



**Horizon Power's submission in response to the
Authority's Draft Report**

Schedule B

Response Reference Number	Comments as per the Authority's Draft Report	Report Section Reference	Horizon Power's Response
1	"At the current gazetted levels (\$122.1m in 2009/10, \$175.7m in 2010/11 and \$181.2m in 2011/12), the growth in the TEC is increasing Western Power's network distribution charges by CPI plus 15.7 per cent (over three instalments, March 2010, July 2010 and July 2011).- Referenced to ERA Media release (4 December 2009), ERA releases final decision on Western Power's revisions."	Executive Summary	<p>There should be no expectation network distribution charges will move with CPI (or any other index) as the charges do not solely reflect the costs Western Power incurs in providing the service. Rather, network distribution charges reflect the cost of the underlying service and the recovery of additional revenue to provide a subsidy to regional electricity consumers.</p> <p>It should be noted the electricity industry in Western Australia has always funded itself in this manner, though not explicitly through additional revenue from network distribution charges. In this manner, all electricity consumers in Western Australia cover the total cost of supply across the State in the manner intended by government policy.</p>
2	"This inquiry into the funding arrangements of Horizon Power seeks to simulate the beneficial aspects of a competitive market"	Executive Summary	<p>Horizon Power has a broader mandate than to simulate the beneficial aspects of a competitive market. The Horizon Power mandate is to (among other things) provide services to regional and remote Western Australians. A competitive marketplace is unlikely to deliver these services. Horizon Power is also required to facilitate the equity and social policy aspect of service provision as well as to deliver against a range of other, sometimes competing, requirements. Details of Horizon Power's broader mandate can be found within its Strategic Development Plan and this matter is specifically considered on pages 1 and 2 of the business's submission to the Issues Paper.</p>
3	"Finally, the Authority compiled a set of statutory accounts for Horizon Power to ensure that the recommended variations in the costs of service provide for Horizon Power to remain financially viable, assuming Horizon Power operates in accordance with the Authority's efficient level of costs."	Executive Summary	<p>Horizon Power highlights its concern that the Authority has not agreed with Horizon Power a set of agreed business viability criteria to underpin its financial modelling. We note however that the Authority's modelling shows a deteriorating balance sheet with increasing levels of debt and no payment of dividends to Government. These are not indicators of a sustainable business.</p>

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4	<p>"One issue of difference between the Authority and Horizon Power is in the use of price escalation factors in estimating costs. Horizon Power has used alternative price escalators to the Consumer Price Index (CPI) as it is of the view that CPI does not reflect the underlying inflation it faces, particularly in the North West of the State, where competition for resources can drive prices higher than in other parts of the State. Whilst the Authority recognises that regional prices have probably risen at a higher rate than CPI in the past, there is no indication that this trend will continue, especially as Horizon Power's preferred inflator has fallen since June 2008. Therefore, with the exception of any inflation fixed by contractual terms, the Authority has concluded that the use of a historically based index to predict future escalation is inappropriate. The Authority's proposed reductions to operating and capital costs outlined below have been applied in real terms, which for this inquiry are prices as at 30 June 2009 (the beginning of the inquiry period)."</p>	Executive Summary	<p>Horizon Power notes that the Authority's recommendation is not consistent with the advice that the Authority received from its technical consultants, Parsons Brinckerhoff. Further, Horizon Power provides specialist advice as to the inappropriateness of reducing Horizon Power's forecast escalation from BCI to CPI. Within this submission Horizon Power addresses this matter directly in response to Recommendation 4 and also provides anecdotal evidence.</p>
5	<p>"Horizon Power did not propose an asset valuation based on a current cost valuation of its assets and instead supplied information on the historical cost valuation of assets at disaggregation, new capital additions to date and forecast capital expenditure for the inquiry period. The Authority has valued Horizon Power's initial capital base in historic cost terms at \$264.1m at 30 June 2009. This takes into account Horizon Power's new capital assets, which have been recognised at cost, and Horizon Power's calculation of the remaining lives of the assets that were taken over at disaggregation.⁷ Horizon Power did submit a Depreciated Optimised Replacement Cost for the NWIS and Modern Equivalent Asset values for the rest of its assets. This information was used to inform the Authority's decision on the initial capital base."</p>	Executive Summary	<p>Horizon Power requests it be noted in the Authority's Final Report that while no definitive proposal was put forward in Horizon Power's submission to the Issues Paper on the preferred approach to valuing the Regulatory Asset Base, the business did invite the Authority to engage with Horizon Power to develop an approach which would deliver a Sustainable Revenue Requirement sufficient to acquit its mandate. This issue is addressed in Horizon Power's written response to Recommendation 2 (refer Section A)</p>

