

Determination on Western Power's Application to Waive the Regulatory Test for a Major Augmentation to the Great Southern Transmission Network to Supply the Southdown Mine

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Economic Regulation Authority



WESTERN AUSTRALIA

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DETERMINATION

1. On 16 June 2011, the Economic Regulation Authority (**Authority**) received an application from Western Power requesting it to waive the regulatory test in respect of a proposed major augmentation to the Great Southern transmission network to supply the Southdown Mine (approximately 90 km north east of Albany).¹ The application was made under section 9.24 of the *Electricity Networks Access Code 2004* (**Access Code**).
2. Western Power has applied for a waiver of the regulatory test on the basis that:
 - there are no viable alternative options for the major augmentation to supply the required capacity to the Southdown Project by the required supply date;
 - the nature of the proposed major augmentation is such that significant advance planning is required and no alternative options exist;
 - the nature of the funding of the proposed major augmentation means that the proposed major augmentation will not cause a net cost to those who generate, transport and consume electricity; and
 - the application of the regulatory test would result in significant delays to the construction of the transmission line due to the optimal construction windows being missed.
3. The Authority considers that the regulatory test has an important role to play in achieving the objectives of the Access Code to promote economically efficient investment in and the operation and use of the network to promote competition in markets upstream and downstream of the network. The test is particularly important given the current transmission constraints Western Power has, which are likely to become an increasing issue if demand for electricity continues to increase. Careful consideration needs to be given to the objectives of the Code before waiving the test.
4. The Authority requested further information from Western Power. As a result, Western Power has provided two supplementary submissions (dated 8 July 2011 and 2 August 2011).
5. The Authority has considered each of the reasons put forward by Western Power. It has a number of concerns with Western Power's application but considers that the application of the regulatory test in respect of the proposed major augmentation would be contrary to the objectives of Chapter 9 of the Code, as there is only one viable option which can be delivered within the timescale required to deliver a supply of electricity to the Southdown Mine by March 2014.
6. Consequently, in accordance with the provisions of section 9.23 of the Access Code, the Authority has formed the view that the application of the regulatory test in

¹ Western Power, 14 June 2011, Request for Waiver of Regulatory Test: Major Augmentation to Great Southern transmission network to supply the Southdown Mine (hereafter referred to as "**waiver application**").

respect of the proposed major augmentation would be contrary to the objectives of Chapter 9 of the Access Code.

7. The Authority has decided to publish a notice, pursuant to section 9.24(a) of the Access Code, which meets the requirements in relation to the Authority exercising its power to waive the application of the regulatory test for the proposed major augmentation under section 9.23(f) of the Access Code.
8. In making its determination the Authority has had regard to the provisions dealing with the regulatory test as set out under Chapter 9 of the Access Code, as well as Western Power's application and supporting information.
9. Western Power has advised that a decision will be made at the end of the first quarter of 2012 as to whether the proposed line will proceed. If the decision has not been made by June 2012, then the Authority reserves its right to review its decision on this waiver application.
10. Prior to any new facilities investment being approved for inclusion in its capital base, Western Power will need to demonstrate that the costs are efficient and meet one of the following criteria:
 - the incremental revenue arising from the augmentation is expected to at least recover the expenditure; or
 - the augmentation provides a net benefit in the covered network that justifies the approval of higher reference tariffs; or
 - the augmentation was necessary to maintain the safety or reliability of the covered network or its ability to provide contracted covered services.
11. The specific reasons for granting the regulatory test waiver are set out below.

REASONS

12. The Authority's determination on the major augmentation proposal is limited to the scope of the regulatory test under Chapter 9 of the Access Code and addresses the question of whether the regulatory test should be waived. While the Authority's determination is necessary for Western Power to commit to the proposed transmission line, approvals and permissions relating to a number of other matters are outside of the Authority's role and responsibilities. Such matters include environmental management, compensation arrangements for affected landowners and the commencement and timing of works.
13. In these reasons the following matters are addressed:
 - the requirements for the regulatory test under Chapter 9 of the Access Code;
 - the circumstances in which the regulatory test may be waived as set out in sections 9.23 to 9.24 of the Access Code;
 - Western Power's reasons for the waiver application;
 - identification of alternative options to the proposed major augmentation;
 - the nature of the funding of the proposed major augmentation; and
 - the potential delay to the project if the regulatory test is not waived.

