

Economic Regulation Authority

 WESTERN AUSTRALIA

Promoting fair prices, quality services and choice.

Public Forum

Proposed Revisions to Western Power's Access Arrangement for the South West Interconnected Network

Monday, 10 November 2008

Perth Convention Exhibition Centre (Meeting Room 6)



Hosted by the Economic Regulation Authority, in conjunction with Western Power

Forum Overview

- To allow interested parties to hear ‘first hand’ about the proposed revisions to Western Power’s access arrangement, and provide an opportunity to raise questions in relation to the proposed revisions.
- Forum Agenda
 - Economic Regulation Authority (~30mins)
 - Role of the Authority
 - Access arrangement assessment process and criteria
 - Authority’s issues paper
 - Western Power (~60mins)
 - Western Power overview
 - Proposed revisions to the access arrangement
 - Interested Parties / Questions (~45mins)

The Economic Regulation Authority

Independence

- State's independent economic regulator
- Decisions are independent of industry, government and other interests

Functions

- Administers access to monopoly infrastructure
- Licenses service providers
- Monitors and regulates markets
- Conducts inquiries (referred by State Government)

Industries

- Electricity, gas, rail and water

Access Arrangement Review: Authority's Assessment Process

- Sections 4.46 to 4.52 of the Access Code apply (review of an access arrangement)
- Essentially the same process that was required for the consideration of the current access arrangement:
 - Invitation for submissions on proposed revisions (and issues paper)
 - First round public consultation
 - Draft decision
 - Second round public consultation
 - Final decision
 - If required, further final decision

Access Arrangement Review: Authority's Assessment Criteria

- Must have regard to the objectives and requirements of the Access Code
 - Code objective (section 2.1)
 - Requirements of Chapter 5 (and Chapter 9, if applicable)
- In making draft and final decisions, must consult with the public
 - Public submissions are an important part of the decision making process
 - Authority will consider all issues brought to its attention
- If objectives and requirements met, Authority must approve proposed revisions, even in the event that there are other revisions that could be made

Assessment Stages Completed...

- Western Power's **proposed revisions submission** lodged 1 October 2008
- **Invitation for Submissions** on proposed revisions published and advertised 8 October 2008
 - Public submission period 8-Oct-08 to 19-Nov-08
- **Issues Paper** published on 5 November 2008
 - Optional for the Authority to publish
 - Within 20 b/days after invitation for submissions
- Public Forum held 10 November 2008 (no requirement)

Assessment Stages to Come...

- Publication of **Draft Decision**
- **Second Round Public Consultation**
- [WP Revised Proposed Revisions]
- Publication of **Final Decision**

If required,

- [WP Amended Proposed Revisions]
- Publication of **Further Final Decision**

(Projected Timeframe*)

- 16-Jan-09
- Closing 16-Feb-09
- [optional for WP]
- 31-Mar-09
- [optional for WP]
- 19-May-09

* Subject to extensions of time or suspensions of deadlines as permitted under the Access Code

Authority's Issues Paper (1/3)

- Published 5 November 2008, and available from the Authority's web site
- Not an exhaustive review of the proposed revisions, or the matters to be address by the Authority
- Submissions invited on particular matters identified in the issues paper, AND any other matters of concern:
 - Current access arrangement (2006/07 to 2008/09)
 - Proposed revised access arrangement (2019/10 to 2011/12)
- First round public consultation closing date for submissions:
Wednesday, 19 November 2008

Authority's Issues Paper (2/3)

Key Points

- Electricity Transfer Access Contract
 - Provision to unilaterally reduce a user's contracted capacity
 - Sunset clauses for payment errors
- Expenditure levels
 - Actual expenditures substantially higher than expenditures originally forecast to occur in current access arrangement period
 - Proposal for substantial increase in non-capital costs (particularly distribution) over actual costs incurred in current access arrangement period, and substantial increases in new facilities investment
- Substantial increases in target revenue and reference tariffs
 - Real increases of **40%** from 2008/09 to 2009/10 for transmission and distribution charges
 - Subsequent annual real increases of **37.2%** (transmission) and **30%** (distribution) in 2010/11 and 2011/12