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6	"However, the main driver of the capital expenditure program over the inquiry period relates to Horizon Power's strategy to build, own and operate its own power stations in Marble Bar, Nullagine, Carnarvon and South Hedland."	Executive Summary	Horizon Power does not have a clear strategy to build own operate power stations. As identified to Parsons Brinckerhoff, Horizon Power reviews the appropriate approach on a case by case basis.
7	"However, the Authority is concerned that, based on the information available, the decision to bring some generation capacity in-house is not the optimal business model for Horizon Power to adopt."	Executive Summary	<p>To deliver an economically efficient cost of supply, Horizon Power must ensure a competitive tension is maintained across all areas of generation.</p> <p>In addition, context is required regarding the Marble Bar and Nullagine projects; these projects were not simply about replacing generation, they were also an investment in technology that could be deployed to other systems to reduce reliance on fossil fuels and thus reduce costs. This investment is not expected to be realised in the very short-term. Horizon Power accepts and has openly stepped through the shortcomings in the manner in which these projects were delivered with Parsons Brinckerhoff. However as identified by Parsons Brinckerhoff, Horizon Power has "correctly identified areas for improvement and this should ensure future project expenditure forecasts and approvals adhere to best practice project management...". (PB report page 71).</p>
8	"In determining a return on capital, the Authority reviewed the underlying parameters that Horizon Power proposed and where appropriate amended these to reflect current market conditions. This has resulted in a real pre-tax return on capital of 6.49 per cent. However, if Horizon Power's actual cost of debt is used in the return on capital calculation, the real pre-tax return reduces to 4.89 per cent."	Executive Summary	Horizon Power has identified significant concerns as to the Authority's approach to valuing WACC for the purposes of the Inquiry. These concerns and Horizon Power's preferred approach is identified in response to Recommendations 7 and 8 (refer Section A). Horizon Power has also provided its advice from Economic Insights Pty Ltd to be read in conjunction with this submission.

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9	"The Authority's preferred position is that the TEC is funded by a CSO payment paid directly to Horizon Power. However, if the Government continues to choose to fund the TEC via network charges in the SWIS then the Authority considers that lower TEC payments would be expected to pass through to lower distribution network tariffs for the benefit of all Western Power's customers."	Executive Summary	Terms of Reference do not include consideration of the mechanism to be applied to derive Horizon Power's required funding, nor do they require a view of the appropriateness of the current funding mechanism or the efficiency of the mechanisms of Government to be considered by the Authority in determining Horizon Power's efficiency. These concerns are discussed within the covering letter and in response to Recommendations 9 and 10.
10	For proposed building expenditure, PB suggested that the \$7.2m (real as at 30/6/2009) proposed for the Esperance depot was based on a building design that had larger capacity than would be required based on forecast staff numbers and so made a reduction accordingly. The Authority supports this reduction and has included it in Table 8.2.	8.5 Non system capital costs	Horizon Power advises the Authority that the Esperance Depot building is now over 50% complete. It is much too late to change the design and reduce the size of the building. Should the Authority recommend a lower funding for this project, Horizon Power's ability to fund existing commitments may be impaired. Horizon Power also advises that the estimates made by Parsons Brinckerhoff of the savings from any downsizing, as a proportional cost, are an overestimate. To reduce the building size would require a complete redraw and engineering and ancillary redesign at a significant cost. It is not a straight forward sqm calculation. Horizon Power provides photos of the existing building for the Authority's consideration within the Confidential Appendices.
11	The Authority will expect any safety issues around the recommended reductions to the ENRUP programme to be addressed in any submission Horizon Power may publish in response to the draft report.	8.4 Distribution Costs	Horizon Power advises that this expenditure is necessary to deliver its compliance with safety obligations. A detailed response is provided in response to Recommendation 6 within section A.