The Regulatory Test

14. Chapter 9 of the Access Code establishes the regulatory test that is applied to proposals for major augmentations of a covered network. The objectives of Chapter 9 as set out in section 9.1 are:
 - (a) to ensure that before a *service provider commits* to a proposed major augmentation to a *covered network*, the *major augmentation* is properly assessed to determine whether it maximises the *net benefit after considering alternative options*; and
 - (b) to provide an incentive to a *service provider*, when considering *augmentation* to a *covered network*, to select the option (which may involve a *major augmentation* or may involve not proceeding with an *augmentation* at all) which maximises the *net benefit after considering alternative options*; and
 - (c) to minimise:
 - (i) delay to projects and other developments; and
 - (ii) administrative and regulatory costs; and
 - (iii) any other barriers to the entry of *generators* and *consumers* into the electricity market;

arising from the application of the *regulatory test*.
15. The regulatory test is required only for “major augmentations” of a covered network, as defined in Chapter 1 of the Access Code:

“major augmentation” means an augmentation for which the new facilities investment for the shared assets:

 - (a) exceeds \$10 million (CPI adjusted)², where the network assets comprising the augmentation are, or are to be, part of a distribution system; and
 - (b) exceeds \$30 million (CPI adjusted)³, where the network assets comprising the augmentation are, or are to be, part of:
 - (i) a transmission system;
 - (ii) both a distribution system and a transmission system.
16. Under section 9.2 of the Access Code, a service provider must not commit to a major augmentation before the Authority determines, or is deemed to determine, that the regulatory test is satisfied.

² The 2011 CPI adjusted threshold is \$10.9 million as stated in the Economic Regulation Authority's Notice on 2011 Consumer Price Index Adjustments, 7 June 2011.

³ The 2011 CPI adjusted threshold is \$32.7 million as stated in the Economic Regulation Authority's Notice on 2011 Consumer Price Index Adjustments, 7 June 2011.

17. The process of the regulatory test commences with the submission, by a service provider to the Authority, of a “major augmentation proposal”. This may occur either:
- with the major augmentation proposal submitted as part of a proposed access arrangement, and the Authority’s determination of whether the regulatory test is satisfied forming part of the Authority’s decision on the proposed access arrangement (section 9.10 of the Access Code); or
 - with a major augmentation proposal submitted other than as part of a proposed access arrangement and the Authority’s determination on whether the regulatory test is satisfied being a determination separate from the approval process for a proposed access arrangement (section 9.15 of the Access Code).
18. Section 9.16 of the Access Code establishes the requirements for a major augmentation proposal submitted to the Authority other than as part of a proposed access arrangement:
- 9.16 A major augmentation proposal submitted under section 9.15:
- (a) must describe in detail each major augmentation to which the major augmentation proposal relates; and
 - (b) must state that, in the service provider’s view, each proposed major augmentation maximises the net benefit after considering alternative options; and
 - (c) must demonstrate that the service provider has conducted a consultation process in respect of each proposed major augmentation which:
 - (i) included public consultation under Appendix 7; and
 - (ii) gave all interested persons a reasonable opportunity to state their views and to propose alternative options to the proposed major augmentations, and that the service provider had regard to those views and alternative options; and
 - (iii) involved the service provider giving reasonable consideration to any information obtained under sections 9.16(c)(i) and 9.16(c)(ii) when forming its view under section 9.16(b);
- and
- (d) must comply with the current requirements published under section 9.17.
 - (e) may include a request that the Authority give prior approval under section 6.72 in respect of the new facilities investment for one or more proposed major augmentations.
19. “Alternative options” and “net benefit”, referred to in section 9.16(b), are defined under Chapter 1 of the Access Code:

“alternative options”, in relation to a major augmentation, means alternatives to part or all of the major augmentation, including demand-side management and generation solutions (such as distributed generation), either instead of or in combination with network augmentation.

...

“net benefit” means a net benefit (measured in present value terms to the extent possible) to those who generate, transport and consume electricity in (as the case may be):

- (a) the covered network; or
- (b) the covered network and any interconnected system.

20. For a major augmentation proposal submitted to the Authority other than as part of a proposed access arrangement, the requirements for the regulatory test to be satisfied are set out in section 9.20 of the Access Code:

9.20 The test in this section 9.20 is satisfied if the Authority is satisfied that:

- (a) the service provider’s statement under section 9.16(b) is defensible; and
 - (b) the service provider has applied the regulatory test properly to each proposed major augmentation:
 - (i) using reasonable market development scenarios which incorporate varying levels of demand growth at relevant places; and
 - (ii) using reasonable timings, and testing alternative timings, for project commissioning dates and construction timetables for the major augmentation and for alternative options;
- and
- (c) the consultation process conducted by the service provider meets the criteria in section 9.16(c).

