

# Determination on the Proposed 2010/11 Price List for Western Power's Covered Electricity Network

Submitted by Western Power

14 May 2010

Economic Regulation Authority

 WESTERN AUSTRALIA

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## DETERMINATION

1. On 27 April 2010, Western Power submitted a proposed 2010/11 price list for its network to the Economic Regulation Authority (**Authority**) for approval under Chapter 8 of the *Electricity Networks Access Code 2004* (**Access Code**).<sup>1</sup>
2. Western Power's proposed price list has been submitted under terms of the amended access arrangement that applies to Western Power's electricity network for the second access arrangement period (2009/10 to 2011/12), which commenced on 1 March 2010.<sup>2</sup>
3. The Authority has assessed the proposed 2010/11 price list and considers that the proposed price list complies with the price control and pricing methods of the amended access arrangement.
4. The Authority notes that the proposed price list for 2010/11 introduces new compact fluorescent lamp (**CFL**) streetlight options, with three new light specifications (42W CFL SE, 42W CFL BH, 42W CFL KN) available for users on the RT9 "streetlighting" reference tariff.<sup>3</sup> Western Power indicates that the introduction of CFL options is in response to demand from customers and changes to the Australian standard for road and public space lighting (AS 1158.6:2010).<sup>4</sup> The fixed asset charges for the new CFL options range from 21.152 cents per day to 25.335 cents per day. The Authority observes that the new CFL options are in addition to the existing options offered under previous price lists.
5. The Authority also observes that section 6 of Western Power's proposed price list contains a list of fees referred to as "non-reference service tariffs". This determination does not apply to these stated fees/tariffs, as the Authority is not required to assess or approve such fees/tariffs as part of its price list determination.
6. In accordance with the requirements of section 8.2 of the Access Code, the Authority approves the 2010/11 proposed price list and determines that this price list has effect from 1 July 2010. The Authority has published the proposed price list and price list information on its website.<sup>5</sup>

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<sup>1</sup> Western Power, 27 April 2010, 2010/11 Price List and 2010/11 Price List Information.

<sup>2</sup> Western Power, 24 December 2009, Amended Proposed Revisions to the Access Arrangement for the South West Interconnected Network owned by Western Power (hereafter cited as "**amended access arrangement**"). The amended access arrangement was approved by the Authority on 19 January 2010, with a commencement date of 1 March 2010.

<sup>3</sup> Western Power, 27 April 2010, 2010/11 Price List, section 5.11 (Table 18).

<sup>4</sup> Western Power, 27 April 2010, 2010/11 Price List Information, section 1.2.2.

<sup>5</sup> Economic Regulation Authority website: [http://www.erawa.com.au/2/486/48/price\\_determina.pm](http://www.erawa.com.au/2/486/48/price_determina.pm)

## REASONS

### Access Code Requirements

7. Chapter 8 of the Access Code sets out requirements for a service provider to submit proposed price lists, and for the Authority to approve and publish the proposed price lists and related price list information.

#### **Approval of price lists if required**

- 8.1 If a service provider's access arrangement requires it to submit price lists to the Authority for approval, the service provider must, at least 45 business days before the start of each pricing year (except for the first pricing year), submit to the Authority:

- (a) a proposed price list to apply for the next pricing year; and
- (b) price list information.

- 8.2 If the Authority considers that a service provider's proposed price list complies with:

- (a) the price control in the service provider's access arrangement; and
- (b) the pricing methods in the service provider's access arrangement,

then the Authority must:

- (c) approve and publish the service provider's proposed price list which has effect from a date specified by the Authority; and
- (d) publish the service provider's price list information.

- 8.3 The Authority must not approve a service provider's proposed price list if the proposed price list does not comply with sections 8.2(a) and 8.2(b), and must notify the service provider that it does not approve the proposed price list and provide reasons.

- 8.4 If a service provider is notified under section 8.3 that the Authority does not approve a proposed price list submitted by the service provider, the service provider may at any time submit a revised proposed price list to the Authority.

