westernpower
networks today & tomorrow

363 Wellington Street Perth WA 6000
GPO Box L921 Perth WA 6842
T: (08) 9326 4911 F: (08) 9326 4595
www.westernpower.com.au
ABN: 18 540 492 861

Our ref: 5228569
Contact: Peter Mattner – 9326 4556

17 December 2008

Mr Robert Pullella
Access Arrangement Review
Electricity Access
Economic Regulation Authority
PO Box 8469
PERTH BC WA 6849

Dear Robert

ISSUES PAPER ON PROPOSED REVISIONS TO THE ACCESS ARRANGEMENT FOR THE SOUTH WEST INTERCONNECTED NETWORK

Thank you for the opportunity to comment on the Issues Paper on Proposed Revisions to the Access Arrangement for the South West Interconnected Network released by the Economic Regulation Authority in November 2008.

Western Power has provided specific comment on a number of the issues raised in the issues paper in Attachment 1 and looks forward to working with the Authority over the coming months to attain an approved Access Arrangement in early 2009.

Yours sincerely

Phil Southwell
General Manager
Strategy & Corporate Affairs

ATTACHMENT 1

RESPONSE TO ISSUES PAPER ON PROPOSED REVISIONS TO THE ACCESS ARRANGEMENT FOR THE SOUTH WEST INTERCONNECTED NETWORK

This attachment follows the structure of the Issues Paper on Proposed Revisions to the Access Arrangement for the South West Interconnected Network ("the issues paper").

1. REFERENCE SERVICES

The issues paper states, at paragraph 25, that Western Power has not proposed any revisions to its list of reference services. In the interests of clarity Western Power would like to highlight that it has proposed two minor changes to the list of reference services.

Firstly, the Time of Use Energy (Small) Exit Service (A3) eligibility criteria has been modified so that this service is available only to residential users and the name of the service has been modified accordingly – Time of Use Energy (Residential) Exit Service (A3).

Secondly, the Time of Use Energy (Large) Exit Service (A4) eligibility criteria has been modified so that this service is available only to commercial users and the name of the service has been modified accordingly – Time of Use Energy (Commercial) Exit Service (A4).

The purpose of these changes is to allow for differing on and off peak periods for residential and commercial users of the network (to better suit existing metering capabilities), to create alignment with the energy only reference services and to simplify the administration of the two reference services.

2. STANDARD ACCESS CONTRACT

The issues paper discusses two changes that Western Power has proposed to the electricity transfer access contract which the ERA considers substantive (paragraphs 34 & 35). Western Power provides the following further discussion on the two changes.

<u>Reduction of a User's contracted capacity at a connection point – paragraph 34</u>

As stated in Appendix 12 to the Access Arrangement Information, the purpose of the provision is to not allow user's to 'sit' indefinitely on unused capacity to the detriment of other potential users of that capacity.

It is feasible that contracted capacity which remains un-utilised can, in the limit, lead to new investment in the network through the addition of network capacity which is physically not required, but is necessary to meet Western Power's contractual obligations. Western Power's objective in proposing the provision is to avoid this type of new investment in the network occurring. Western Power has "in principle" support from some stakeholders including Landfill Gas and Power (submission to ERA dated 12 December 2008) and Pacific Hydro (submission to ERA dated 2 December 2008).

Western Power's intention is to establish a process in response to the principle that withholding un-used capacity from the market, for whatever reason, can lead to investment in additional capacity that is unwarranted from an overall network perspective.

Western Power welcomes suggestions as to how the outcome can be otherwise achieved.

Sunset clause on adjustment of payments – paragraph 35

Western Power has, based on operating experience during the current access arrangement period, proposed sunset clauses on claims for adjusting payments in respect of payment errors. Western Power considers it highly desirable to provide certainty to both parties as to how far back in time a billing error will be corrected.

As stated in Appendix 12 to the Access Arrangement Information, the 12 month limitation for data errors aligns with a similar limitation under section 65 of the Energy Operators (Powers) Act 1979 for errors in meter data and promotes accuracy in the data information kept by both parties.

The proposed time limits are considered to be reasonable, practical and a worthwhile improvement to the standard access contract.

3. SERVICE STANDARD BENCHMARKS

Paragraph 52 of the issues paper details the consideration that the Authority intends to give to Western Power's level of expenditures in the context of service standard benchmarks. Western Power's submission to the ERA on 1 October 2008 contains detailed information that will assist the Authority in their consideration of the reasonableness of Western Power's service standards. In particular Western Power would like to bring the following sections to the attention of the Authority:

- Part A of the Access Arrangement Information (AAI) document articulates Western Power's risk based approach to formulating its expenditure forecasts and related service standards.

- Further details are provided in subsequent sections of the AAI (Part C section 3 & 4, Part D section 3) and in the detailed expenditures report at Appendix 1.

Western Power will provide further justification as to why actual expenditures were higher than the approved forecasts during the current access arrangement period to the ERA via the Wilson Cook & Co review process, at an individual work category level.