21. Section 9.18 of the Access Code establishes the timeframes for a determination by the Authority on whether the regulatory test is satisfied or not satisfied:

9.18 The Authority must in respect of a major augmentation proposal submitted under section 9.15 make and publish a determination whether the test in section 9.20 is satisfied or not satisfied, and must do so:

- (a) if the Authority has consulted the public under section 9.19 – within 45 business days; and
- (b) otherwise – within 25 business days,

after receiving the augmentation proposal.

22. The role of the Authority is to consider the information provided by a service provider in the major augmentation proposal and to determine whether the regulatory test set out in section 9.20 of the Access Code is satisfied. Section 9.21 of the Access Code places the onus on the service provider to demonstrate that the regulatory test is satisfied.

9.21 If the Authority is unable to determine whether the test set out in section 9.20 is satisfied or is not satisfied because the service provider has not provided adequate information (despite the Authority having notified the service provider of this fact and given the service provider a reasonable opportunity, having regard to the time periods specified in section 9.18, to provide adequate information), then the Authority may determine that the test in section 9.20 is not satisfied.

23. The Authority's role ends with the determination of whether the regulatory test is satisfied or not satisfied. If the latter determination is made, the Authority does not have a role to remedy any deficiency in the major augmentation proposal or to make any determination on the alternative option that may maximise net benefits.

Waiver of Regulatory Test

24. Under certain circumstances, the Authority may form the view that the application of the regulatory test would be contrary to the Chapter 9 objectives and that the test should be waived or modified. This is set out in section 9.23 of the Code.

If the *Authority* forms the view that the application of the *regulatory test* under sections 9.10 to 9.14 or sections 9.15 to 9.22 in respect of a proposed *major augmentation* would be contrary to the *Chapter 9 objectives*, including because:

- (a) there are no, or it is unlikely that there are any, viable *alternative options* to the proposed *major augmentation*; or
- (b) the nature of the proposed *major augmentation* is such that significant advance planning is required and no *alternative options* exist; or
- (c) the nature of the proposed *major augmentation*, or part of it, is such that it should be submitted to the Independent Market Operator established under the *Electricity Industry (Independent Market Operator) Regulations 2004*; or
- (d) the nature of the funding of the *proposed major augmentation* means that the *proposed major augmentation* will not cause a net cost (measured in present value terms to the extent that it is possible to do so) to those who *generate, transport and consume* electricity in the *covered network* and any *interconnected system*,

then the *Authority* may, by *publishing* a notice:

- (e) expedite or otherwise modify the application of the *regulatory test* in respect of the *major augmentation* to the extent the *Authority* considers necessary to meet the *Chapter 9 objectives*; or
- (f) waive the application of the *regulatory test* in respect of the *major augmentation* if the *Authority* considers it necessary to do so to meet the *Chapter 9 objectives*.

25. Section 9.24 of the Code provides for a request to be made to the Authority to form a view under section 9.23.

Without limiting the circumstances in which the *Authority* may publish a notice under section 9.23, if a person requests the *Authority* to form a view under section 9.23 in respect of a *proposed major augmentation* which is described to the *Authority* in reasonable detail then the *Authority* must as soon as practicable form a view and either:

- (a) *publish* a notice under section 9.23; or
- (b) notify the person that the *Authority* does not propose to *publish* a notice under section 9.23.

Western Power's Regulatory Test Waiver Application

Proposed Major Augmentation

26. On 16 June 2011, the Authority received an application from Western Power requesting it to waive the regulatory test in respect of a proposed major augmentation to the Great Southern transmission network to supply the Southdown Mine. The application was made under section 9.24 of the Access Code.
27. Western Power's application states that the proposed major augmentation will cost an estimated \$387.5 million and comprises:
 - reinforcing the existing network by replacing the Muja to Kojonup 81 route with a 330 kV double circuit line and rehabilitating the pre-existing line route; and
 - building a single circuit 330 kV line from Kojonup to Southdown.
28. In response to enquiries from the Authority, Western Power made further submissions on 8 July 2011 and 2 August 2011.⁴

Reasons for the Regulatory Test Waiver

29. In its application, Western Power considers that a waiver in respect of the proposed major augmentation is justified due to the following reasons:
 - There are no viable alternative options for the major augmentation to supply the required capacity to the Southdown Project by the required supply date (section 9.23(a) of the Code).
 - The nature of the proposed major augmentation is such that significant advance planning is required and no alternative options exist (sections 9.23(b) of the Code).
 - The nature of the funding of the proposed major augmentation means that the proposed major augmentation will not cause a net cost (measured in present value terms) to those who generate, transport and consume electricity in the covered network and any interconnected system (section 9.23(d) of the Code).
 - The application of the regulatory test would result in significant delays to the construction of the transmission line due to the optimal construction windows being missed. This would also cause further delays to the Southdown Project which would prevent the Southdown Joint Venture (**SDJV**) from taking advantage of an optimal iron ore pricing window. These delays are likely therefore to risk the future of the Southdown Project and its benefits to the Western Australian community.
 - In the above circumstances the project delay, regulatory and administrative costs and consequent barrier to the Southdown Project's access to the network are not justifiable in light of the Chapter 9 objectives.