- 8.5 If the Authority:

- (a) notifies a service provider under section 8.3 that it does not approve a proposed price list submitted by the service provider; and
- (b) has not approved a revised proposed price list,

then the price list most recently in effect continues in effect until the Authority approves a revised proposed price list submitted by the service provider under section 8.4.

- 8.6 If the Authority has not notified a service provider that it does not approve a proposed price list within 15 business days after receiving either:

- (a) the proposed price list; or

- (b) any further information the Authority has requested in relation to the proposed price list,

(whichever is later), then the Authority is to be taken to have approved the price list.

### **Publication of price lists if approval not required**

8.7 If a service provider's access arrangement does not require it to submit price lists to the Authority for approval, the service provider must, at least 25 business days before the start of each pricing year (except for the first pricing year), submit to the Authority a copy of:

- (a) a price list to apply in respect of the next pricing year which complies with:
  - (i) the price control in the service provider's access arrangement; and
  - (ii) the pricing methods in the service provider's access arrangement;and
- (b) price list information.

8.8 Where a service provider submits a price list and price list information to the Authority under section 8.7, the Authority must publish the price list and price list information.

## **Proposed Price List Submission**

- 8. Clause 3.10 of Western Power's amended access arrangement requires it to submit to the Authority a proposed price list, together with price list information at least 45 business days before the start of each pricing year (except for the first pricing year).
- 9. On 27 April 2010, Western Power submitted a proposed 2010/11 price list and price list information to the Authority. Western Power has also provided the Authority with confidential spreadsheets containing additional supporting information and calculations to indicate the forecast of revenue associated with the proposed price list.

## **Compliance of the Proposed Price List with the Price Control**

### ***Specification of the Price Control under the Access Arrangement***

- 10. Under the Access Code, "price control" refers to the provisions of an access arrangement that determine the target revenue to be earned by the service provider, enable users to predict likely annual changes in target revenue during the access arrangement period, and aim to avoid price shocks (material tariff adjustments between succeeding years).
- 11. Clauses 5.25 to 5.48A of the amended access arrangement establish revenue cap price controls for each of the transmission and distribution networks. The operation of these price controls within an access arrangement period is set out in clauses 5.35 to 5.37A and 5.46 to 5.48A of the amended access arrangement as follows.

- 5.35 For this access arrangement period, the maximum transmission reference service revenue  $MTR_t$  is determined as follows:

$$MTR_t = TR_t + AA\#1_t + TK_t$$

Where:

$TR_t$  is the dollar amount in money of the day terms (current prices) for the financial year  $t$  calculated from the dollar amounts (expressed in 30 June 2009 prices) set out in the table below.

**Transmission reference service revenues to be used for calculating  $TR_t$   
(\$ million real as at 30 June 2009)**

	2009/10	2010/11	2011/12
$TR_t$	262.90	332.05	384.34

$TK_t$  is the correction factor calculated in accordance with sections 5.36 and 5.37 of this Access Arrangement, which takes account of any difference between the maximum transmission reference service revenue in financial year  $t-1$  and the actual transmission reference service revenue in financial year  $t-1$ .

$AA\#1_t$  is a positive or negative smoothed amount for the financial year  $t$  calculated to give effect to the following adjustments (if applicable) in accordance with the previous access arrangement:

- Adjusting target revenue for unforeseen events;
- Adjusting target revenue for technical rule changes;
- Investment adjustment mechanism; and
- Capital contributions adjustment mechanism.

For the avoidance of doubt,  $AA\#1_t$  must take account of inflation, the time value of money and estimates (if any) of the above adjustments that have been included in the calculation of  $TR_t$  in this section 5.35 of this Access Arrangement. Western Power will provide model outputs to the Authority to demonstrate that the above smoothed adjustments have been made in accordance with the previous access arrangement.

For the purpose of determining compliance with this revenue cap and calculating  $TR_t$ ,  $TK_t$  and therefore  $MTR_t$ , in each financial year CPI adjustments will be effected by using published CPI data relating to the relevant March quarters.

