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MEDIA STATEMENT

Draft Decision on Western Power's Proposed Access Arrangement Revisions

The Economic Regulation Authority today issued its draft decision on Western Power's proposed access arrangement revisions for the South West Interconnected Network, which distributes electricity to more than 840,000 residential and business properties stretching from Kalbarri to Kalgoorlie and Albany, and including Perth.

The Authority's draft decision does not approve Western Power's proposed revisions for the second access arrangement for the network, a period ranging from 2009/10 to 2011/12.

The Authority's reasons have been set out in detail in its draft decision document, together with 46 amendments required for the Authority to approve Western Power's proposed revisions to the access arrangement. The Authority has invited submissions on the draft decision to allow stakeholders, including Western Power, to provide relevant input to the final decision.

Lyndon Rowe, the Authority's Chairman, said the draft decision allowed Western Power revenue of $795 million in 2009/10, increasing to $1,115 million in 2011/12 (excluding allowances for inflation). This was 33 per cent less than the utility had proposed for the same period.

The revenue allowed provided for "real" increases in network charges over the next three years of approximately 12 per cent a year for transmission services and approximately 6 per cent a year for distribution services. Overall, the real increase in network charges amounted to 8.5 per cent a year over the next three years. If this increase were passed through to retail electricity tariffs, it is estimated that retail tariffs would increase by approximately 3 per cent a year.

If the Authority had accepted Western Power's proposed revisions, it would have meant real annual increases in network charges of up to 42.2 per cent for transmission services and 32.2 per cent for distribution services.

However, in a subsequent submission received in late May 2009, Western Power indicated that it anticipated significant reductions to the proposed revisions because of the economic downturn and funding constraints imposed by Government.

The revenue increases allowed by the draft decision included a pre-tax real rate of return on the capital base of 7.06 per cent, compared with 8.95 per cent proposed by Western Power and 6.76 per cent in the current access arrangement. The Authority determined that the rate proposed by Western Power did not comply with the requirements of the Access Code.

The draft decision also refused to allow some of the $2.58 billion capital investment made by Western Power in the three years from 2006/07 to 2008/09 to be reflected in the new levels of revenue to be allowed.

Mr Rowe said $474 million was excluded because of concerns the utility had sought to earn a return on projects that had been discontinued, had suffered cost overruns and because Western Power had provided insufficient justification for cost increases.

“While the Authority’s consultants indicate that Western Power’s processes and systems are improving, we believe there is evidence of inefficiency in the management of capital works in the past,” Mr Rowe said.

The Authority also reduced the forecast capital and operating costs to be taken into account in setting the allowed revenue for the second access arrangement period. Capital costs have been reduced by $970 million and operating costs by $204 million. Mr Rowe said this was both because of the economic downturn and because the Authority was not convinced that all proposed operating costs had been adequately justified.

The cost forecasts approved would still allow for real increases in network capital investment of $1.4 billion, or 54 per cent more than the investment levels from 2006/07 to 2008/09. For operating costs, the Authority had allowed a real increase of $138 million, or 14 per cent more.

“The increases allowed by the Authority take into consideration the need for continued improvements in service standards and network reliability,” Mr Rowe said.

Western Power had proposed that the new access arrangement include mechanisms that created commercial incentives for it to seek operating efficiencies and to achieve and improve upon the service standard benchmarks for the reliability of network services.

The access arrangement includes service standard benchmarks that specify the reliability level customers can expect for network services. Western Power’s proposed revisions included benchmarks for transmission services that were similar to those in the first access arrangement, and sought a modest improvement for distribution services.

The draft decision approved the proposed benchmarks, but required others to be included for additional reliability measures for transmission services, consistent with what is imposed on transmission businesses throughout Australia.

Under the amended incentive mechanism for service standards, substantial under-performance against the benchmarks for reliability will expose Western Power to penalties of more than one per cent of its maximum revenue.

Both Western Power’s proposed revenue and that determined by the Authority in the draft decision were based on the Western Australian Government not requiring the utility to include an amount in distribution charges to finance subsidies paid to Horizon Power to provide electricity services in regional areas (through the Government’s Tariff Equalisation Fund).

Information provided to the Authority indicated the Government could require Western Power to collect $403 million for the Tariff Equalisation Fund between 2009/10 to 2011/12. The overall impact on network charges including the tariff equalisation contribution is to increase these charges by around 17 per cent a year.

The impact on retail tariffs is uncertain and will depend on whether the Government decides to pass on the full value of the increase in network charges to residential retail tariffs. Assuming all increases in network charges were passed on, the Authority has estimated that retail tariffs would increase by approximately 6 per cent a year if the tariff equalisation contribution was included.

(It is important to note that network charges are only one component of retail costs. Retail tariffs also need to cover the cost of generation and retailing. There is also evidence to suggest that the current government regulated retail tariffs are not cost reflective. The increases in retail tariffs estimated above only reflect the impact of increases in network charges.)

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LYNDON ROWE
CHAIRMAN

16 July 2009