Authority's Issues Paper (3/3)

Key Points (...continued)

- Service Standards
 - Western Power's access arrangement service standard report available on Authority's web site (06/07 and 07/08 performance data)
 - Expenditure levels in relation to actual performance and proposed benchmarks
- Role of Authority is to determine whether Western Power's proposal complies with the requirements of the Access Code
 - Code objective
 - Requirements of Chapter 5 (and Chapter 9, if applicable)
- Public submissions are encouraged from interested parties



Proposed 2009 Revisions to SWIN Access Arrangement

**Public Forum
10 November 2008**



DMS# 5209670

An Energy Solutions Business
For a sustainable future

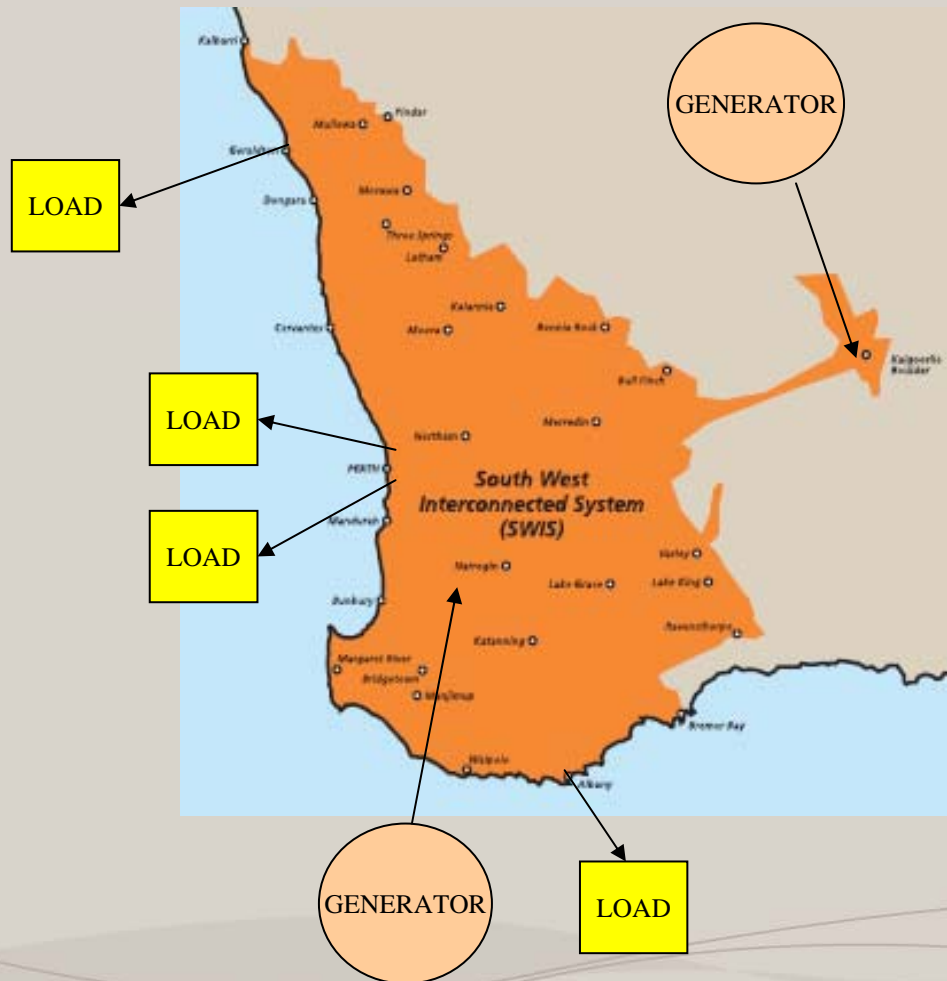


PRESENTATION OBJECTIVES

To provide information about:

1. Brief overview of basics - WP's regulated business model
2. Proposed revisions to the AA from 2009

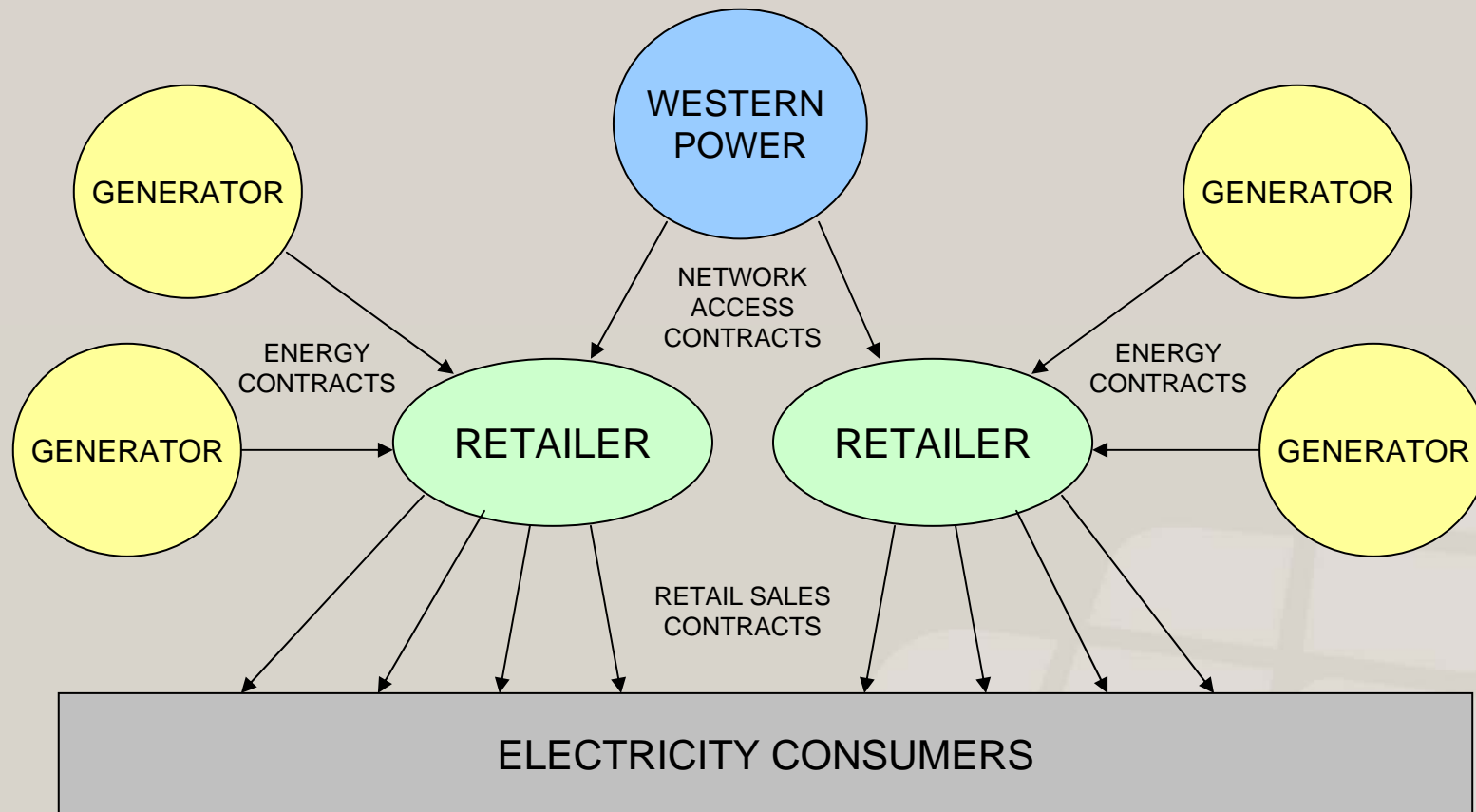
THE ROLE OF THE NETWORK



Each Retailer:

- has a portfolio of generators and customers
- pays WP for use of the network to transport electricity (“network access”)

THE ELECTRICITY MARKET



YOUR ELECTRICITY BILL

- Who gets the money?