- 5.36 For financial years commencing on 1 July 2010 and 1 July 2011:

$$TK_t = (MTR_{t-1} - ATR_{t-1}) * (1 + WACC_{pre-tax\ real})$$

Where:

$MTR_{t-1}$  is the maximum reference service revenue for Western Power's transmission network in the previous financial year.

$ATR_{t-1}$  is the actual transmission reference service revenue in the previous financial year as defined in accordance with section 5.29 of this Access Arrangement.

$WACC_{pre-tax\ real}$  is 7.98%.

For the financial year commencing on 1 July 2009,  $TK_t$  will be calculated in accordance with the previous access arrangement.

For the avoidance of doubt, it should be noted that the annual tariff-setting process for financial year  $t$  typically takes place before the end of financial year  $t-1$ . Therefore,  $TK_t$  will need to be estimated in the first instance, and then recalculated in the subsequent financial year when  $ATR_{t-1}$  is known.

5.37 The correction factor,  $TK_t$ , will also apply in the first year of the next access arrangement period to adjust for any difference between maximum transmission reference service revenue and actual transmission reference service revenue, in relation to the financial year commencing on 1 July 2011.

5.37A To manage the overall price increases in this access arrangement period, Western Power has deferred the recovery of some transmission reference service revenue from this access arrangement period to the third or subsequent access arrangement periods. The deferred amount of revenue is \$64.5 million (\$ real as at 30 June 2009) expressed in present value terms as at 30 June 2009. An amount must be added to the target revenue for the transmission network in the third access arrangement period or subsequent access arrangement periods such that the present value (at 30 June 2009) of the total amount added to target revenue (taking account of inflation and the time value of money) is equal to the present value of the deferred transmission reference service revenue (at 30 June 2009). For the avoidance of doubt, the addition to target revenue in the third and subsequent access arrangement periods must leave Western Power financially neutral compared to a situation where transmission reference service revenue deferral had not occurred. The timeframe for recovering deferred revenue will consider the price impact on users of reference services and will be subject to approval by the Authority.

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5.46 For this access arrangement period, the maximum regulated distribution revenue  $MDR_t$  is determined as follows:

$$MDR_t = DR_t + TEC_t + AA\#1_t + DK_t$$

Where:

$DR_t$  is the dollar amount in money of the day terms (current prices) for the financial year  $t$  calculated from the dollar amounts (expressed in 30 June 2009 prices) set out in the table below.

**Distribution reference service revenues to be used for calculating  $DR_t$   
(\$ million real as at 30 June 2009)**

	2009/10	2010/11	2011/12
$DR_t$	389.01	510.49	646.77

$TEC_t$  is any cost incurred by the distribution network for the financial year  $t$  as a result of the tariff equalisation contribution in accordance with section 6.37A of the Code.  $AA\#1_t$  is a positive or negative smoothed amount for the financial year  $t$  calculated to give effect to the following adjustments (if applicable) in accordance with the previous access arrangement:

- Adjusting target revenue for unforeseen events;
- Adjusting target revenue for technical rule changes;
- Investment adjustment mechanism; and

- Capital contributions adjustment mechanism.

For the avoidance of doubt,  $AA\#1_t$  must take account of inflation, the time value of money and estimates (if any) of the above adjustments that have been included in the calculation of  $DR_t$  in this section 5.46 of this Access Arrangement. Western Power will provide model outputs to the Authority to demonstrate that the above smoothed adjustments have been made in accordance with the previous access arrangement.

$DK_t$  is the correction factor calculated in accordance with sections 5.47 and 5.48 of this Access Arrangement, which takes account of any difference between the maximum regulated distribution network revenue in financial year  $t-1$  and the actual regulated distribution network revenue in financial year  $t-1$ .

For the purpose of determining compliance with this revenue cap and calculating  $DR_t$ ,  $DK_t$  and therefore  $MDR_t$ , in each financial year CPI adjustments will be effected by using published CPI data relating to the relevant March quarters.

