

9 June 2008

330kV Mid-West New Facilities Investment Test
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ERA Issues Paper - Preapproval of New Facilities Investment

On 9 April 2008, Western Power submitted an application for the pre-approval of the new facilities investment associated with a proposed major augmentation (being the construction of a 330 kV transmission line from Pinjar to Geraldton and associated works). The Economic Regulation Authority (the ERA or the Authority) subsequently released an issues paper. In response, Western Power is now pleased to provide some additional commentary.

With respect to the proposed major augmentation, Western Power does not at this stage have any significant new information to provide. Western Powers' view is that it is clearly obliged to maintain and operate the shared transmission network in accordance with the technical rules as approved by the Authority and the proposed major augmentation is required to enable Western Power to meet these obligations. The proposed new facility has previously been determined by the Authority to meet the requirements of the *regulatory test* under Chapter 9 of the Code.

Western Power's intention is to construct the 330kV line from Pinjar to Moonyoonooka and associated major substation works at lowest cost, using its alliance partners, and other related minor works will be managed prudently in accordance with Western Power's standard practices. The *new facility* provides market benefits but is primarily required to maintain the safety and reliability of the *covered network* given the projected load forecasts in accordance with the *technical rules*. The proposed *new facility* consequently meets the new facilities investment test as it meets the requirements of section 6.52(a) and 6.52(b)(iii) of the Code.

Generally, the specific issues raised by the Authority in relation to this project are not as significant as the more general issue of the interpretation of the New Facilities Investment Test in the Access Code. This response is consequently structured to first address some minor selected items from the Authorities issues paper and will then present a general discussion regarding NFIT and some of the broader issues which must be kept cognisant.

ERA Paper Issues Paper

Western Power will reference selected items from the Authority's issues paper using the section numbers from that paper.

ERA Issues Paper - Section 7

Western Power's current approved treatment of capital contributions is to include the relevant capital expenditure in the capital base. Therefore, in respect of the current access arrangement, Western Power notes that in addition to "that amount of new facilities investment that meets the new facilities investment test", the amount of new facilities funded by capital contributions (in accordance with section 6.56 of the Code) can be added to the capital base of the network and recovered through regulated network tariffs."

ERA Issues Paper - Section 19-36 and Figure 1

The Authority recognises the situation where it may be necessary to apply the NFIT to groups of projects in aggregate, and Western Power concurs and suggests this is a likely requirement particularly when assessing historical investment as part of an access arrangement review process.

However, while the approach outlined may be useful for assessing groups of projects which have different benefits, WP would also like to emphasise that there are likely to be many examples of single large projects that also have multiple benefits and it is not always practicable to quantitatively allocate costs of a single project to the separate categories of benefits for separate analysis under different legs of NFIT. The current project (the subject of this submission) for example will:

- result in incremental revenue,
- provide a net benefits (by way of connecting possibly cheaper generation to the SWIS), and
- provider reliability benefits (by way of maintaining an adequate network to meet the load forecast).

ERA Issues Paper - Section 36.

Section 36 states: "if the primary purpose of a new facility was to maintain reliability of the network, then consideration could first be given to whether the condition of section 6.52(b)(iii) is satisfied, and consideration given to the other conditions only if the total relevant amount of new facilities investment does not satisfy section 6.52(b)(iii)." This statement could be read to suggest that possibly only part of an amount of new facilities investment for a safety and reliability augmentation may satisfy NFIT. However, there is no suggestion under section 6.52(b)(iii) of an assessment of the benefits and cost of a new facility for safety and reliability. Consequently, if the new facility is required due to statutory requirements such as the technical rules established under the Code or requirements to meet industry best-practice standards etc. then section 6.52(b)(iii) of the Code will be met.

ERA Issues Paper - Section 72

Section 72 states: "In its consideration of the pre-approval application, the Authority will address the interpretation of the safety and reliability test under section 6.52(b)(iii) of the Access Code and potential inconsistencies in the application of this test."

WP recognises (and we believe other key stakeholders also recognise) there is tension between various requirements of the Electricity Industry Act with respect to the requirements for efficiency and prudence of expenditure and the overall development of the network and the state. This is discussed in more detail below.

ERA Issues Paper - Section 77

Section 77 states: "The report by CRA International did not include details of the demand forecasts and revenue calculations used. The Authority will seek details of calculations prior to making a determination on the pre-approval application."