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12	PB also suggested that Horizon Power should review its current strategy of providing free housing for regional staff as an alternative 'housing allowance' may prove more economical and reduce ongoing expenditure. However, PB did not quantify the level of any possible savings.	8.5 Non system capital costs	Horizon Power is undertaking a review with the support of consultants into potential alternatives in providing regional staff housing. The review will consider the risks and opportunities of alternative provision models. The report is due in first half of 2011 and will be presented to the Business's senior management for consideration. At the same time, eligibility to housing and the housing allowance is being reviewed to ensure effective and cost efficient policies are in place. Horizon Power highlights to the Authority that it is currently unaffordable for staff to provide their own housing in many locations with rents as much \$2700/per week and the cost to buy a basic house about \$1.3million (Port Hedland). Refer Confidential Appendix for supporting anecdotal information. The housing allowance provided by Horizon Power is however much lower than the true cost of housing. Other initiatives are being investigated to reduce the costs of providing housing whilst maintaining the ability of the Business to attract and retain staff (and their families) to regional areas. Horizon Power provides a recent article from the Western Australian newspaper entitled Pilbara Rents Top Nation for consideration by the Authority within the Public Appendices.
13	Should Horizon power wish to submit an alternative escalation forecast between the draft and final reports it should ensure that these forecasts have been independently verified.	3 Escalation	Horizon Power has provides information within the submission and wishes to discuss the issue of price escalation and uplift with the Authority.
14	South Hedland alternate costs	7 Operating Costs	Horizon Power has not, as yet, been advised of the outcome of Government's deliberations on the South Hedland power station business case. Horizon Power is of the view the prudent manner by which to manage budget uncertainty is by utilising costs determined as under the proposed hire plant strategy.

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15	Overheads	7.3.5 Overheads	In its discussion on corporate overheads the Authority neglects to mention Parsons Brinckerhoff's observation that the basis of their findings as to why Horizon Power's overheads are high, is that Horizon Power allocates some costs "most electricity businesses would direct charge [...] to OPEX line items or to the appropriate line items or to the appropriate work activities", PB Report page 48. Horizon Power spent a considerable amount of time explaining the basis for this method of accounting to Parsons Brinckerhoff. Horizon Power is concerned, in setting efficiency targets as they have, the Authority has not understood the basis of Horizon Power's costing model and how that delivers efficiencies to Horizon Power and its customers.
16	In its report the ERA says "PB indicates that although Horizon Power is past its initial period of establishment and restructuring, following disaggregation, it is still forecasting average increases in real controllable operating costs of 3 percent per annum between 2010/11 and 2013/14."	7.5	Parsons Brinckerhoff actually says (p89) "PB concludes that historical opex levels are in line with expectations of a company undergoing the establishment and restructuring phase that Horizon Power has undergone within the past 4 years. However PB would expect that eventually increases in opex should cease and then start to decrease as the company realises efficiencies." There is no suggestion by Parsons Brinckerhoff that Horizon Power has 'Past' an establishment phase and, in fact, Parsons Brinckerhoff notes in a section above, that once adopted processes and procedures are fully operational, efficiencies may be realised. Horizon Power holds the view that the Authority has not given full consideration of Horizon Power's position with its lifecycle. These matters are addressed in the covering letter and in response to Recommendation 4 in Section A.

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17	The Authority will further examine this allocation of assets in the final report.	8.1.1	Horizon Power's asset register did not, in August 2010, categorise assets in classes required by the Authority. The Authority was aware Horizon Power was undertaking a review of its asset register in an endeavour to ensure the Authority had the best possible information available. It should therefore not be surprising to the Authority some assets were moved between asset classes.
18	The final outturn costs are expected to be available and published in the final report (Nullagine Power Station).	8.2.1	Horizon Power provides the Project Implementation Review in its Confidential Appendices.
19	Horizon Power has subsequently advised the Authority that it has 81% of the cost of the project fixed under contract and that the remaining 19% are comprised of Horizon Power's own internal costs.	8.2.1	Horizon Power has not yet committed to this expenditure. However, we would like to correct an earlier statement that it is Horizon Powers "intention" to fix a significant proportion of the cost of this project under fixed contracts.
20	"For this inquiry, Horizon Power has proposed a WACC following a study conducted on its behalf by Deloitte."	9.1	<p>To put this matter in context, Horizon Power submitted its calculations on weighted average cost of capital (WACC) as the starting point for a conversation on an appropriate WACC for Horizon Power for use in the inquiry. As Horizon Power is not a regulated entity, the business has not developed expertise in areas such as WACC. Instead the business relies on external parties to provide advice. Despite requests from Horizon Power, the Authority has not taken the opportunity to discuss an appropriate WACC with Horizon Power.</p> <p>Horizon Power has subsequently sought advice on the issue of an appropriate WACC and provides its views to this matter in response to Recommendations 7 and 8. We also provide advice received from Economic Insights which we request be read in conjunction with this submission.</p>