4. TOTAL COSTS AND TARGET REVENUE

Western Power's response addresses the issues paper discussion on:

- the matters that the Authority will examine in relation to Western Power's application of the New Facilities Investment Test (paragraph 72);

- Western Power's application of the New Facilities Investment Test to forecast capital expenditure (paragraph 76);

- the reasons for revenue deferral (paragraph 83); and

- the methodology that Western Power intends to apply in relation to the selection of a value of WACC from within a broad range of values (paragraph 89).

Capital Base and New Facilities Investment

Paragraph 72 – response to first and second dot point.

The first and second dot point under paragraph 72 of the issues paper identifies the following matters that the Authority will examine in relation to Western Power's application of the New Facilities Investment Test:

- The absence of distinction by Western Power between the new facilities investment that is rolled into the capital base by virtue of meeting the new facilities investment test, from that rolled into the capital base by virtue of being financed by capital contributions.; and

- The potential inconsistency of claims by Western Power that the entire amount of new facilities investment meets the new facilities investment test, with the charging by Western Power of capital contributions — the latter only being possible in respect of new facilities investment that does not pass the new facilities investment test, with some limited exceptions.

In response to these issues, Western Power would like to bring to the attention of the Authority that the justification for the AA#1 expenditures being included in the regulated asset base is contained in the Appendix 5 of the Access Arrangement Information (Assessment of AA1 Capex – NFIT Submission). Section 5.2 addresses the issue of how NFI is included in the asset base by virtue of meeting section 6.52 of the Code or 6.56 of the Code. Note that the Code has since been amended and the provisions are now in sections 6.51A and 6.52.

For example, the following diagram details Western Power's approach and is included in the submission:

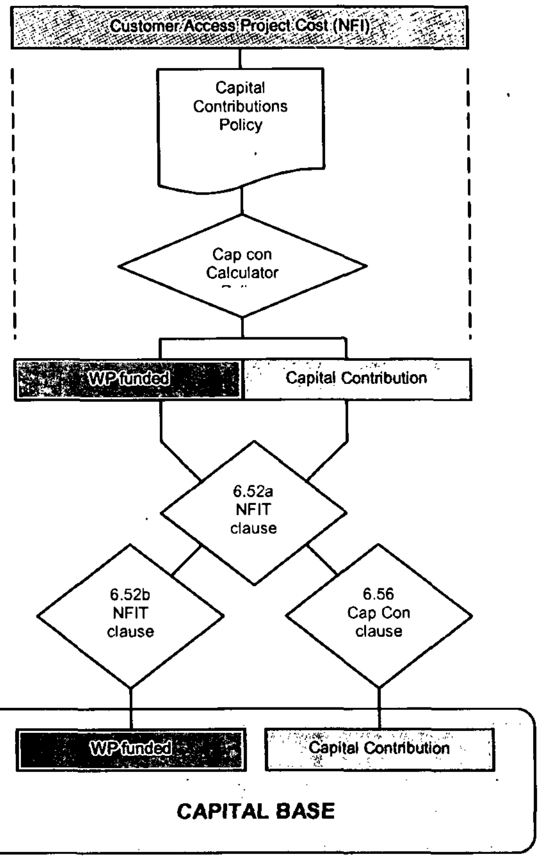

Figure 1 - Flow of Customer Access NFI to the capital base via the Capital Contributions Policy

Paragraphs 2 and 3 of section 5.2 state:

"New facilities investment in Customer Access projects typically includes a portion of NFI that is funded by Western Power and meets leg (i) of Part (b) of the NFIT, commonly referred to as the "incremental revenue leg".

The remainder of the NFI in a Customer Access project is funded by the customer and may be added to the capital base via clause 6.56 of the Code."

Paragraph 72 – response to third dot point.

The third dot point under paragraph 72 of the issues paper identifies the following matters that the Authority will examine in relation to Western Power's application of the New Facilities Investment Test:

- The claim by Western Power that some new facilities investment meets the new facilities investment test by virtue of incremental revenue exceeding the cost of the investment (under section 6.52(b)(i)A) of the Access Code), which is not substantiated by presentation of values of costs and revenues.

Western Power has not provided the information to substantiate the statement that, in some cases the incremental revenue will exceed the cost of the investment. With several thousand customer driven projects being undertaken each year it is clear that there will be a significant number where the incremental revenue received as a result of undertaking the work will exceed the cost of those works. Where the incremental revenue does not cover the cost and the new facilities investment does not meet any other component of the NFIT a capital contribution is sought for the difference.

Western Power's Distribution Quotation and Management (DQM) system has standard functionality in place that assesses the incremental revenue against the cost of the works. In the instances where the incremental revenue does not cover the costs DQM automatically determines the capital contribution that is required.

It is noted that in the instances where the incremental revenue received exceeds the incremental cost of the connection works that this does not lead to Western Power over-recovering its revenue cap. Adjustments to reference tariffs over time ensure that Western Power only receives the approved revenue cap.

Paragraph 72 – response to fourth dot point.