For every unit of electricity ...



14 cents/kWh

Retailer – 1 cent

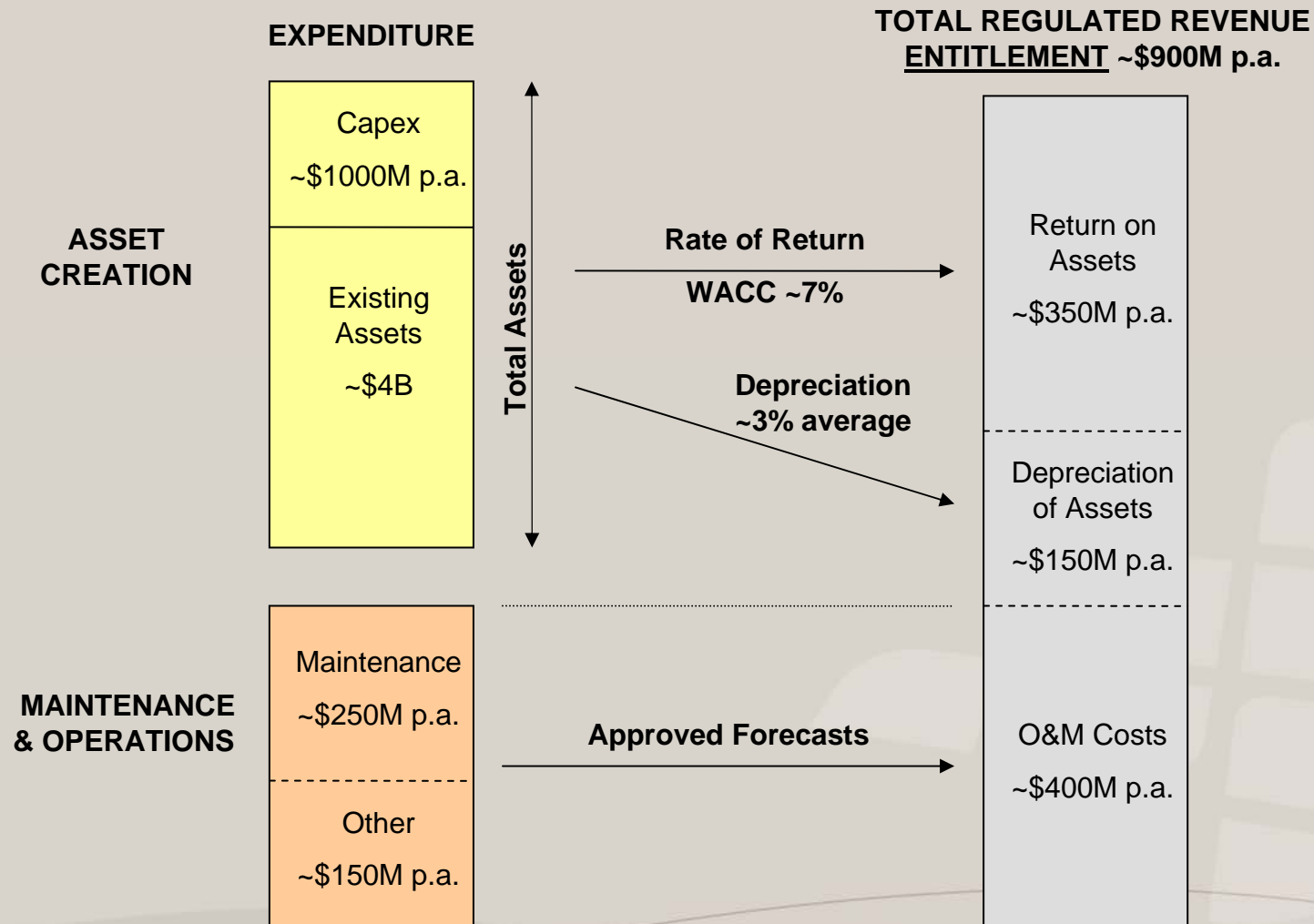
Western Power – 6 cents

Generation – 7 cents

WHY & HOW ARE WE REGULATED

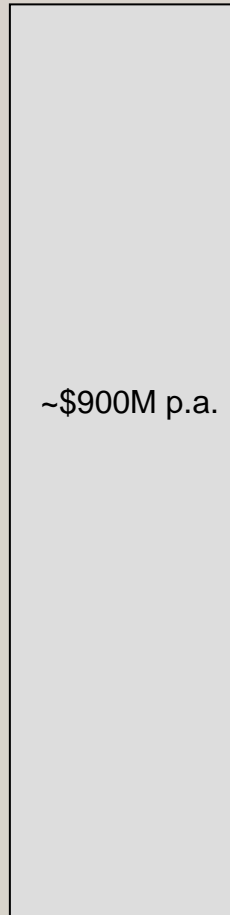
- Western Power is a monopoly business
- “Regulation” acts as a proxy for competition
 - To assure that WP delivers an efficient service at a fair price
- The Regulator (ERA):
 - assesses WP’s efficient business costs; and
 - determines an appropriate level of income (revenue from services) to:
 - Meet service standards; and
 - Sustain a viable, efficient business

HOW OUR BUSINESS REVENUE IS DETERMINED (illustrative only)

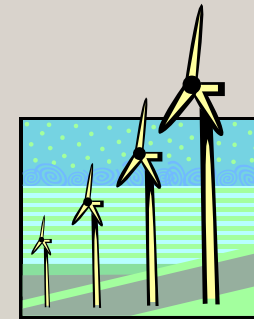
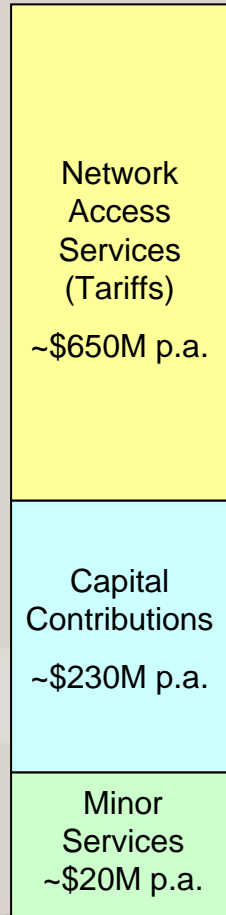