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21	Table 9.3 - shows Nominal Pre-tax WACC of 9.44% (using ERA's formula in rear of document, it is not possible to calculate a 6.49% Real Pre-Tax WACC with an inflation rate of 2.62%). ERA's models show 9.28% Nominal Pre-Tax WACC.	9.2	Horizon Power has been unable to reconcile the Authority's calculations from 9.44% as shown in table 9.3 to a 6.49% real pre tax WACC utilising the formulas contained in the appendices.
22	"Bentley head office"	10	As previously advised to the Authority, Horizon Power's head office is located in Karratha, not Bentley.
23	"...to achieve the required operating cost savings, Horizon Power can seek to achieve the efficiency gains in whatever way it chooses..."	11.1	Horizon Power has identified its concerns that the Authority has recommended aggressive Efficiency Targets, while failing to identify an area where Horizon Power may deliver these savings. Horizon Power does not support the approach taken by the Authority with regards to the Efficiency Targets. The Authority should have regard for the views put forward by Horizon power in response to Recommendation 4.
24	The Authority has used the efficient level of costs reported in sections 7 and 8 to determine the overall revenue required by Horizon Power to perform its functions at the required levels of service.	12	Horizon Power's forecasts of its costs are part of a balanced Performance Bargain with Government in which the service standards and broader mandates are linked to an appropriate cost of delivery. Any change to Horizon Power's budget allocation will have a significant impact on the business's ability to deliver against its mandate. Horizon Power provides its position on these matters in its response to Recommendations 1 and 4.

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25	TEC funded by CSO	12.4	<p>Horizon Power has a legislative requirement to operate in a commercial manner and derive an economic profit. The course the Authority purports to set for Horizon Power is one of increasing debt and a worsening financial position, seemingly justified by reducing the distortion on the SWIS electricity market. A broader view of the electricity market, encompassing the whole of Western Australia, shows all consumers in that market contribute to the total cost of supply.</p> <p>Horizon Power advises the Authority that regardless of the funding mechanism, the business must have access to sufficient funds to acquit its mandate and remain financially viable. These matters are further discussed in response to Recommendations 2 and 4.</p>
26	"PBs observation that HP has adopted processes of a larger legacy business"	7.5	<p>Horizon Power identifies that many of the processes and systems inherited at disaggregation require sufficient time and resources to replace and streamline. This is linked to the transformation work that the business continues to undertake and the business's rationale for not base-lining any efficiency target until 2010/11. Refer to Horizon Power's response to Recommendation 4. The Authority should also note that while Horizon Power is certainly a "small utility" in terms of customer numbers, the business has the same legislative and regulatory obligations to comply with as any utility. Indeed, as Horizon Power services all elements of the supply chain, has a greater regulatory burden than many of its counterparts.</p>

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27	"Horizon Power submit in response to the draft report individual business cases for any additional operating expenditure requests over and above the recommended profile as outlined in Table 7.8. The Authority will then consider each request on a case by case basis and include any additions to the efficient level of operating costs in the final report."	7.6	Horizon Power identifies to the Authority that Horizon Power is not subject to a formal regulatory regime that requires the submission to submit NFIT proposals. The business also highlights that the approach taken by the Authority to establish efficient operating expenditure constrains Horizon Power in how the business identifies what the Authority views as an efficient operating project and what must be the subject of a business case submission to the Authority. Horizon Power provides further information in its response to Recommendation 5 and within the Confidential Appendices.
28	Fairway Drive substation	8.3	Horizon Power does not support the deferral of this expenditure. A detailed response is provided in response to Recommendation 6 and in the Confidential Appendices.
29	"PB suggested that in economic terms the case for the ENRUP programme is: Poorly supported and that rectification of the network should occur during the replacement of assets due to condition."	8.4	Horizon Power does not support the Authority's proposed adjustments to this budget allocation. A detailed response is provided in response to Recommendation 6.
30	Contingency reduction from 10% to 4.6%	8.6	Horizon Power contends that comparisons with large Eastern States distribution and transmission companies with relatively small geographic footprints and uniform climactic conditions are inappropriate. Horizon Power's large geographic footprint and variety of climactic conditions experienced, combined with its relatively small number of projects, requires a higher level of contingency.
31	Escalation Rates quoted in the in Table 3.1 are not those that underpin the forecasts provided to the Authority.	3	Horizon Power provided the Authority with the escalation rates that underpinned the expenditure forecasts. The escalation rates that were published by the Authority are not those used in Horizon Power's forecasting. Horizon Power appends the correct escalators in the Confidential Appendices.