The fourth dot point under paragraph 72 of the issues paper identifies the following matters that the Authority will examine in relation to Western Power's application of the New Facilities Investment Test:

- A consultant report provided by Western Power, in support of its claim that new facilities investment meets the new facilities investment test, states that it is unnecessary to apply the new facilities investment test to any new facilities investment that is not covered by the investment adjustment mechanism under the access arrangement (and Western Power has not done so).

Section 2 of Appendix 5 of the Access Arrangement Information explains the rationale for this approach. In summary Western Power has taken the view that there is sufficient financial incentive to ensure the work undertaken that is not subject to the IAM will by definition be in accordance with the requirements of section 6.52 (a) of the Code. The position taken is that in the absence of any clawback provision for expenditure outside that forecast in the access arrangement submission, Western Power has sufficient financial incentive to ensure efficient investment. As stated in section 2 of the report, the approach taken in the NEM is that there is no need to undertake any prudence review of capex if there is an appropriate financial incentive on the service provider to undertake new facilities investment prudently.

In addition this category of work will satisfy section 6.52 (b)(iii) of the Code and consequently meets the requirements of the NFIT.

Paragraph 72 – response to fifth dot point.

The fifth dot point under paragraph 72 of the issues paper identifies the following matters that the Authority will examine in relation to Western Power's application of the New Facilities Investment Test:

- The consultant report provided by Western Power, in support of its claim that new facilities investment meets the new facilities investment test, examines a sample of projects for detailed examination of whether project documentation is adequate to support claims that the new facilities investment test is met, but these projects comprise less than one per cent of the new facilities investment for the current access arrangement period.

The purpose of the sample of projects was to illustrate how the governance arrangements described throughout the report are followed by Western Power in undertaking its capital expenditure programme. The Authority's technical consultant has sought additional documentation to assist in their assessment of Western Power's NFIT compliance.

Paragraph 76

It is Western Power's view that the forecast capital expenditure is reasonably expected to either meet the new facilities investment test or be financed by contributions.

For new facilities investment to be included in Western Power's regulatory asset base it must meet the requirements of clause 6.51A of the Code. Western Power has proposed a conventional treatment of capital contributions which by definition implies that it is only seeking new facilities investment, for which no capital contribution was required, to be included in its regulated asset base. The question here is on what basis Western Power asserts that expenditure for which no capital contribution is sought meets the NFIT.

Western Power will undertake all expenditure on the basis that it meets the requirements of section 6.52 (a) of the Code. There are appropriate procedures and controls in place to ensure that expenditure is only undertaken on a prudent basis. Those procedures and controls are outlined in the Access Arrangement Information Appendix 5, "Assessment of AA1 Capex – NFIT Submission". In other words all work included in the forecast expenditures, including that which will attract capital contributions is considered to be prudent.

Capital contributions are sought for new facilities investment that does not meet the NFIT as defined in clause 6.52 of the Code, or for "Appendix 8 work". New facilities investment that falls under the category of "Appendix 8 work" will be financed by capital contributions generally at the full forecast cost of the works. Therefore, to the extent that capital contributions equal the cost of the works, no "Appendix 8 work" will be included in the regulatory asset base.

Other types of work are assessed against the requirements of the NFIT and capital contributions are sought for forecast new facilities investment that do not meet the NFIT. Capital contributions will be determined in accordance with the approved "Contributions Policy". Therefore all work that is not "Appendix 8 work" will either be considered to meet the NFIT or it will attract a capital contribution. To support this Western Power will provide an independent report as part of the Access Arrangement number 3 submission that provides sufficient supporting information to enable the Authority to form an opinion as to what work meets the NFIT.

Treatment of Capital Contributions

The statement at paragraph 83 suggests that the specific intent of the revenue deferrals is to offset the effect of changing the treatment of capital contributions. This is not strictly correct; the reasoning for proposing the revenue deferrals was two fold:

- to effect a transition to the conventional approach to capital contributions; and
- to manage the price increase in the forthcoming access arrangement period as a result of Western Power's increased expenditure needs.

The revenue deferrals have been designed to provide a transition path from present prices to cost reflective prices over a period of 4 years, thereby avoiding a much larger step increase in the first year and reduce the price shock impact.

An outcome of this approach is to partially offset the price effect of the change in capital contributions treatment.

Rate of Return

Paragraph 89 of the issues paper makes the statement that Western Power's submission is unclear as to how Western Power intends to revise the proposed WACC value given that it is selected from a broad range of values. The following will provide clarity to the Authority on Western Power's intended approach.

Western Power has proposed that the value of WACC will be subject to revision to reflect the prevailing interest rates and the corresponding 10-year inflation outlook over a sampling period to be agreed (on a confidential basis) between the Authority and Western Power.

It is Western Power's intention to revise the plausible range for WACC based on the parameter recommended by KPMG and the revised market data from the agreed sampling period. It can be reasonably anticipated that Western Power will select a point value from the revised range based on the parameter values currently specified in Chapter 6A of the National Electricity Rules in relation to: equity beta (1.0); gamma (0.5); market risk premium (6%); and gearing (60%).