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5 December 2011

Mr Tyson Self
Manager Projects Access
Economic Regulation Authority
PO Box 8469,
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By Email: publicsubmissions@erawa.com.au

Dear Mr Self

ISSUES PAPER ON WESTERN POWER"S PROPOSED REVISIONS TO THE ACCESS ARRANGEMENT FOR THE WESTERN POWER NETWORK

Alinta Energy (Alinta) appreciates the opportunity to comment upon both Western Power's Third Access Arrangement (AA3) submitted to the Economic Regulation Authority (the Authority) in September 2011, and the Authority's Issue Paper on AA3 released on 7 November 2011.

Alinta is an active investor in the energy retail, wholesale and generation markets across Australia. Alinta has over 2500MW of generation facilities in Australia (and New Zealand), and maintains over 670,000 retail energy customers in Western Australia, South Australia and Victoria with a commitment to growing its retail energy business in Australia.

Alinta has limited this submission to addressing a number of important issues which directly affect its WA retail business. In summary we note that:

- The rate of return applied in AA3 should incentivise Western Power to act in a commercial manner when making investment decisions;
- The recovery of Western Power's deferred revenue from AA2 should occur over a number of access arrangements, rather than recovered in its entirety in the AA3 period;
- While Alinta supports amending the current Access Queuing Policy, further clarification is sought regarding the expected process for new access seekers;
- The proposed reduction in service standard benchmarks is inconsistent with Western Power's allowed revenue in the current access arrangement period;
- The service standard adjustment mechanism should be balanced so as to provide the incentive to Western Power to maintain or exceed the appropriate level of service standards at all times, not just over the regulatory period; and
- Western Power's proposed capital and operating expenditure are both ambitious and should be scrutinised thoroughly by the Authority and its consultants.

Rate of Return

Alinta notes that there is considerable debate at present regarding the appropriate parameters used to establish a Weighted Average Cost of Capital (WACC) in regulatory decisions.

Alinta strongly believes that the regulated rate of return should incentivise service providers to act in a commercial manner when making investment decisions. Further, the costs of capital for a service provider must reflect the level of risk involved in operating the service. Finally, Alinta notes that the *Electricity Networks Access Code 2004* provides a much higher level of discretion to the regulator in assessing an appropriate cost of capital for a service provider than that afforded under the National Electricity Law (NEL) and National Electricity Rules (NER).

While the rate of return allowed for Western Power is a major driver of both the regulated revenue and the level of tariffs, Alinta does not intend commenting directly on this issue at the current point in time, although it reserves the right to provide commentary to the Authority after the release of its draft decision.

Recovery of Deferred Revenue from AA2

Western Power has proposed in AA3 that it be allowed to recover revenue of $967 million which was deferred from its second Access Arrangement (AA2). The Authority stated in its AA2 decision that Western Power will have the opportunity to recoup this deferred revenue which resulted from a change in the approach used by the Authority for the treatment of capital contributions between AA1 and AA2.

Alinta understands that the Authority's approach to the treatment of capital contributions in AA1, while NPV neutral over the life of the assets, resulted in lower tariffs initially before transitioning to higher tariffs once the contributed assets reached a sizeable proportion of the asset base. In contrast, the conventional approach adopted by other regulators (not including capital contributions in the Regulated Asset Base) did not consider intergenerational equity. Therefore, Alinta views the main issue for consideration by the Authority is, at what rate is it appropriate to transition to the conventional treatment of capital contributions, balanced against the potential price shock that may occur to users of the network today.

While Alinta is understanding of the revenue impact that the approach used for assessing capital contributions had upon Western Power in the first access arrangement (AA1), and the financial impact of the transition towards a more conventional approach and the resultant deferred revenue, Alinta does not agree with the Western Power proposal to recover all of this deferred revenue within a single regulatory period. Alinta does not necessarily consider that the revenue should be recovered over the life of the assets (as this will tend to replicate the financial outcomes had Western Power not moved to the conventional approach), but rather the deferred revenue should be recovered through tariffs proportionately over a number of access arrangements.

Therefore Alinta requests:

- that the Authority reject Western Power's proposal to recover all of the deferred revenue over the upcoming AA3 period.
- That the Authority allow Western Power to recover the deferred revenue over 3 to 4 access arrangement periods, as Alinta considers this an appropriate balance between allowing Western Power to adjust to the financial implications of the conventional treatment of capital contributions in addition to reducing the level of price shock to users of the network.
- That the Authority be transparent as to the approach to be applied in AA3 and future access arrangements, regarding the trajectory of the recouped deferred revenue.

Proposed Revisions to the Applications and Queuing Policy

Alinta considers that the current Access Queuing Policy (AQP) and its 'first come, first served' nature does not adequately facilitate the connection of new generators or access seekers. We therefore support changes that will improve the AQP.

Alinta's understanding of the proposed AQP is that there are two distinct stages:

Stage 1 – An assessment undertaken by Western Power to determine a preliminary view as to projects that are within the queue that are likely to proceed.

Stage 2 – Applications deemed ready to proceed are grouped together out of the access queue and Western Power prepares an offer for connections to those access seekers grouped together.

Alinta would like to raise two key issues at this initial stage.

1. While Alinta agrees that Western Power's proposed AQP is an improvement over the current AQP, Alinta considers there are some critical uncertainties that remain within the proposed AQP which need to be addressed.

   Alinta requests that the Authority direct Western Power to provide further guidance on the process for gaining access should a competing group of applications be grouped together in the second stage of the AQP before granting approval of the revised AQP for AA3 under the Networks Access Code.

   Alinta seeks clarity regarding the process for stage 2, in particular what happens if only one applicant deems it is ready to proceed following an offer by Western Power to a group of applicants. Alinta would be concerned if Western Power were to make an offer to a group of applicants that is conditional on them all proceeding. Clarity on this issue would be welcome.