⁴ These submissions are available on the ERA's website:

http://www.erawa.com.au/3/1177/48/binningup_desalination_plant_augmentationregulator.pm

These reasons have been considered in the following sections.

Alternative Options

Requirements of the Access Code

30. The regulatory test requires the service provider to demonstrate that the proposed major augmentation maximises the net benefit after considering alternative options. The service provider must also demonstrate that it has conducted a consultation process which gave all interested parties a reasonable opportunity to state their views and to propose alternative options to the one proposed and that the service provider had regard to those views and alternative options.
31. Under section 9.23 of the Code, possible grounds for waiver of the regulatory test include where there are no, or it is unlikely that there are any, viable alternative options to the proposed major augmentation or the nature of the proposed major augmentation is such that significant advance planning is required and no alternative options exist.

Western Power's Application

32. Western Power considers that there are no viable alternative options for the major augmentation to supply the required capacity to the Southdown Project by the required supply date and that the nature of the proposed major augmentation is such that significant advance planning is required and no alternative options exist.
33. Western Power states that the only alternative option to connecting Southdown Mine to Western Power's network is to consider onsite generation which would involve the construction of a power plant and onsite supply of gas or diesel. However, given the location of the mine and the extent of generation required, this option was considered uneconomic compared with connecting to Western Power's network and was therefore rejected by the SDJV. The SDJV has also considered wind, solar and biomass alternatives but has ruled them out on the basis of cost and capability. A report prepared by the SDJV evaluating these alternatives was included in Western Power's submission to the Authority dated 2 August 2011⁵.
34. The SDJV first approached Western Power in 2005. Between 2005 and 2007 Western Power developed a proposal to supply the Southdown Mine direct from Muja by constructing a new transmission line between Muja and Southdown. Development of the Southdown Mine was put on hold in 2008 due to the global financial conditions at that time.
35. Discussions with the SDJV recommenced in May 2010. The waiver application is based on a revised proposal which involves upgrading the existing line between Muja and Kojonup and building a new line from Kojonup to Southdown utilising the line route which had been secured during the original project negotiations. The size

⁵ Grange Resources Ltd - Southdown Project - Power Supply Options Study Southdown Minesite, December 2006.

of the proposed transmission line has also been increased from 220 kV to 330 kV due to a significant increase in the requested power supply by the SDJV.

Considerations of the Authority

36. The Authority notes the information put forward by Western Power in relation to alternative options to a connection to the network. Given that the SDJV has ruled out alternatives to a network connection on the basis of cost and capability, the Authority agrees that there are no viable alternative options to a major augmentation to the network.
37. Western Power's waiver application included a number of options for augmenting the network. However, it was not clear from the application whether all possible options had been considered. In response to queries from the Authority, Western Power provided an additional submission on 2 August 2011 which included significantly more information in relation to the development of the current proposal and explained the factors driving the choice of project.
38. Taking account of the additional information provided, the Authority accepts that, given the timescale now left for the project to commence in order to meet the SDJV's timescale, it is not practicable for Western Power to consider options other than the one presented in its waiver application. Western Power has advised that a decision will be made at the end of the first quarter of 2012 as to whether the proposed line will proceed. If the decision has still not been made by June 2012, then the Authority reserves its right to review its decision on this waiver application.
39. Prior to any new facilities investment being approved for inclusion in its capital base, Western Power will need to demonstrate that the costs are efficient and meet one of the following criteria:
 - the incremental revenue arising from the augmentation is expected to at least recover the expenditure; or
 - the augmentation provides a net benefit in the covered network that justifies the approval of higher reference tariffs; or
 - the augmentation was necessary to maintain the safety or reliability of the covered network or its ability to provide contracted covered services.

Nature of Funding

Requirements of the Access Code

40. Under section 9.23(d) of the Code, possible grounds for waiver of the regulatory test include where the nature of the funding of the proposed major augmentation means that the proposed major augmentation will not cause a net cost (measured in present value terms to the extent that it is possible to do so) to those who generate, transport and consume electricity in the covered network and any interconnected system.

