

ATCO
AUSTRALIA*Corporate Office*

28 January 2011

Economic Regulation Authority (ERA)
PO Box 8469
Perth Business Centre
PERTH WA 6849

Attention: Sara O'Connor
Analyst

Dear Sara

Subject: Inquiry into the Funding Arrangements for Horizon Power

ATCO Australia appreciates the opportunity to make a submission on the draft report on the ERA's inquiry into the funding arrangements of Horizon Power and the draft recommendations contained therein.

In summary, ATCO supports the draft recommendations by the ERA but believes that the recommendations relating to the capital and O&M programmes sought by Horizon do not go far enough and should be further extended to reduce capital and O&M associated with Horizon's proposed new power generation developments.

In our submission ATCO have outlined our belief in:

1. The creation of a level playing field in power generation as a mechanism to ensure efficient generation costs and optimise private versus public capital expenditure
2. The private sector's capability to deliver power generation solutions to the Pilbara and remote Western Australia

The benefit of private sector involvement was highlighted in 2010 by the successful completion "on budget and on time" of the 86 MW Karratha Power Station (KPS), a joint project with Horizon and ATCO. The KPS was constructed as virtually a Private Public Partnership (PPP), a structure which is a preferred model for delivering multi-infrastructure projects that have a combination of private and public components.

Should you have any questions or require further clarifications on any of the items raised, we would be pleased to meet with you in person to discuss or alternately address via email. Please contact me at your convenience.

Yours sincerely



Barry Ford
General Manager Business Development
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Summary

ATCO supports the draft recommendations by the ERA but believes that the recommendations relating to the capital and O&M programmes sought by Horizon do not go far enough and should be further extended to reduce capital and O&M associated with Horizon's proposed new power generation developments.

Level Playing Field

ATCO believes that the creation of a level playing field in power generation will naturally lead to the establishment of the efficient generation costs and the appropriate allocation of risk and capital in new power station developments in Western Australia.

ATCO supports an environment that ensures that State owned utilities do not enjoy unfair advantages over investor owned utilities. ATCO believes that government policy should provide for rules so that an efficient market for electricity based on fair and open competition can develop in which neither the market nor the structure of the Western Australia electric industry is distorted by unfair advantages of government-owned participants or any other participant.

The State of Western Australia is experiencing strong growth mainly driven by the resources sector. The resulting population growth has increased the requirement for public infrastructure such as schools, hospitals and roads. Funding power generation infrastructure can be willingly funded and effectively delivered by private enterprise where the government is limited for debt capacity.

There exists a global availability of private equity looking for secure investments. With the appropriate controls and regulation, private investment can contribute to the State's infrastructure needs. Currently, private enterprise cannot compete with Horizon's government funding options for power generation infrastructure underpinned by a cost of debt of 4.89 per cent.

Providing a level playing field for the development of power generation infrastructure will ensure a competitive outcome where the government does not need to increase the risk to cost and schedule of these projects and deliver a negative effect on the shareholders of Horizon and ultimately the taxpayer.

Private Sector Capability

ATCO believes that the private sector has demonstrated the capability to deliver power generation in the Pilbara and there is no reason the government should have to fund future electricity generation infrastructure growth.

In 2010 the benefit of private sector involvement was highlighted by the successful completion "on budget and on time" of the 86 MW Karratha Power Station (KPS), a joint project with Horizon and ATCO. Horizon provided the land access, switchyard upgrade, transformers and interconnects while ATCO provided the power station. In working with Horizon ATCO recognised that the very high operational costs associated with operating infrastructure in the Pilbara cannot be underestimated. The KPS was constructed as virtually a Private Public Partnership (PPP), a structure which is



becoming more common in the State of Western Australia as the government's preferred model for delivering multi-infrastructure projects that have a combination of private and public components.

As stated in the draft ERA report, the decision by Horizon Power in 2006 to bring new generation capability in-house has led to over half (50.9%) of Horizon Power's forecast capital expenditure programme being driven by generation projects. Consequently Horizon Power built, owns and operates (BOO) generation capacity at Marble Bar and Nullagine and has proposed BOO generation for Carnarvon (under construction) and South Hedland (to be commissioned by 1 July 2013). This will result in an increase of over 350 percent in capital expenditure between the period of 2006/07 to 2008/09 and 2009/10 to 2013/14.

The ERA is rightly concerned that the decision to bring generation in house may not be the optimal business model for Horizon to adopt. As indicated in the ERA report, this decision may result in cost overruns as has already been demonstrated at Marble Bar and Nullagine. This risk of cost overrun will be significantly magnified should Horizon proceed along the BOO pathway with the greater magnitude (\$300M plus) and complex South Hedland power station as Horizon has proposed.

There are a number of independent power producers that are capable of delivering a generation solution in the Pilbara. Several of the major resource companies (i.e. Rio Tinto, BHPB, and Woodside) already generate power for their own needs.

Capital Expenditure

ATCO strongly believes that Recommendation 6 by the ERA should go further than just reducing the transmission, distribution and non system costs but should also include reductions in the capital for new power generation infrastructure. ATCO shares the ERA's concerns about whether Horizon bringing power generation in-house is the appropriate business model for a government entity. ATCO believe that there is a very competitive private sector market that could finance these activities and as such there is no need for Horizon to include new build power station capital costs in its capital plans.