SERVICES & INCOME

**TOTAL REVENUE
ENTITLEMENT** ~\$900m p.a.

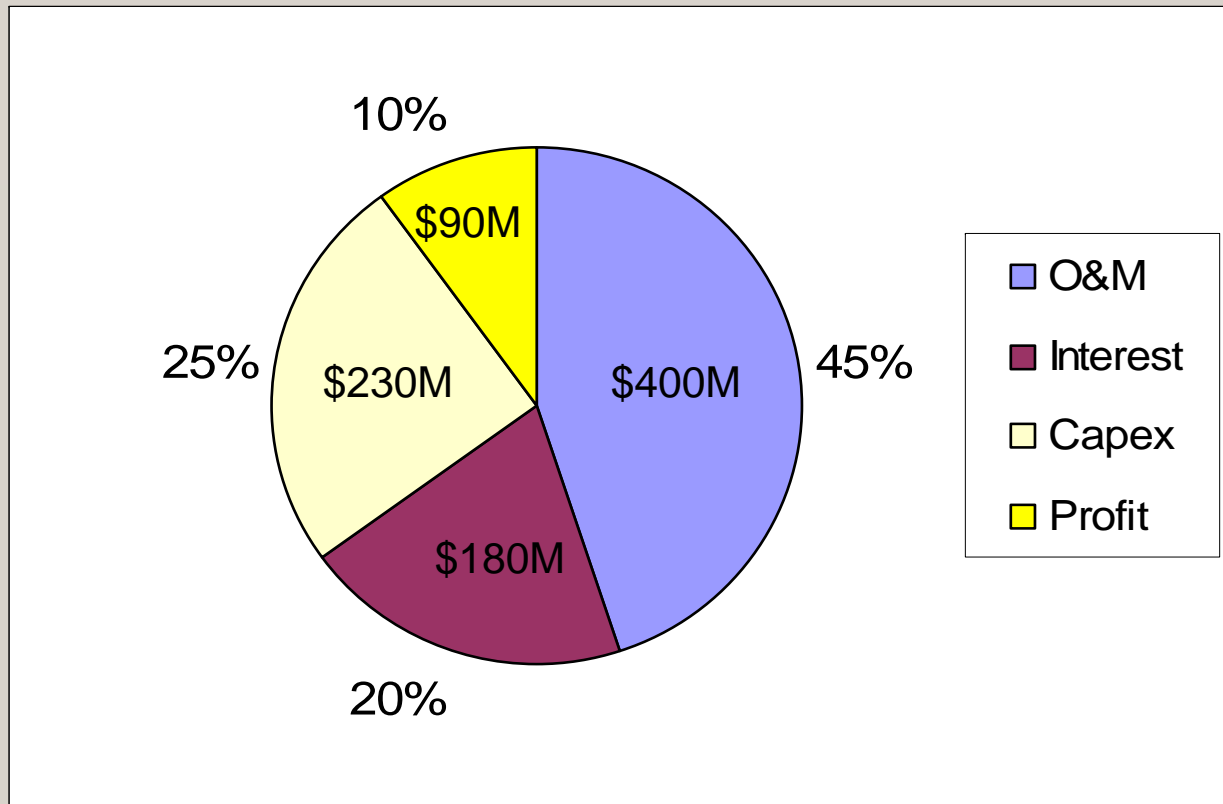


ACTUAL INCOME
~\$900m p.a.



HOW WE USE OUR MONEY