Western Power's Application

41. Western Power's waiver application stated that the proposed major augmentation would not cause a net cost to those who generate, transport and consume electricity in the covered network and any interconnected system because:

- any costs associated with the major augmentation which do not meet the new facilities investment test will be funded by SDJV; and
 - the double circuit line between Muja and Kojonup replaces necessary works that would have been undertaken by Western Power in respect of the Great Southern network in the next five years, regardless of the Southdown Project's requirements.
42. The waiver application included a copy of a letter from the Managing Director of Grange Resources to the Authority stating that:

Subject to the Project proceeding, SDJV has undertaken to meet any capital contributions required under WP's Contributions Policy for those costs which do not subsequently meet the new facilities investment test under the Electricity Networks Access Code and accordingly we understand there will be no net cost to other users of the network resulting from the major augmentation.

Considerations of the Authority

43. The Authority did not consider Western Power's waiver application provided sufficient evidence to demonstrate that the proposed major augmentation would not cause a net cost. Although the application included a letter from Grange Resources, as noted in paragraph 42 above, the waiver application did not include any specific detail of the amount of contribution. The Authority sought further clarification from Western Power of the costs that will be funded by the SDJV and, to the extent that any costs are not funded by the SDJV, evidence to demonstrate that these costs will not result in a net cost to those who generate, transport and consume electricity on the network.
44. Western Power provided a supplementary submission on 8 July 2011. The supplementary submission continues to place reliance on the operation of the new facilities investment test to
- “...insulate the users of the network from costs which are inefficiently incurred, or those which are not otherwise offset by incremental revenue, net benefits to users or the necessity of the works in maintaining covered service provision within required safety and reliability requirements.”⁶
45. The supplementary submission also notes that the potential net benefits generated by the major augmentation could be significant, including that the increased overnight load will enable more efficient generator dispatch, which will result in cost savings and a downward pressure on the marginal cost of generation.⁷
46. The argument put forward by Western Power in relation to the new facilities investment test potentially applies to any major augmentation where a customer is required to pay a capital contribution. The grounds for waiver are straightforward where the customer has agreed to pay a contribution for the full cost of the augmentation because there is clearly no cost to users. However, it is unclear whether it was the intention of section 9.23(d) that a waiver should be granted by relying on the operation of the new facilities investment test.

⁶ Western Power, 8 July 2011, Supplementary Submission page 10

⁷ Western Power, 8 July 2011, Supplementary Submission page 9

47. As set out in paragraphs 36 to 38, the Authority has approved the waiver application on the basis of there being only one viable option which can be delivered within the timescale required to deliver a supply of electricity to the Southdown Mine by March 2014. The Authority reserves its position on whether the arguments put forward by Western Power, in relation to there being no net cost, are valid and will give further consideration to the intention of section 9.23(d) of the Code.

Potential Delay to Project

Requirements of the Access Code

48. Section 9.1(c)(i) states one of the objectives of Chapter 9 of the Access Code is to minimise delay to projects and other developments.
49. Section 9.18 of the Access Code requires the Authority to publish a determination in relation to a regulatory test application within 45 days if the Authority has consulted the public or, otherwise, within 25 business days after receiving the major augmentation proposal.

Western Power's Application

50. Western Power submits that the time scale required to apply the regulatory test is too long to be carried out within the project's timescale.
51. Western Power commenced negotiations in relation to the current proposal with the SDJV in May 2010. The SDJV advised a supply was needed by March 2014. Western Power considers it needs to commence construction in early 2012 in order to meet this timescale. Western Power submitted the regulatory test waiver application to the Authority in June 2011.

Considerations of the Authority

52. The Authority considers that for a major augmentation it is not unreasonable to expect that the time provided for regulatory test assessments by the Authority, as set out in the Access Code, should generally be incorporated in Western Power's planning process. The regulatory test is a key mechanism in the Access Code to achieve the Code objectives by ensuring that, before a service provider commits to a proposed major augmentation, the proposal is properly assessed to determine whether it maximises the net benefit after considering alternative options. A significant element of this assessment is demonstrating that adequate consultation has been conducted to give all interested persons a reasonable opportunity to state their views and to propose alternative options to the proposed major augmentation and that Western Power had regard to those views and alternative options.
53. The Authority notes that discussions with the SDJV recommenced in May 2010, following earlier discussions which had been put on hold in 2008 due to the global financial conditions at that time. The Authority received the request for waiver in June 2011. The Mid West Project (Southern Section)⁸, a major augmentation of

⁸ Further information is available on the ERA's website:

similar size driven by large mining projects and also on a time critical path, has recently undergone extensive consultation and a full regulatory test.

54. The Authority does not consider there was insufficient time for a regulatory test to be undertaken and therefore does not agree that a waiver should be granted on this basis.