level of performance, as opposed to driving service improvements (p.181).*

Alinta notes that despite significant increases in distribution non-capital expenditure and new facilities investment over that forecast for the current access arrangement period, there were no material improvement in network performance standards during the current access arrangement period. In addition, Western Power is not proposing any material changes in service performance standards for its transmission network, and only modest improvements in distribution network performance. This is despite a significant increase in new facilities investment for the next access arrangement period.

For these reasons, the probability of Western Power not achieving its benchmarks and the probability of it exceeding the benchmarks are not symmetrical. The probability that Western Power will not achieve its benchmarks is much lower than the probability it will exceed the benchmarks. In fact, Western Power implies that there should not be a strong incentive for it to improve its performance above the proposed benchmarks.

In these circumstances, Alinta considers it would be appropriate for the SSAM to also be asymmetrical, resulting in a higher penalty for underperformance, compared to the reward available to Western Power if service performance standards are exceeded. For example, if Western Power under performed relative to the benchmark by 10 per cent, the penalty might be say $2 million, whereas if it out performed the benchmark by 10 per cent, the reward might be $1 million. An asymmetrical SSAM would provide a much stronger incentive for Western Power to at least meet its performance standard benchmark targets.

In addition, Alinta considers that the SSAM proposed by Western Power places too small an amount of revenue at risk (in aggregate just $7.3 million or 0.5 per cent of revenue), and is therefore unlikely to provide a sufficiently strong incentive for it to at least meet the proposed system performance benchmarks.

Alinta believes that the amount of revenue at risk with respect to distribution system performance standards should be increased to more effectively incentivise Western Power to achieve its performance standard benchmark targets. Ultimately, Alinta agrees with Western Power's observation that the amount of revenue at risk should bear some relationship to the value that customers place on the incremental change in reliability.

In addition, Alinta considers that the SSAM should cap only the aggregate penalty for under performance (rather than for under performance with respect to each benchmark), but should cap rewards for each benchmark. Again this structure would better reflect the asymmetrical probabilities associated with achieving and not achieving network performance at least equivalent to the benchmarks.

Deferral of revenue

Alinta does not support Western Power's proposal to defer a portion of target revenue from one access arrangement period into future access arrangement periods in order to reduce the increase in network charges in the earlier access arrangement period.

Western Power has indicated that its proposal to defer revenue into future access arrangement periods is intended to manage the increase in network charges that would otherwise be necessary in the next access arrangement period due to:

- the change in its treatment of capital contributions; and
- substantial increases in its forecast non-capital expenditure and new facilities investment.

As noted by the Authority in its Issues Paper, clause 6.4(a) of the Code, which establishes how 'target revenue' is to be determined, does not contemplate adjustments to permit for the discretionary deferral of revenue to a later access arrangement period (nor for the inclusion of previously deferred target revenue in a later access arrangement period) as is proposed by Western Power.

Consequently, it appears that the merits of allowing an adjustment to target revenue between access arrangement periods for the reason proposed by Western Power would need to be considered through a Code amendment process, even if the proposal is intended to avoid price shocks between successive years [and therefore on face value appears not to be inconsistent with the intention of clause 6.4(c)].

An implicit conclusion that may be drawn from Western Power's proposal to defer a portion of target revenue to a later access arrangement period is that the magnitude of the increase in network charges that would otherwise be required is inconsistent with the Code requirements and/or objective.

Alinta believes this to be the case, and for this reason would not support an amendment to the Code to allow a discretionary portion of target revenue to be deferred from one access arrangement period into future access arrangement periods, as this would appear to result in the Code objective being circumvented.

Alinta is also concerned that if the Code were to permit the discretionary deferral of target revenue from an access arrangement period into a future access arrangement period simply to reduce the increase in network charges, it may unreasonably impede the ability of the Authority to consider future access arrangement proposals on their individual merit.

"D" factor scheme

Alinta does not support the inclusion of a "D" factor scheme as proposed by Western Power, which would adjust target revenue in a future access arrangement for:

- any additional non-capital expenditure incurred as a result of deferring or avoiding a capital expenditure project; and
- any additional non-capital or capital expenditure incurred in relation to demand management initiatives.

Alinta notes that the Authority's Issues Paper comments that there is no explicit contemplation within the existing Code for an adjustment to target revenue between access arrangement periods for the reasons proposed by Western Power. Consequently, it appears that the merits of allowing an adjustment to target revenue between access arrangement periods for the reasons proposed by Western Power under the "D" factor scheme should be the considered through a Code amendment process.