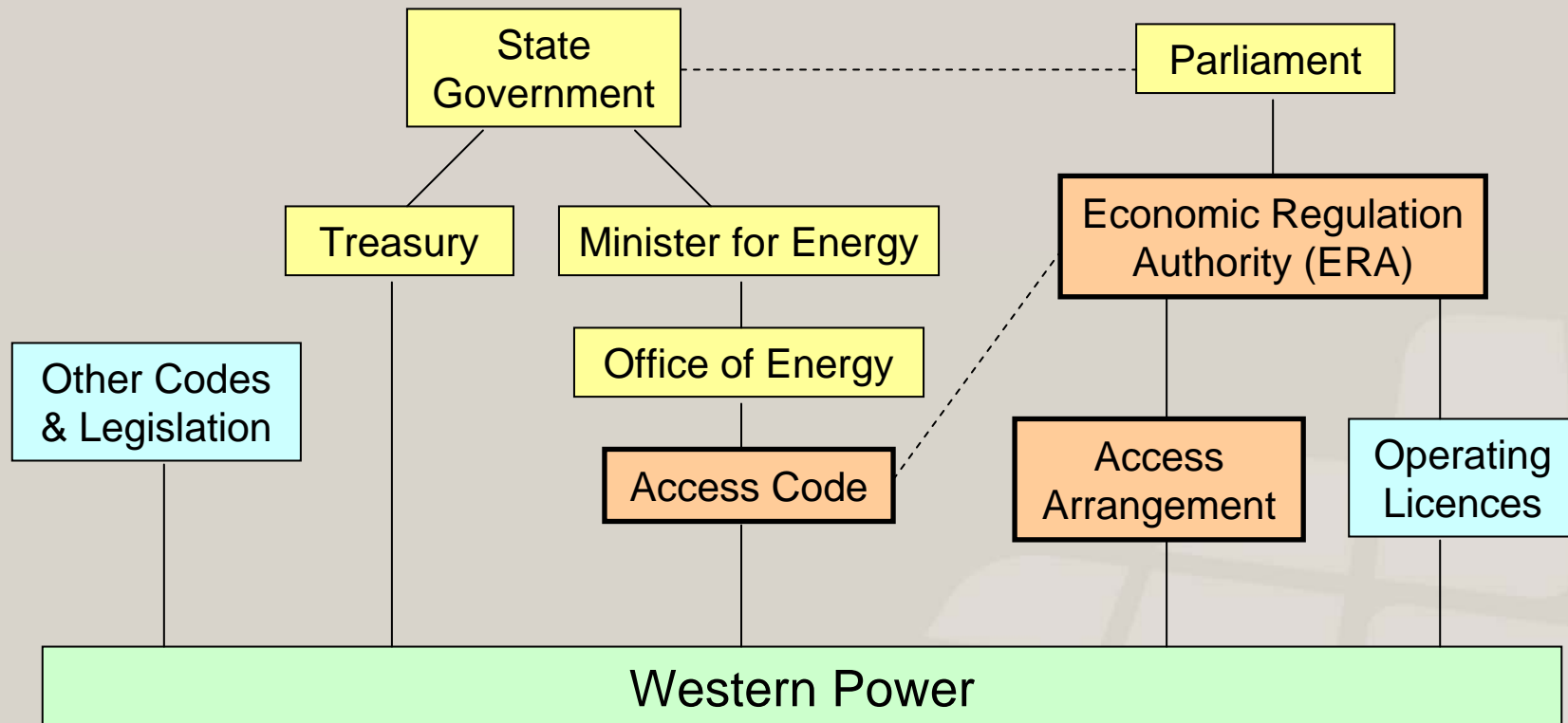
WP is a self funded corporation (no subsidies from Govt) and uses its annual income as follows: (indicative)