Efficient Procurement

The draft report raises a number of concerns about the Horizon investment evaluation process and decision making stating that the Horizon comparison with the private submissions were very close, not well costed and more work should be done before deciding who is awarded the South Hedland option. Consistent with our points above, ATCO believe that a competitive procurement process, with an impartial method of evaluation will lead to a more efficient procurement and ultimately a lower cost to Western Australian consumers and taxpayers.

ATCO, along with other Independent Power Producers (IPPs), responded to the Horizon Request for Proposal dated 25 August 2009 to build, operate and maintain a power generation facility at Port Hedland to serve Horizon Power's requirements. The proposal submitted on 8 October 2009 was a fixed priced bid backed up with firm supply and installation contracts.

The ERA has stated that based on the BOO cost estimates that Horizon has prepared for South Hedland, Horizon has determined that the BOO option is the preferred option on the basis of



highest net present value (NPV). Whether or not this is the optimal solution depends on several issues such as:

- The accuracy of Horizon Power's comparison of the various options e.g. if alternatives have been compared on a like for like basis regarding what costs are included and excluded and the rate of return applied to the various options;
- The extent to which options are re-costed and re-compared again as the actual costs of the project harden;
- What arrangements are assumed and costed and which party bears the risk of this if the projects are delayed and temporary capacity is required to meet demand in the interim; and
- If Horizon Power's forecast of increased demand prove to be accurate.

Horizon has only recently (December 2010) gone out publicly for expressions of interest for early contractor involvement for the South Hedland power station, which suggests that Horizon's current South Hedland selection analysis is based on engineering estimates.

A comparison of firm bids against engineering estimates, which may not reflect the reality of building in the Pilbara, may provide a skewed selection analysis. In coming to a decision to take the BOO approach Horizon may be using unreliable cost estimates when comparing BOO against the IPP firm pricing bids options. As the ERA has noted, this has led to the selection of the BOO approach when in reality the true cost of the power stations may favour the IPP approach (outside of lower cost of capital and debt with government funding).

The ERA has confirmed that several options obtained from IPP's for the development of South Hedland were very close (within 8 per cent of each other) and that any slight amendment to the estimates in any option could alter the ranking. While Horizon has suggested that the business case could be resubmitted for further consideration (once further cost estimation is carried out prior to construction) the proposed timeline to deliver the new combined cycle power station by 1 July 2013, even for an experienced developer, is exceedingly tight.

In summary, while the methodology for selection of the best option may be questionable, ATCO believe that fundamentally the private sector can deliver the required power generation infrastructure and that Horizon should not include new build power station capital costs in their capital programme.



ATCO Australia

ATCO Group is a diversified, Canadian based international group of companies with approximately \$10 billion in assets and more than 7,500 people engaged in:

- **Utilities** – transportation and distribution of natural gas and electricity in Canada. ATCO owns and operates over 8,500 km of natural gas pipelines and 70,000 km of electricity transmission and distribution network,
- **Energy** – development and operation of 19 power generation plants and 14 natural gas gathering processing and liquids extraction facilities as well as an innovative gas storage facility.
- **Structures and Logistics** – providing global infrastructure solutions such as workforce housing, site support services and logistics as well as noise reduction technologies. Supported by manufacturing facilities in North and South America, Australia and the Middle East.

ATCO Australia represents a consolidation of several ATCO companies to provide a full range of expertise and energy solutions. ATCO has established a new headquarter operation in Perth with plans to expand its financial investment in people and resources in the coming months.

ATCO's presence in Australia dates back to 1961 with the opening of a 70,000 square foot modular building manufacturing plant in Adelaide. ATCO has experienced impressive growth in Australia during the past decade, first within ATCO Structures (now ASL) followed by ATCO Power partnering in innovative power plants.

Along with the three power plants already in operation in Australia, ATCO provides a full range of energy services, integrated with and drawing upon the expertise of ATCO Pipelines, ATCO Electric, ATCO Midstream and ATCO Power.

ATCO Power is a wholly owned subsidiary of ATCO Group, and is a leading world-class developer, construction manager, owner and operator of technologically advanced and environmentally progressive independent power generation plants. ATCO has over 75 years of experience in developing, owning, and operating 19 power generation facilities in Australia, Canada, and the United Kingdom with a combined capacity of approximately 5,000 MW.

ATCO has successfully managed the development, design, construction, commissioning and operation of numerous independent power projects in Australia and internationally ranging in size from 32 MW to 1,000 MW. ATCO's success is due largely to the experience and expertise of the people involved in the projects. ATCO employs highly skilled executives, engineers, managers, and technical staff who are committed to the success of every project. With this strong resource, ATCO is able to effectively develop, design, procure, construct and operate world-class power generating facilities. For each phase of the project, including the long-term operations, qualified personnel are drawn from an international pool of experienced resources.



In the past year ATCO has taken steps that underline the strategic importance of Western Australia to ATCO and the commitment that ATCO has to Australia. In April 2010 ATCO's 86 MW Karratha Power Station reached commercial operation two weeks ahead of schedule and on budget. This is a significant achievement in the logistically challenged Pilbara region.

The development, construction and effective operation of generation assets requires an organisation to have a very different set of skills and experience in comparison with an organisation responsible for distribution, transmission and the retailing of electricity. Power generation facilities cost and risk profiles are significantly different to "wires" based assets. Power generation facilities are capital intensive, technically complex and require specially trained resources for the operation and maintenance. ATCO has these skilled resources and is keen to bring international best practices to bear in a public private partnership for the benefit of Western Australia.