- 5.47 For financial years commencing on 1 July 2010 and 1 July 2011:

$$DK_t = (MDR_{t-1} - ADR_{t-1}) * (1 + WACC_{pre-tax\ real})$$

Where:

$MDR_{t-1}$  is the maximum regulated revenue for Western Power's distribution network in the previous financial year.

$ADR_{t-1}$  is the actual regulated distribution revenue in the previous financial year as defined in accordance with section 5.40 of this Access Arrangement.

$WACC_{pre-tax\ real}$  is 7.98%.

For the financial year commencing on 1 July 2009,  $DK_t$  will be calculated in accordance with the previous access arrangement.

For the avoidance of doubt, it should be noted that the annual tariff-setting process for financial year  $t$  typically takes place before the end of financial year  $t-1$ . Therefore,  $DK_t$  will need to be estimated in the first instance, and then recalculated in the subsequent financial year when  $ADR_{t-1}$  is known.

- 5.48 The correction factor,  $DK_t$ , will also apply in the first year of the next access arrangement period to adjust for any difference between maximum distribution reference service revenue and actual distribution reference service revenue, in relation to the financial year commencing on 1 July 2011.
- 5.48A To manage the overall price increases in this access arrangement period, Western Power has deferred the recovery of some distribution reference service revenue from this access arrangement period to the third or subsequent access arrangement periods. The deferred amount of revenue is \$484.2 million (\$ real as at 30 June 2009) expressed in present value terms as at 30 June 2009. An amount must be added to the target revenue for the distribution network in the third access arrangement period or subsequent access arrangement periods such that the present value (at 30 June 2009) of the total amount added to target revenue (taking account of inflation and the time value of money) is equal to the present value of the deferred distribution reference service revenue (at 30 June 2009). For the avoidance of doubt, the addition to target revenue in the third and subsequent access arrangement periods must leave Western Power financially neutral compared to a situation where revenue deferral had not occurred. The timeframe for recovering deferred revenue will consider the price impact on users of reference services and will be subject to approval by the Authority.

12. Related to the price control is a “side constraint” that limits the extent to which component charges of reference tariffs may be increased or decreased from one pricing year of the access arrangement period to the next. Clauses 3.10A and 3.11 of the amended access arrangement establishes side constraints on price changes that allows reference tariff charges to change by a factor of plus or minus (+/-):
- “CPI + 13 percentage points for the transmission network”; and
  - “CPI + 18 percentage points for the distribution network”.<sup>6</sup>

### Reference Service Revenue

13. Western Power has set out its determination of maximum transmission reference service revenue ( $MTR_t$ ) and maximum distribution reference service revenue ( $MDR_t$ ) in sections 2.1.1 and 2.1.2 of the price list information respectively.

### Transmission Services

14. Western Power’s derivation of the reference service revenue for transmission services is indicated in Table 1 below.

**Table 1 Western Power’s determination of maximum transmission regulated revenue for 2010/11**

Calculation Parameter	Value (\$million)	Source
Revenue cap ( $TR_{2010/11}$ , dollar values of 30 June 2009)	332.1	Amended Access Arrangement, clause 5.35
Correction factor ( $TK_{2010/11}$ , dollar values of 30 June 2009)	-6.1	2010/11 Price List Information, section 2.1.1 (Table 3)
<b>Maximum regulated transmission revenue (<math>MTR_{2010/11}</math>, dollar values of 30 June 2009)</b>	<b>325.9</b>	
<i>Inflation factor</i>	1.031	2010/11 Price List Information, section 2.1.3 (Table 8)
<b>Reference service revenue (nominal dollar values)</b>	<b>336.1</b>	

15. Western Power has provided to the Authority on a confidential basis a model containing the calculations used to derive the correction factor (K).<sup>7</sup>
16. The correction factor for transmission ( $TK_t$ ) is calculated from required and collected revenues from previous pricing years and is indicated (showing only the two previous pricing years) in Table 2 below.<sup>8</sup> The correction factors for 2009/10 ( $TK_{2009/10}$ ) and 2010/11 ( $TK_{2010/11}$ ) were derived by applying a weighted average cost

<sup>6</sup> The actual side constraint is plus or minus (+/-) the total of the percentage change in the CPI, plus 13 or 18 percentage points for the transmission or distribution network respectively. The CPI is the CPI (weighted average for eight capital cities) for the most recent December quarter compared to the December quarter in the previous year.

