

DM: 22012011

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Dear Sir/Madam

Submission on Alinta's proposed ringfencing rules

With the commencement of coverage of some Pilbara networks from 1 July 2021, Horizon Power and Alinta DEWAP will be subject to the Pilbara Networks Access Code 2021 (PNAC).

As Horizon Power and Alinta DEWAP operate integrated electricity businesses, they are required to submit their proposed ringfencing rules to the Economic Regulation Authority (ERA) for approval.

Thank you for the opportunity to review and provide comments on Alinta's proposed ringfencing rules. Horizon Power has reviewed Alinta DEWAP's proposed ringfencing rules. This submission identifies a number of questions for the ERA's consideration as part of the approval process. These are discussed in further detail in the following sections.

A. Recognising the structure and nature of the NSP's business

Section 127(2)(a) of the PNAC includes a secondary ringfencing objective to allow for:

flexibility, recognising the fact that the structure and nature of [Network Service Provider's] NSP's businesses differ substantially.

Alinta DEWAP (ADEWAP) appears to have included background material in its proposed ringfencing rules to justify that they are reasonable based on the structure and nature of its business as an NSP. In particular, it identifies that:

- The ADEWAP Network and ADEWAP Generation businesses exist within the same entity.¹
- ADEWAP has existing power purchase agreements that 'bundle' contracts for both power supply and network access.²
- The ADEWAP Network is fully contracted under long term agreements.³
- There is no availability of network capacity in the near to medium term that is capable of being contracted by a new prospective network user.⁴

Section 127(2)(b) and (c) of the PNAC include secondary ringfencing objectives to allow for:

(b) a balancing of cost and disruption against the primary objective of this Chapter 8; and

¹ Alinta Energy, *Ringfencing Rules, Alinta DEWAP Network*, Version 2, page 10

² *ibid*

³ *ibid*

⁴ *ibid*

(c) *flexibility to deal with changing circumstances over time.*

Horizon Power questions whether ADEWAP's proposed ringfencing rules have appropriately balanced the costs and disruption of the ringfencing rules against the primary ringfencing objectives, and allow for flexibility to deal with changing circumstances when:

- The Pilbara Network Rules (PNR) provide for a constrained network access regime.⁵
- The PNAC requires a Network Service Provider (NSP) to make an access offer to any prospective user, including Horizon Power's retail business.⁶
- ADEWAP holds an integrated regional licence which authorises it to sell electricity to customers in the Port Hedland area, other than small use customers.⁷
- the Alinta group (of which ADEWAP comprises part of) is planning to expand its Port Hedland Power Station.⁸

Additionally, Horizon Power queries the appropriateness and relevance of some of the information provided in ADEWAP's ringfencing rules which is inconsistent with its obligations under the PNAC and PNR, in particular, sections 3.3 and 4.2 of Alinta's proposed ringfencing rules.

B. Associate arrangements

Section 131 of the PNAC states that:

If the network business of an NSP provides one or more covered services to an other business of the NSP (deemed associate arrangement) then:

- (1) *The network business and the other business must record in writing the full terms and conditions of the deemed associate arrangement by which the network business is to provide the covered services to the other business, to the same standard as they would if they were arms-length separate entities;*

Our understanding of Alinta Energy's business model, based on ADEWAP's proposed ringfencing rules, is that, for the purposes of the PNAC:

- ADEWAP Network is the network business of the NSP.
- ADEWAP Generation is an other business of the ADEWAP Network.
- Alinta Sales is an other business of the ADEWAP Network.

While ADEWAP's ringfencing rules state that it will record the full terms and conditions of any associate arrangements, they also refer to power purchase agreements between ADEWAP Generation and Alinta Sales, and between ADEWAP Generation and iron ore mining businesses. The power purchase agreements are "essentially 'bundled' contracts for both power supply and network access".⁹ Horizon Power queries whether there is a deemed associate arrangement recorded in writing

⁵ Refer subchapter 9.1

⁶ Refer section 71

⁷ Refer <https://www.erawa.com.au/cproot/12688/2/Alinta%20DEWAP%20Pty%20Ltd%20-%20retail%20licence%20area%20map.PDF>

⁸ For example, EPA is assessing an application from Alinta Energy (refer <https://www.epa.wa.gov.au/proposals/port-hedland-power-station-expansion>) and RenewEconomy reported on 29 June 2021 that "Alinta plans big solar farm and four hour battery in Port Hedland grid play" (refer <https://reneweconomy.com.au/alinta-plans-big-solar-farm-and-four-hour-battery-in-port-hedland-grid-play/>)

⁹ Alinta Energy, *Ringfencing Rules, Alinta DEWAP Network*, Version 2, page 10

for the provision of covered network services between ADEWAP Network and ADEWAP Generation and/or Alinta Sales as required under the PNAC.