WHAT IS AN “ACCESS ARRANGEMENT” WHY DO WE NEED ONE?

- The AA is a formal set of “business rules” for how WP goes about providing network services to the market
- Required by the Access Code
- Approved by the ERA in 2006 after consultation with retailers, generators and customers
- Currently applies for a three year period (to 30/6/09)
- WP has now submitted revisions to take effect after 30/6/09 for a further 3 years

REGULATORY FRAMEWORK (Economic)



KEY FEATURES OF THE ACCESS ARRANGEMENT

The approved Access Arrangement includes:

- Annual “revenue cap”
- Published network tariffs
- Specific customer service standards that must be met (reliability, connection times, etc)
- Capex & Opex limits for each year
- Regulatory tests on capital investments
- Capital contributions policy
- Queuing policy for managing new connections
- Standard access contract for network users
- Technical Rules* for design & operation of the Network - Western Power, generators & consumers must comply

PROPOSED (KEY) CHANGES TO THE ACCESS ARRANGEMENT (1)

WP's proposed AA revisions from 1/7/09 include:

1. Revenue cap and price increases
2. Changes to the standard access contract
3. Changes to the applications & queuing policy
4. Changes to the capital contributions policy
5. Revenue "at risk" for network performance
6. New gain sharing mechanism
7. New "D factor"
8. Technical Rules revisions

PROPOSED (KEY) CHANGES TO THE ACCESS ARRANGEMENT (2)

WP's process:

- Expert regulatory consultant to guide thinking on key issues – NEM guidance
- Expert engineering consultant to assist development of Capex & Opex forecasts
- Engagement with OOE and State Treasury during development
- Strong oversight by Board

REVENUE & PRICE INCREASES (1)

- Drivers of increases
 - Increased capex & opex
 - Increase in WACC
 - Cost reflectivity - change in regulatory treatment of capital contributions
- Mitigation by WP
 - TEC (~\$100M p.a.) removed and proposed as CSO – unofficial Govt support
 - Deferral of ~\$200M revenue to AA#3

REVENUE & PRICE INCREASES (2)

- Proposed increases (average price):
 - Year 1 (from 1 July 2009) – 43%
 - Year 2 – 30%
 - Year 3 – 30%
- Expect direct effect on network access prices to generators, large consumers, most contestable customers
- Franchise customers' exposure limited by retail tariff increases – yet to be determined by Govt

REVENUE & PRICE INCREASES (3)

Capital & Operating Expenditure Forecasts

- \$6B over 3 years - driven by high economic growth
- Major risks if investment is not made – ability to connect customers, public safety, reliability

Regulated Rate of Return (WACC)