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32	"Therefore, with the exception of any inflation fixed by contractual terms, the Authority has conducted that the use of a historically based index to predict future escalation is inappropriate"	Executive Summary	Horizon Power identifies that CPI is in fact an historically based index used to predict future escalation.
33	"The Authority recommends that this inquiry be repeated in three years to ensure a continued path towards efficiency. It is the Authority's experience that as more efficiency reviews are undertaken, confidence in the underlying data quality and regulatory methodology increases, which drives further improvements in performance".	Executive Summary	Horizon Power has previously identified the issues that arise for the business, operating within its current Performance Bargain. Horizon Power appreciates the Draft Report as one of a series of inputs into the development of a more comprehensive framework for the business. It is Horizon Power's preference to work with its key stakeholders, including the Office of Energy, Department of Treasury and Finance and its Minister to develop these arrangements which will position the business to more efficiently deliver against its mandate into the future.
34	"As PPA's expire, Horizon Power competitively tenders for new contracts from a panel of four IPPs"	2.3.2	Horizon Power clarifies that this panel of independent power producers is utilised only for its North West Interconnected System. The resulting prices are then compared to the price from a build own operate option. This competitive tendering approach was discussed at length with Parsons Brinckerhoff. Parsons Brinckerhoff did not identify any significant concerns.
35	Paragraph 5 - Cost reflective and efficient costs are different	2.4	Horizon Power identifies that the Authority's Terms of Reference require it to review the business's cost reflective and efficient cost when assessing the Sustainable Revenue Requirement, the value of tariffs and the TEC. Horizon Power views that while the Authority may have addressed itself to calculating the efficient costs it has not approached the requirement of cost reflectivity.

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36	"For comparative purposes, all costs are shown in prices as at 30 June 2009, having been deflated by CPI. It should be noted that the embedded inflation factors in IPP contracts may differ from CPI"	7.2	Horizon Power identifies that its external contracts have embedded escalation requirements. Any artificial escalation applied by the Authority may result in the business not recovering sufficient funds to cover these real expenditures. Horizon Power provided full escalation details for its cost base.
37	"The Authority has not determined a separate retail margin for Horizon Power because the systematic risks faced by Horizon Power as a vertically integrated electricity supplier will be accounted for in the calculation of its return on capital. This also ensures an appropriate return on any retail assets Horizon Power owns, which are minimal"	7.3.4	Horizon Power identifies that the Authority has not, as required by its Terms of Reference, calculated a retail margin for the business. An appropriate retail margin would allow the business to cover such risks such as customer default (bad debt margin) and changes to debtors turnover.
38	Paragraph 2: "The problem with applying an efficiency gain to controllable operating costs is the possibility that the proposed reductions to controllable operating costs from the efficiency target are offset by increases in costs resulting from increased demand for electricity"	7.5	Increases in costs resulting from increases in demand is a logical and acceptable outcome. The Authority's approach to calculating an efficiency target on a per connection basis is not consistent with Horizon Power's scale. Horizon Power does not have the economies of scale available to larger business, such as Western Power, and such an approach does not well consider the step changes in costs incurred in small towns when new increments of capacity are required or when significant maintenance is required, which can only be recovered from a few customers. Horizon Power addresses this matter in response to Recommendation 4.
39	"HP is not subject to competitive pressure from the market, as is the case of the Victorian electricity distributors"	7.5	Horizon Power identifies that the business is an integrated retailer, generator and network provider. As such the business is exposed to credit risk from its larger customers and generation counterparties.