Additionally, we note that ADEWAP has an integrated regional licence, but note that the proposed ringfencing rules do not mention ADEWAP's retail function nor any deemed associate arrangement between ADEWAP's network and retail functions.

C. Operational / functional separation

As there is no structural separation between Alinta Energy, Alinta Sales, ADEWAP Network and ADEWAP Generation, and no legal separation between ADEWAP Network and ADEWAP Generation, there is a reliance by ADEWAP Network on operational or functional separation to mitigate the harms of anti-competitive behaviour.

ADEWAP's ringfencing rules propose a number of forms of operational or functional separation, including:

1. Restricted data access, while noting that restrictions are enforced between the ADEWAP team and other Alinta Energy staff, but not between ADEWAP Network and ADEWAP Generation.
2. Commercial dealings, while noting that the independent observer nominated is Alinta Energy's WA Wholesale Regulation Manager, who has an incentive to favour the wholesale parts of Alinta Energy's business, compared to ADEWAP Network.
3. Corporate structure, while noting that there is no separation between ADEWAP Network and ADEWAP Generation staff, and no indication as to whether access to different floors in Alinta Energy's Perth office is restricted in any way.
4. Declarations, while noting that the declaration process is administered by the WA Wholesale Regulation Manager, who has an incentive to favour the wholesale parts of Alinta Energy's business, compared to ADEWAP Network.
5. Annual audit, while noting that the audit will be undertaken by the WA Wholesale Regulation Manager. Horizon Power queries whether there is the potential for the WA Wholesale Regulation Manager to require access to sensitive and confidential information in conducting this audit.
6. Reporting breaches, similar to the above, Horizon Power queries whether there is the potential for the WA Wholesale Regulation Manager to require access to sensitive and confidential information when investigating breaches.

D. Cost allocation methodology

Cost allocation methodologies generally have a hierarchy with:

- direct attribution of costs to the covered entity, in ADEWAP's case this would be to ADEWAP Network;
- allocation of shared costs associated with the legal entity, in ADEWAP's case this would be the allocation of ADEWAP's costs to ADEWAP Network and to ADEWAP's other businesses; and
- allocation of shared costs associated with the parent entity, in ADEWAP's case this would be allocation of costs associated with the Alinta Energy parent entity to ADEWAP Network, ADEWAP's other businesses and other Alinta Energy businesses.

ADEWAP does not appear to have any direct attribution of costs to ADEWAP Network. Rather, all ADEWAP's direct costs, income and expenditure appear to be

shared and allocated between the generation and network functions. This raises two questions:

- Are there direct costs, income and expenditure associated with ADEWAP that should be directly attributed to ADEWAP Network or to ADEWAP Generation? In particular, we would expect that a significant proportion of direct costs would relate to fuel, which is directly attributable to ADEWAP Generation.
- Given that ADEWAP has an integrated regional licence, are there any direct costs, income and expenditure associated with a retail function?

Where ADEWAP allocates direct costs, income and expenditure to the generation and network functions, these are allocated on a basis that is not specified in the ringfencing rules or, where “there is no clear rationale for allocation”¹⁰, 12 per cent is allocated to ADEWAP Network and 88 per cent to the generation function. The basis for the 12 per cent is the revenue contribution of the ADEWAP Network relative to the total revenue for the entire ADEWAP business.

Given that the ringfencing rules do not indicate that any direct costs, income and expenditure are directly attributed to ADEWAP Network business, Horizon Power queries the circulatory nature of using a revenue allocator when the costs that are allocated would be expected to comprise a significant proportion of the revenue.

Horizon Power notes that 50 per cent of the IT & Communication costs and marketing costs are allocated to ADEWAP Network. Horizon Power queries the basis for this allocation, and any others that are not specified in the ringfencing rules or are not consistent with the commonly used 12 per cent. In particular, Horizon Power queries the allocation of 50 per cent of marketing costs to a covered network business that has “no availability of firm network capacity capable of being contracted by new prospective users of the ADEWAP Network”.¹¹

ADEWAP’s ringfencing rules note that a percentage of corporate common costs (overheads) are allocated from the Alinta Energy parent entity to ADEWAP “based on the corporate charge allocation”.¹² Horizon Power queries whether this is sufficient information to be able to assess whether the allocation is true and fair, as required by section 134(1)(b) of the PNAC.