- Increase of ~2% driven by financial conditions
- WP proposal consistent with both ERA and national regulatory guidelines

REVENUE & PRICE INCREASES (4)

Treatment of Capital Contributions

- “Queensland treatment” (capcons included in revenue cap) no longer considered sustainable
- Current tariffs below cost of service
- Future higher tariffs provide effective large subsidy
- Decision supported by independent expert advice

REVENUE & PRICE INCREASES (5)

Principles of Revenue Deferral

- Provides transition to cost reflective prices
 - Moderates initial step increase
 - Price stability restored during AA#3
- Allows WP to:
 - Deliver reasonable financial performance in short term
 - Be financially sustainable in the longer term
 - Manage responsible levels of debt
 - Recover deferred revenue in AA#3

STANDARD ACCESS CONTRACT

Proposed changes include:

- Ability to offer limited service prior to full service becoming available
- Options for invoicing to meet customer preferences
- WP may, acting reasonably, re-assign un-used capacity in some circumstances
- Reinforcement of Technical Rules compliance obligations
- Sunset provision for adjustment of billing errors
- Further details provided in Appendix 12 of AA

APPLICATIONS & QUEUING POLICY

Proposed changes aimed at making the queue operation more efficient & effective:

- Applications to be “more complete” to get on the queue
- Tighter timelines for WP to process applications
- Streamlined process for routine modifications to existing contracts
- Details provided in Appendix 10 of AA

CAPITAL CONTRIBUTIONS POLICY

Proposed changes based on imminent Code amendments (now implemented) and include:

- Provisions of “Extensions & Expansions Policy” now moved to Appendix 8 of Code
- Now a “contributions policy”
 - Includes distribution headworks charges
 - Includes capital and non-capital payments
- Revision of time payment and rebate provisions
- Further details in Appendix 11 of AA

REVENUE AT RISK FOR NETWORK PERFORMANCE

- Code requires a Service Standards Adjustment Mechanism
 - Incentive to perform better than target reliability & availability
 - Penalty for worse performance
- AA1 – reporting regime but no \$s at risk
- AA2 – WP proposes \$s at risk
 - To meet ERA's stated expectation
 - Approx \$5M p.a. at risk
- Further details in Part D of AAI document

GAIN SHARING MECHANISM

- Regulatory incentive to improve economic efficiencies (ongoing)
- Was not required for AA1
- WP proposal:
 - Efficiency benchmark – approved annual operating costs
 - Mechanism – retain legitimate efficiency gains for several years before adjusting prices
 - Similar approach to other jurisdictions
 - Further details in Part D of AAI document

NEW “D FACTOR”

- Designed to compensate WP for additional Opex where a non-network option defers/replaces planned Capex
- Removes financial disincentive to consider non-network solutions
 - Not an “incentive” scheme
- Maintains integrity of forecast Opex – scope & \$s

CHANGES TO TECHNICAL RULES

- WP has submitted revisions to Technical Rules
 - No show-stoppers
 - Published on ERA website
- Currently being assessed by ERA via:
 - Technical Rules Committee
 - Small Generators Working Group (advice to TRC)
 - Consensus approach
- Approval of new Rules due 30/6/09

CONSEQUENCES OF CHANGING ECONOMIC OUTLOOK

- Uncertain economic outlook
- Some moderation of load growth and capex forecasts is possible
 - Some major projects could be delayed
- Opex requirements not impacted
- WACC increase may be less
- Some moderation of proposed price increases possible
- Easing of financial and resourcing challenges for WP

CONVENTIONAL TREATMENT OF CAPITAL CONTRIBUTIONS

- Customer contributes to up-front cost of assets
- Only net asset value included in asset base i.e. contributions reduce future potential revenue
- Contributions additional to revenue cap in year received

“QUEENSLAND” TREATMENT OF CAPITAL CONTRIBUTIONS

- Customer contributes to up-front cost of assets
- Contributions included in revenue cap in year received
- Full asset value included in asset base i.e. full return earned in future years
- Higher future tariffs = revenue deferral

QUESTIONS & DISCUSSION