<sup>7</sup> Western Power, 27 April 2010, K Factor Model (confidential).

<sup>8</sup> Western Power, 2010/11 Price List Information, section 2.1.1 (Tables 2 and 3).

of capital (**WACC**) of 7.98 per cent, as approved in the amended access arrangement for the second access arrangement period.<sup>9</sup> The correction factors prior to 2009/10 were derived by applying a WACC of 6.76 per cent, which applied under the access arrangement for the first access arrangement period.

**Table 2 Western Power's determination of the 2010/11 correction factor ( $TK_t$ ) for the determination of maximum regulated transmission revenue**

Calculation Parameter	Value (\$million, real 30 June 2009)		
	AA1 2008/09	AA2 2009/10	AA2 2010/11
Transmission Revenue, $TR_t$	248.4	262.9	332.1
<i>plus</i> Correction Factor, $TK_t$ (= over/under revenue collection <sub>t-1</sub> multiplied by (1+ WACC))	-5.9	-4.0	-6.1
<b>Maximum Transmission Revenue, <math>MTR_t</math></b>	<b>242.5</b>	<b>258.9</b>	<b>325.9</b>
Deemed Capital Contribution <sub>t</sub>	14.6	n/a*	
<i>plus</i> Transmission Reference (covered) Service Revenue Collected	231.6 (actual)	264.6 (forecast)	
<b>Actual Transmission Revenue, <math>ATR_t</math></b>	<b>246.2</b>	<b>264.6</b>	
<b>Over/Under Revenue Collection<sub>t</sub></b>	<b>-3.7</b>	<b>-5.7</b>	

\*Not applicable (under the amended access arrangement applying for the second access arrangement period, capital contributions are excluded from the determination of target revenue and associated reference tariffs).

## Distribution Services

17. Western Power's derivation of the reference service revenue for distribution services is indicated in Table 3 below.

<sup>9</sup> Western Power, 24 December 2009, Amended Access Arrangement, clause 7.1.

**Table 3 Western Power's determination of maximum distribution regulated revenue for 2010/11**

Calculation Parameter	Value (\$million)	Source
Revenue cap (DR <sub>2010/11</sub> , dollar values of 30 June 2009)	510.5	Amended Access Arrangement, clause 5.46
Tariff equalisation contribution (TEC <sub>2010/11</sub> , dollar values of 30 June 2009)	170.4	2010/11 Price List Information, 2.1.2 (Table 6); Amended Access Arrangement Revenue Model <sup>10</sup>
Correction factor (DK <sub>2010/11</sub> , dollar values of 30 June 2009)	-12.2	2010/11 Price List Information, section 2.1.2 (Table 6)
<b>Maximum regulated distribution revenue (MDR<sub>2010/11</sub>, dollar values of 30 June 2009)</b>	<b>668.6</b>	
<i>Inflation factor</i>	1.031	2010/11 Price List Information, section 2.1.3 (Table 8)
<b>Reference service revenue (nominal dollar values)</b>	<b>689.5</b>	

18. As is the case with transmission services, the correction factor for distribution (DK<sub>t</sub>) is calculated from required and collected revenues from previous pricing years and is indicated (showing only the two previous pricing years) in Table 4 below.<sup>11</sup> The correction factors for 2009/10 (DK<sub>2009/10</sub>) and 2010/11 (DK<sub>2010/11</sub>) were derived by applying a WACC of 7.98 per cent, with the correction factors prior to 2009/10 derived by applying a WACC of 6.76 per cent.

<sup>10</sup> Western Power, 24 December 2009, Amended Revised Access Arrangement Information, Attachment 2: Revenue Model (Distribution\_COS, row 87).