Alinta considers that the "D" factor scheme proposed by Western Power would provide it with too much flexibility, and is likely to weaken incentives for it to ensure that it is able to deliver its forecast capital works (new facilities investment) within an access arrangement period.

Alinta is also concerned that the "D" factor scheme proposed by Western Power may enable it to compete unfairly with retailers, who are already offering demand side management products to customers, as it would allow Western Power to 'smear' the cost of demand management initiatives across of SWIN users.

Finally, Alinta is concerned that if the Code permitted the adjustment of target revenue as proposed by Western Power under the "D" factor scheme, it may unreasonably impede the ability of the Authority to consider future access arrangement proposals on their individual merit.

Applications and Queuing Policy

Submissions are invited from interested parties on the operation of the applications and queuing policy in the current access arrangement period and whether any revisions to this policy, in addition to those proposed by Western Power, are required to meet the requirements of the Access Code.

Current Applications and Queuing Policy

Alinta notes that the queuing rules under the current Applications and Queuing Policy (AQP) generally operate on a "first come, first served" basis, although there is provision for "bypass" of connection applications.

However, Alinta is concerned that the existing queuing rules, in combination with the Capital Contribution Policy, may inhibit the efficient entry of generators into the market, create barriers to entry in markets upstream and downstream of the network, and have a negative impact on competition on those markets.

These outcomes may arise as connection costs (and hence capital contributions) under the current policies are highly likely to be dependent on the place of a prospective generator's connection application in the connection queue. The costs of connecting a generator to the network are likely to be highly dependent on the place in the queue. Consequently, entry into the generation market may be materially affected by when a generator lodged a connection application, rather than by its economic efficiency.

Proposed Revised Applications and Queuing Policy

<u>Definitions</u>

Alinta does not support the amendment of clause 3.2 and the addition of a definition of 'complete' in the AQP as proposed by Western Power.

The existing AQP requires that the applicant use reasonable endeavours to accurately and completely address each item in the application form (Clause 3.2). The proposed new definition of 'complete' in relation to an application or a notice in the revised APQ is subject to Western Power being satisfied that the application or notice is complete.

Alinta is concerned that the inclusion of the proposed definition of 'complete' (and the amendment of Clause 3.2) creates uncertainty as it will be Western Power that determines when an application or notice is 'complete'.

<u>Clause 4.9 Security</u>

Alinta does not support Western Power's proposal to revise the AQP to included the proposed clause 4.9(c) which would allow it to require a user to provide an irrevocable and unconditional bank guarantee (or equivalent financial instrument), despite a user having at least the unqualified credit rating prescribed by clause 4.9(b).

The inclusion of the proposed clause 4.9(c) would be inconsistent with the intent of clause 4.9(b), which provides that where an applicant has an unqualified credit rating of at least BBB from Standard and Poor's Australia Pty Ltd; or Baa from Moody's Investor Service Pty Ltd, Western Power cannot require an indemnity or guarantee on the basis that there is a risk the applicant will not be able to meet its liabilities under an access contract.

Alinta considers that the proposed clause 4.9(c) creates uncertainty as to how the security provisions of the APQ would operate, and would therefore not meet the Code objectives.

Contributions Policy

Submissions are invited from interested parties on operation of the capital contributions policy during the current access arrangement period and on Western Power's proposed revisions to the capital contributions policy.

Current Capital Contributions Policy

Alinta considers that Western Power's current approach with respect to capital contributions may lead to inefficient generation market entry, create barriers to entry in markets upstream and downstream of the network, and have a negative impact on competition on those markets.

The existing "deep approach" to capital contributions that has been adopted by Western Power can impose a significant financial burden on new generators. For example, connection costs that Western Power seeks to recover from new generators through capital contributions may include costs it claims are necessary to reinforce the broader network, including for example providing reactive power deep within the network.

Under the "deep approach" to capital contributions, inefficient new generators may connect to the network because connections costs (and capital contributions) are highly dependent on the plant's position in the connection queue (which is governed by the Applications and Queuing Policy). The costs of connecting a generator to the network are likely to be highly dependent on the place in the queue. Consequently, generation market entry may be determined by when a plant lodged its electricity transfer application or connection application, rather than by its efficiency.