The proposed ringfencing rules state that “where the allocation of an amount differs from the 12% general allocation rule, it is subject to review by the WA Wholesale Regulation Manager to determine the efficacy and fairness of the rationale for allocation that was applied”.¹³ Horizon Power queries the appropriateness of the WA Wholesale Regulation Manager to undertake this review given the incentive for Alinta Energy to shift costs from the contestable retail / generation (wholesale) parts of the business to the covered network part of the business.

E. Fully Contracted Network

From a technical and operational perspective, Horizon Power queries the validity of Alinta stating “no availability of firm network capacity capable of being contracted by new prospective users of the ADEWAP Network”¹¹.

From an operational perspective, network access contracts can be established purely for the purpose of supplying existing loads. Under such an arrangement, a network User may seek to connect a generator (with ISO approval), which would be exposed

¹⁰ Alinta Energy, *Ringfencing Rules, Alinta DEWAP Network*, Version 2, page 11

¹¹ *Ibid*, page 7

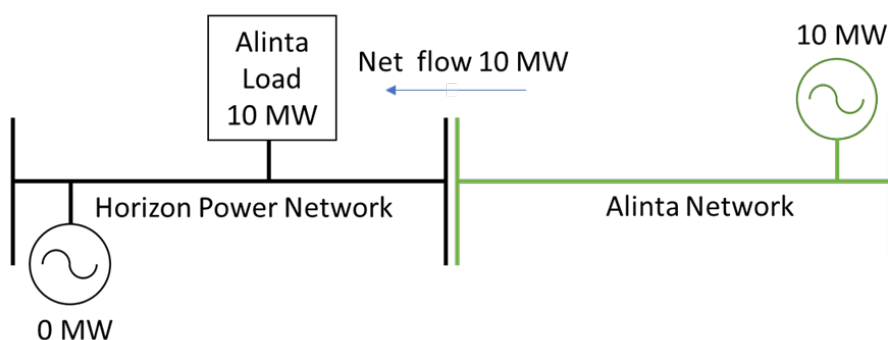
¹² *Ibid*, page 11

¹³ *Ibid*, page 12

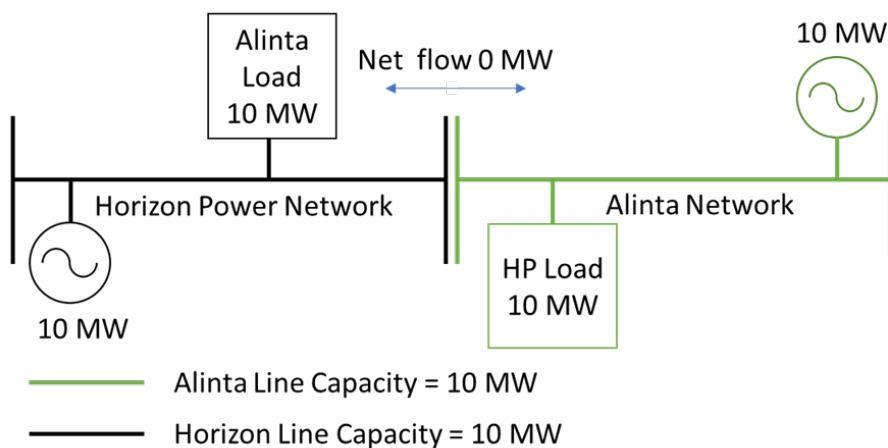
to the constrained access regime detailed in Subchapter 9.1 of the PNR. Under section 15(2) of the PNAC, Alinta would not have the right to refuse such a connection. Such a User could then seek to churn existing customers on the Alinta network hence utilising existing capacity currently utilised for existing arrangements. Under this arrangement it would not be appropriate to state that existing capacity cannot be utilised for “new prospective Users”.

From a technical perspective, counterflows to the current operational arrangements will actually increase the available capacity. As an example, should Horizon Power Retail procure a new customer on Alinta’s network and seek to provide them power via the Horizon Power/Alinta interconnect, such flows would reduce the net flow through the interconnect (currently only consisting of Alinta supplying power into Horizon Power’s network) hence freeing capacity. This scenario is shown in a highly simplified diagram below for reference.

Current arrangement, Alinta claims lines are at full contract capacity



New arrangement, capacity on Alinta Network increased by counter flow



Yours sincerely

Sandy Morgan

Manager Network Regulation & Open Access

HORIZON POWER