<sup>11</sup> Western Power, 2010/11 Price List Information, section 2.1.2 (Tables 5 and 6).

**Table 4 Western Power's determination of the 2010/11 correction factor (DK<sub>t</sub>) for the determination of maximum regulated distribution revenue**

Calculation Parameter	Value (\$million, real 30 June 2009)		
	AA1 2008/09	AA2 2009/10	AA2 2010/11
Distribution Revenue, DR <sub>t</sub>	520.1	389.0	510.5
<i>plus</i> Tariff Equalisation Contribution, TEC <sub>t</sub>	72.0	121.1	170.4
<i>plus</i> Correction Factor, DK <sub>t</sub> (= over/under revenue collection <sub>t-1</sub> multiplied by (1+ WACC))	-9.7	-27.4	-12.2
<b>Maximum Distribution Revenue, MDR<sub>t</sub></b>	<b>582.4</b>	<b>482.7</b>	<b>668.6</b>
Deemed Capital Contribution <sub>t</sub>	138.8	n/a*	
<i>plus</i> Distribution Reference (covered) Service Revenue Collected	474.0 (actual)	494.0 (forecast)	
<b>Actual Distribution Revenue, ADR<sub>t</sub></b>	<b>607.8</b>	<b>494.0</b>	
<b>Over/Under Revenue Collection<sub>t</sub></b>	<b>-25.4</b>	<b>-11.3</b>	

\*Not applicable (under the amended access arrangement applying for the second access arrangement period, capital contributions are excluded from the determination of target revenue and associated reference tariffs).

## Inflation Factor

19. Western Power indicates in section 2.1.3 of the price list information that the inflation factor, used to calculate the required revenue from reference services in nominal dollar values, is derived from a forecast of inflation for the annual periods March 2009 to March 2010 (0.8 per cent) and March 2010 to March 2011 (2.3 per cent).<sup>12</sup> Subsequent to Western Power submitting its proposed price list on 27 April 2010, the Australian Bureau of Statistics released actual inflation data for the March 2010 quarter.<sup>13</sup> The data indicates inflation of 2.9 per cent for the period March 2009 to March 2010, which is greater than the 0.8 per cent assumed by Western Power. The Authority notes however, that future price lists will include a correction for differences in forecast and realised (actual) inflation.

## Forecast Revenue

20. Spreadsheets provided by Western Power to the Authority (on a confidential basis) comprise calculations of the expected revenue to be collected from the component charges of reference tariffs as set out in the proposed price list, given forecasts of demand for each charge.<sup>14</sup> The total values of expected revenue are indicated in Table 5.

<sup>12</sup> These forecasts of inflation are consistent with the amended access arrangement revenue model (Western Power, 24 December 2009, Amended Revised Access Arrangement Information, Attachment 2: Revenue Model).

<sup>13</sup> Australian Bureau of Statistics, 6401.0 – Consumer Price Index, Australia, March 2010 (released 28/04/2010).

<sup>14</sup> Western Power, 27 April 2010, 2010/11 Price List Information (and confidential revenue spreadsheets for transmission and distribution: WE\_n 7077016v1 and WE\_n 7078655v1).

**Table 5 Western Power's forecast revenue to be collected from reference services for 2010/11**

Revenue Component	Value (\$million)
<b>Transmission Revenue</b>	
Revenue from transmission reference tariffs (net of non-reference standby access charges of \$0.5 million)	336.5
Target reference services revenue (from Table 1 of this determination)	336.1
<b>Forecast over/under recovery</b>	<b>0.4</b>
<b>Distribution Revenue</b>	
Revenue from distribution reference tariffs	695.9
Target reference services revenue (from Table 3 of this determination)	689.5
<b>Forecast over/under recovery</b>	<b>6.4</b>