Alinta believes that the Capital Contributions Policy should be brought into line with the approach taken in other jurisdictions (nationally and internationally), by adopting a "shallow approach" to establishing connection costs for new generators seeking connection to the network. If demand for electricity is sufficient to justify the entry of new generators, then the costs associated with, for example providing reactive power works, should be shared among all network users. Moving the cost of such shared assets into common infrastructure promotes competition in generation, and would assist in supporting more efficient generation investment.

Alinta notes that the new facilities investment test also recognises that network users may receive a net benefit through the connection of new generators to the network, and the Code requires that any contributions be limited to the extent that any part of the new facilities investment does not meet the test.

As commented in detail in the section discussing the Western Power's new facilities investment during the current access arrangement period, Alinta is concerned that, where Western Power requires a capital contribution from an applicant, in many cases it has not demonstrated that the contribution reflects only the extent to which the new facilities investment does not meet the new facilities investments test.

Further evidence is Western Power's current capital contributions policy is potentially not being applied in a manner that is consistent with the Code requirements is the Authority's Draft Determination on whether the 66/11 kV medical centre zone substation expansion and voltage conversion of the distribution network provided satisfied the new facilities investment test. The adjustments made by the Authority would appear to have a material impact on the quantum of the capital contribution that Western Power could require to be made towards the project.

For these reasons, Alinta considers that the contributions policy should require Western Power to provide evidence that the new facilities investment test has been applied, and that the amount of the capital contribution sought by Western Power is consistent with the requirements of the Code.

Proposed Revised Contributions Policy

As noted above, Alinta considers that the contributions policy should require Western Power to demonstrate that the new facilities investment test has been applied to any new facilities investment, and that the amount of the contribution sought by Western Power from an applicant reflects only the extent to which any part of the new facilities investment does not meet the test.

<u>Clause 4.3(a) and 4.3(b) Applicant must provide security for new revenue</u>

The amendments proposed by Western Power to clauses 4.3(a) and 4.3(b) appear designed to give it much broader discretion in determining the period for which an applicant is required to provide a bank guarantee (or equivalent).

The current clause could require an applicant to provide a bank guarantee (or equivalent) for up to 24 months (where the forecast costs of network connection is greater than $50,000), after which time Western Power is permitted to re-determine and adjust the amount of the contribution required to be made by the applicant.

However, with the proposed amendments, and where the forecasts costs of network connection are greater than $50,000 but less than $1 million, clause 4.3(a) would allow Western Power to require that a bank guarantee (or equivalent) guaranteeing the revenue that was used to calculate the amount of the contribution be maintained for a period of 24 months (in place of the current 12 months):

> *"…or other period as reasonably determined by Western Power acting as a reasonable and prudent person".*

Following 12 months, the (amended) clause 4.3(b)(ii) would also allow Western Power to:

> *"…require the applicant to maintain the bank guarantee or equivalent financial instrument for a further 12 months , (or other period as reasonably determined by Western Power acting as a reasonable and prudent person)"*

Alinta does not support the proposed amendments to clauses 4.3(a) and 4.3(b). The potentially open-ended obligation to provide bank guarantees to Western Power that could result from the proposed amendments have the potential to impose material (and unquantifiable) costs on applicants.

Alinta considers that the proposed amendments create barriers to entry in markets upstream and downstream of the network, and have a negative impact on competition on those markets.

<u>Clause 4.3(c) Applicant must provide security for new revenue</u>

Alinta does not support the proposed additional clause 4.3(c), which would allow Western Power, where the forecasts costs of network connection are equal or greater than $1 million, to require an applicant to provide a bank guarantee (or equivalent) guaranteeing the revenue that was used to calculate the amount of the contribution.

Alinta is concerned that clause 4.3(c) would require network users to provide a security equivalent to the net present value for up to 20 years worth of network charges. The proposed clause also contains no limitations on the period for which Western Power may require an applicant to provide a bank guarantee (or equivalent).

The potential magnitude, and open-ended nature, of the bank guarantee to be provided to Western Power that could result from the proposed amendments have the potential to impose material (and unquantifiable) costs on prospective network users.

Alinta considers that the proposed clause 4.3(c) would create material barriers to entry in markets upstream and downstream of the network, and would have a negative impact on competition on those markets.

<u>Clause 5.2 Calculation of the contribution</u>

Given the Code limits the amount of any contribution sought by Western Power from an applicant to the extent that any part of the new facilities investment does not meet the test, Alinta considers that the Contributions Policy should require Western Power to provide, on request of the applicant, a copy of the calculation (as per clause 5.2) used to calculate the amount of the contribution the applicant must make.

Alinta Sales Pty Ltd
17 December 2008