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40	Recommendation #1: The forecast operating costs incurred as a result of the delay in obtaining funding approval for the South Hedland power station project be borne by Horizon Power. Consequently, the Authority proposes that \$35m be removed from the non-controllable generation operating costs in the NWIS in 2012/13 for the purpose of determining cost reflective tariffs	7.6	As addressed in detail in response to Recommendation 3 and in the covering letter, Horizon Power is firmly of the view that in making this recommendation the Authority is operating outside its terms of reference and has not had due concern for the needs of a commercial business.
41	South Hedland Power Station Project Paragraph 3 - "... 40MW of spinning reserve..."	8.2.1	"Spinning reserve" should read "reserve capacity".
42	"Horizon Power responded by advising PB that a further cost elimination will be carried out prior to construction and, if this estimate exceeds a predetermined amount, it will resubmit the business case for further consideration"	8.2.1	Horizon Power is currently finalising its business case and FID for this commitment. Should this be available prior to the publication of the Authority's final report, this will be made available to the Authority.
43	Paragraph 4 - "Based on the Authority's assumptions using efficient levels.... 6.49 per cent and then run again with the alternative WACC of 4.89 per cent" -	9.2	Horizon Power does not view that a WACC set at this level is consistent with market outcomes nor will it deliver an adequate return on investment to Horizon Power's shareholder. Horizon Power addresses this matter in response to Recommendation 8.
44	Paragraph 4 - "The cost of service model for the aggregate business has a set of statutory..."	10	As identified in Horizon Power's response to Recommendation 2, Horizon Power views that the forecasts prepared by the Authority to not adequately provide for the replacement of the business's assets.
45	Paragraph 2 - "One representation of a cost reflective tariff is the Discounted Weighted Average Tariff (DWAT)..."	11	Consistent with Horizon Power's previous comments, Horizon Power views that the Authority has been requested to assess both the cost reflective and the efficient levels of expenditure. The Authority's analysis to date has only incorporated the Authority's view of Horizon Power's efficient expenditures.

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46	Last paragraph, dot point 1 - "A lower asset base - in the last gazetted TEC calculation Horizon Power used an average asset value of \$452m (nominal)....." -	12.1	Horizon Power identifies its concern that the adoption of a lower asset value by the Authority will place Horizon Power in a position of not recovering sufficient funding to replace its assets. This matter is further discussed in response to Recommendation 2.
47	The Renewable Energy Target legislation	7.4	Horizon Power identifies that the Renewable Energy Target Legislation is no longer known as the MRE, it is now simply referred to as RET.
48	In the Section on Renewable Energy Costs, the Authority appear to have confused the cost of renewable energy and the cost of carbon.	7.4	Horizon Power's cost of renewables is currently influenced by the Business's own renewable generation. That is, electricity the business buys from others using renewable generation, and the business's purchases of RECs, net of the value from any RECs the business generates. As the Authority acknowledges, Horizon Power does not currently contain a cost of carbon within its budgets. For this reason, the third paragraph in Section 7.4 is misleading: Horizon Power has assessed the impact of the RET, and has a key performance indicator in place aimed at driving a reduction in greenhouse gas intensity. However, these two activities belong to two different streams of work with different accountabilities and different drivers (namely, two different pieces of legislation, one of which no longer exists or is in a holding pattern at best). Horizon Power also has supporting business metrics on renewable energy.
49	"The Authority intends to review the impact of these two schemes on Horizon Power's cost efficient tariffs in the final report for the Inquiry.	7.4	Horizon Power is keen to work with the Authority to understand there assumptions with regard to a carbon price for this analysis.
50	"The service level standards for Horizon Power be retained, unchanged from their existing form, for the Inquiry period"	4.2	Horizon Power has identified the critical linkage within the Business's Performance Bargain between service standards and funding. Horizon Power addresses this matter in response to the Authority's Recommendation 1.

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51	"An efficiency target of one per cent compounded per annum be applied to the 2009/10 level of controllable unit operating costs per connection"	7.6	Horizon Power has identified a range of concerns with regard to the Authority's derivation of the efficiency target. These matters are discussed in some detail in response to Recommendation 4.
52	"Horizon Power's actual and forecast capital expenditure program be reduced by \$77.4m (real at 30/06/2009) from \$841.6m (real at 30/06/2009) to \$764.2m (real as at 30/06/2009) as detailed in Table 8.2"	8.7	Horizon Power does not agree with the Authority's recommendations to reduce its forecast capital expenditures. These matters are addressed in response to Recommendation 6.
53	"A second inquiry into the funding arrangements of Horizon Power be undertaken in three years to further review Horizon Power's actual costs and to set new efficiency targets"	13	Horizon Power identifies the significant external costs (in the order of \$1.1M) and distraction from operational activities arising from this Inquiry. Horizon Power, in adding greater clarity to its Performance Bargain. These matters are addressed in response to Recommendations 10 and 11.
54	The ERA refers to 'the key drivers to cost of supply are identified, reviewed, and benchmarked with other electricity suppliers...".	2.4	The ability to benchmark at any levels suggests there are other businesses that are similar and that operate in a similar environment. There are no similar utility companies that Horizon Power is aware of that would make a reasonable comparator.
55	Assets gifted to Horizon Power either as cash or as physical assets by customers, developers, the State or Federal Government have been excluded from the regulatory asset base as they were not directly funded by Horizon Power.	6.3	The exclusion of gifted assets from Horizon Powers asset valuation suggests that these assets are not to be replaced in the future, or that Horizon Power should operate on a non commercial basis where funding for replacement assets will always be available from the government of the day. Such an approach provides no certainty to Horizon Power's customers that its assets will be replaced as required. Horizon Power addresses this matter in response to Recommendation 2.