Full financial details and detailed demand forecasts were provided to the Authority as a part of the major augmentation proposal for the regulatory test. Some of this information is commercially sensitive and has consequently been labelled confidential.

ERA Issues Paper - Section 79

Section 79 states: "Western Power has not undertaken a revised analysis of incremental revenue, but suggests that the finding that the new facilities investment for the proposed transmission line meets the incremental revenue test is still valid."

Western Power has evidence of possible increases in both forecast costs and network usage since the assessment by the Authority under the regulatory test, but considers each of the options discussed under the regulatory test would have been similarly affected. Western Power did not make any claim that the analysis of incremental revenue presented in the major augmentation proposal was still valid, but rather the outcome of the regulatory test itself was still valid.

New Facilities Investment Test (NFIT)

The Issues Paper helpfully sets out the Authority's interpretation of the New Facilities Investment Test (NFIT) and describes in detail how the various elements of the test in section 6.52 of the Code might apply. The Authority has developed a useful diagram on page 5 of the Issues Paper that further explains its interpretation of NFIT.

However, at this stage Western Power would like to separate consideration of the general interpretation of NFIT, from the particular consideration with respect to the proposed investment in the Pinjar to Geraldton 330 kV line.

Western Power takes the view that the provisions of NFIT, as they are currently drafted, do not achieve their desired aim which is to provide regulatory guidance and incentive for the network business to invest prudently, balanced by a degree of certainty that investments so undertaken will in fact be included in the regulated asset base. In fact there is a significant degree of uncertainty as to how the Regulator may apply NFIT particularly in an ex post assessment.

Western Power notes that one practical implication of the Authority's diagram is that the application of NFIT is potentially highly complex. Furthermore, these complexities may not reveal themselves in relation to the current assessment of Western Power's proposed 330 kV double-circuit transmission line between Pinjar and Geraldton. This is because:

- The assessment is a pre-approval in accordance with section 6.71 of the Code, and therefore differences between forecast and actual outcomes are not relevant in this instance; and
- The proposed expenditure is considered by Western Power to satisfy the safety and reliability test under section 6.52(b)(iii), and therefore many of the steps and calculations in the Authority's assessment process are likely to be untested in this application.

In addition to the above comments please note that Western Power is currently undertaking a review of its approach to transmission capital contributions which necessarily includes a discussion on the provisions of NFIT. One intention of this project to produce a guideline for

the interpretation of NFIT. However Western Power also takes the very clear view that such a guideline is of limited value unless it represents a common understanding across the Office of Energy, the Economic Regulatory Authority, and Western Power.

In light of these observations, Western Power believes that further work is required before the Authority's approach to NFIT is fully settled. Western Power looks forward to continuing to work with the Authority on these matters in the coming months.

Conclusions

WP recognises there is tension between various requirements of the Electricity Industry Act with respect to the requirements for efficiency and prudence of expenditure and the overall development of the network and the state. In particular, WP believes the requirements of the new facilities investment test are not definitive in all cases and that further collaborative work between key stakeholders (including the Authority and the Office of Energy) is required to establish a workable framework to encourage efficient and prudent expenditure on electricity infrastructure. Rather than altering Western Powers' system planning methodologies which have evolved in sympathy with industry best-practice, Western Power believes NFIT should be interpreted to reflect industry best practice system planning methodologies.

In the mean time, Western Power is required to facilitate economic development through efficient investment in infrastructure driven by robust strategic planning. A risk based approach to decision making by Western Power may at times be appropriate in anticipation that appropriate investment in network infrastructure which is supported by robust forecasts should be accepted by the Authority.

In the matter of the currently proposed major augmentation (330kV line from Pinjar to Moonyoonooka and associated major substation works), Western Power notes the Authority has previously determined the requirements of the *regulatory test* under Chapter 9 of the Code to be satisfied. The proposed *new facility* provides market benefits but is primarily required to maintain the safety and reliability of the *covered network* given the projected load forecasts in accordance with the *technical rules*. The proposed *new facility* meets the requirements of section 6.52(a) and 6.52(b)(iii) of the Code, and Western Power trusts the Authority will determine the new facilities investment test is satisfied also.

Should you have any queries or wish to discuss any matter please do not hesitate to call either myself or Neil Gibbney on 9326 4564.

Yours sincerely,

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