21. The forecast revenues from transmission and distribution reference services are projected to vary from the respective target revenue approved under the amended access arrangement.
- Forecast revenue from transmission reference services is \$336.5 million compared to the required reference service revenue of \$336.1, indicating a potential over recovery of \$0.4 million.
  - Forecast revenue from distribution reference services is \$695.9 million compared to the required reference service revenue of \$689.5 million, indicating a potential over recovery of \$6.4 million.
22. Western Power submits in the price list information that it considers the difference between forecast and required revenues from reference services to be within a reasonable margin when determining a complex set of reference tariffs. Western Power also notes that under the price control of the access arrangement, any differences between required revenue and actual revenue collected will be corrected for in transmission and distribution prices in future pricing years. The Authority concurs with these statements, noting that corrections are also made to correct for differences in forecast and actual inflation.
23. Clause 3.11 of the amended access arrangement sets out the side constraint that applies to increases in network charges:
- +/- (CPI + 13 percentage points) for the transmission network; and
  - +/- (CPI + 18 percentage points) for the distribution network,
- with CPI being the percentage increase in the CPI (weighted average for eight capital cities) for the most recent December quarter compared to the December quarter in the previous year.

24. The side constraints applying to increases in charges from 2009/10 to 2010/11 is +/- 15.1 per cent for transmission charges and +/- 20.1 per cent for distribution charges, with the limits corresponding to an inflation value of 2.1 per cent for the annual period December 2008 to December 2009.<sup>15</sup>
25. Section 9 of the price list information indicates the percentage changes in charges from the charges established in the 2009/10 price list to the proposed 2010/11 price list. The percentage changes are within the bounds established by the side constraints and comprise:
  - increases in charges for transmission reference tariffs of between 13.9 and 14.1 per cent; and
  - increases in charges for distribution reference tariffs of between 13.6 and 16.2 per cent.
26. Taking into account the derivation of required revenues from reference services, the forecast revenue to be collected, and the changes in reference tariff charges relative to the side constraint, the Authority is satisfied that the proposed 2010/11 price list complies with the price control set out in the amended access arrangement.

## Compliance of the Proposed Price List with the Pricing Methods

27. "Pricing methods" under the Access Code refer to the structure of reference tariffs included in an access arrangement.
28. Clauses 9.1 to 9.30 of the amended access arrangement detail the pricing methods applied by Western Power. The pricing methods, at clause 9.4, indicate that reference tariffs are derived from an amount of required revenue for a pricing year by a method of cost allocation.
  - 9.4 Reference tariffs are derived from an analysis of the cost of service provision which entails:
    - (a) identifying the costs of providing reference services;
    - (b) allocating the costs of providing reference services to particular customer groups;
    - (c) translating the costs of serving particular customer groups to the costs of providing reference tariffs; and
    - (d) determining a structure of reference tariffs in a manner that reflects the underlying cost structure, in accordance with section 7.6 of the Code.
29. The above pricing methods are applied by Western Power to meet the objectives for pricing methods under sections 7.3 and 7.4 of the Access Code.

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<sup>15</sup> Australian Bureau of Statistics, 6401.0 – Consumer Price Index, Australia, December 2009 (released 27/01/2010).

30. Western Power states that the proposed price list for 2010/11 complies with the pricing methods of the amended access arrangement as there have been no changes to the proposed structures of reference tariffs, or the relativities of reference tariff charges in deriving the proposed price list.<sup>16</sup> The proposed prices for 2010/11 were derived by increasing all tariff components by a scaled amount (within the bounds of the allowed side constraint) when compared to the current 2009/10 price list.
31. In assessing compliance with the pricing methods, the Authority notes that the objectives of the pricing methods under sections 7.3 and 7.4 of the Access Code are broad. These objectives require that the reference tariffs recover the forward-looking efficient costs of providing reference services; and that the reference tariff applying to a user recovers an amount of revenue that is greater than the incremental cost of service provision and less than the stand-alone cost of service provision.
32. Taking these matters into account, the Authority considers that the proposed 2010/11 price list complies with the pricing methods established under the amended access arrangement.

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<sup>16</sup> Western Power, 27 April 2010, 2010/11 Price List Information, section 2.3.