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56	"This process has been further complicated by multiple and late revisions to operating and capital expenditures, data omissions in some years and a significant reallocations of assets between functions and between asset classes from when PB conducted its technical inquiry to when this draft report is published."	2.6	The Authority has been critical of the data provided without providing the supporting context as to why these issues arose. Horizon Power identified to the Authority prior to the commencement of the Inquiry that the timing of the Inquiry was sub-optimal given that the business was in the middle of a planning and budgeting cycle. The Authority was therefore well aware that Horizon Power would have to accelerate its processes and timelines to satisfy the Authority's needs. This was further complicated by the fact that Horizon Power's data was not mapped in a format which met the Authority's requirements and that the legacy measuring systems available to the business did not meet the requirements of re-working the data. Further, Horizon Power identifies that changes to the allocation of assets between functions were undertaken at the request of the Authority to provide a better indication of how Horizon Power's assets map to the Authority's model. The issues which gave rise to these outcomes were all identified by Horizon Power in its earlier submission to the Issues Paper.
57	The ERA's valuation of Horizon Power's assets excludes gifted assets and has used an accounting method which excludes many older assets which need to be replaced in the short to medium term. The Authority's approach implies that Horizon Power should not earn sufficient return to enable it to replace all its assets over time and that Government will be able to fund infrastructure requirements over time. The calculation of asset value should provide a return to Horizon Power's owner that enables them to accumulate equity over time for the replacement of assets.	6.3	Economic theory dictates that a business should be able to earn a return on capital that is sufficient to recompense the business for the risk they have accepted and funded and sufficient to allow the business to continue through the future including through the replacement of aged assets. Depreciation allows a business to cover the cost of an asset over time to assist in building equity with the view to replacement of the asset at its end of life. Excluding these assets assumes they will not be replaced. This argument also applies to customer funded assets unless Horizon Power will be able to request the replacement cost from the customers.

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58	As a relevant case study PB referenced the experience of the Victorian electricity distribution businesses since they were privatised. PB reported that, in the first year of the second regulatory period, companies were set operating efficiency targets of between 3.1% and 16.4%, followed by an average operating cost efficiency target of 1.2% in each subsequent year. PB calculated that, overall, this represented an annual average reduction of 3%.	7.5	<p>Horizon Power refutes the applicability of these benchmarks. The Authority has used the Victorian Electricity distributors as a benchmark. To use these businesses as a benchmark would normally require additional work into the effects of economies of scale and geospatial differences given the substantial differences between the businesses. For example, Horizon Power has approx 41,000 customers in 2.3 million square kilometres and the Victorian market has 1.8 million customers in 230 thousand square kilometres. Further, the Victorian experience as a benchmark is difficult to understand without an engineering study of the impact of the extremes of climate in Horizon Power's regions and assets.</p> <p>The Authority also uses the Water Corporation, NT Power and Water Authority's Network Pricing reset as supporting situations in their determination. The Water Corporation have been in control of these assets for many years and are assumed to have been aware of their condition for an extended period therefore enabling management over time. This is not the case for Horizon Power and it is clear that the assets taken over in the disaggregation had been neglected.</p> <p>The NT Power and Water Authority operates in a far less regulated environment than Horizon Power to an extent that would significantly reduce their overheads and operating cost. This matter is further discussed in response to Recommendation 4 and in the advice provided by Economic Insights Pty Ltd.</p>
59	The Authority's efficiency target should be adjusted to reflect that Horizon Power has non-controllable expenditure associated with external works. The Authority has excised the revenue from external works but not the expenditures. There is an anticipated uplift in external works within the forecast period.		