2. Alinta believes the main deficiency with the current AQP is a lack of what would be considered real project criteria which would assist Western Power in determining if a project is likely to proceed. Alinta considers that in order to be assured that a project contained within the queue is ready to proceed, it would likely require the following documents in relation to the applicant's project:

   - Environmental approval;
   - Fuel supply agreement ; and
   - Power purchase agreement.

   Should Western Power amend its AQP to include this as a requirement, then Alinta believes it is likely to allow Western Power to better identify those projects that are actually ready to proceed when assessing proposals for grouping for stage 2, following an assessment during stage 1 of the AQP.

Revisions to the Electricity Transfer Access Contract

Alinta notes that the revisions to the Electricity Transfer Access Contract (ETAC), while only minor, have impacted upon the security requirements for users of the network. Western Power has inserted a new clause 9(c) into the ETAC:

> *If any security held by Western Power* under clause 9(a)(ii)(A)) or 9(a)(ii)(B) at any time is not equal to the Charges* for two months' services, then the Nominated Person* must, within 15 Business Days* of a written request by Western Power* to the User*:*
>
> > *(i) if the security is a cash deposit under clause 9(a)(ii)(A), provide Western Power* with an additional cash payment to increase the security so that it is equal to the Charges* for two months' services; or*
> >
> > *(ii) if the security is a guarantee under clause 9(a)(ii)(B), replace the guarantee with another guarantee (that is in accordance with clause 9(a)(ii)(B)) in an amount that is equal to the Charges* for two months' services.*

While Alinta considers that it is prudent for Western Power to require security from retailers, this new clause in the ETAC potentially will require users of the network to continually upgrade their security to Western Power. For example, if a user continues to grow its customer base in a short period, and therefore increase its level of access charges, then the user may be requested to upgrade its security to Western Power. Further, Western Power has proposed significant year-on-year increases in access charges that are likely to trigger an update of security annually when prices rise. Alinta believes a more appropriate condition within the ETAC would limit the adjustment of security to 6 month intervals. This is likely to minimise the continual need for some users to provide updated security at frequent intervals throughout the access arrangement period.

Reference Services

Alinta welcomes the introduction of a bi-directional reference service for both business and residential customers and supports the Authority approving the proposed reference services.

Service Standard Benchmarks

Western Power has proposed that its current level of service standards be reduced, or more specifically, be redefined as minimum service standard benchmarks. Alinta notes that in its AA2 Final Decision from 4 December 2009, the Authority stated that:

> *"In future reviews of the access arrangement the Authority expects that planned maintenance works that have been paid for by users will be taken into account in setting cost forecasts and service standard benchmarks, even if Western Power has not actually undertaken these works."*

Therefore, because users of the network have throughout AA2 being paying tariffs that reflect a combination of operating and capital expenditure necessary to achieve those service standards in AA2, Alinta does not agree that Western Power should be allowed a significant reduction in its Service Standard Benchmarks for the AA3 period.

However, Alinta notes for the South West Interconnected Network (SWIN) it may be efficient to have lower service standards than in urban areas. The SWIN has many large rural feeders, and these feeders have a significant impact on overall system reliability. Maintaining tight SAIDI and SAIFI on these rural feeders is likely to consume a disproportionate level of operating expenditure in maintaining these lines. Therefore, Alinta does not oppose Western Power's proposal to revise upwards the service standard benchmarks for the rural distribution network.

However, in light of the Authority's conclusion in its AA2 Final Decision about expenditure during the current regulatory period, Alinta is less comfortable with the sizeable increase in terms of SAIDI and SAIFI for the CBD and Urban areas of the network. Alinta requests the Authority examine closely the rationale for reducing the service standard benchmarks for this component of the network, and would like to see Authority undertake a thorough benchmarking exercise with comparable urban distribution networks across Australia.

Service Standard Adjustment Mechanism

Alinta supports the general approach of Western Power in redefining the service standard adjustment mechanism that is currently in place for AA2, for the upcoming AA3 period. Alinta would like the Authority to ensure that adjustment provides the correct incentives for Western Power regarding the interaction between efficient operating expenditure and those service standards expected by users of the network.

The Authority should closely scrutinise if the Service Standard Adjustment Mechanism fully incentivises Western Power on a year-on-year basis to outperform the service standard benchmarks. Alinta's principal concern with the actual proposed mechanism is that it is weighted towards performance over the whole regulatory period. As a retailer to a number of large commercial and industrial customers, Alinta is aware of its customers concerns regarding reliability and service from the electricity network. Alinta would support the service standard adjustment mechanism being redefined to ensure that Western Power has the appropriate incentives to meet its service standard benchmarks on a year on year basis, given that 'major events' will be excluded from the service standard benchmarks should they adversely impact the network

Alinta Energy

Operating Expenditure in AA3

Western Power has proposed an increase in operating expenditure over the allowed operating expenditure from AA2. Further, Western Power has opted to use 2010/11 as an efficient base year when determining the operating expenditure allowance. While Alinta understands that input price pressures are likely to act as an impediment to achieving real operating expenditure unit efficiencies over the upcoming access arrangement period, Alinta questions whether allowing overall operating expenditure to increase at the proposed level corresponds with a benchmark utility acting prudently and efficiently.

Alinta believes that Western Power should be subject to some level of base operating efficiency mechanism over the AA3 period, similar in manner in which the CPI-X framework operates under the National Electricity Rules. Alinta also requests that the Authority examine closely Western Power's choice of base year for its operating expenditure escalation.

Capital expenditure in AA3

Western Power has proposed total capital expenditure for the AA3 period in excess of $4.8 billion. This increased capital expenditure level relative to actual capital expenditure in the AA2 is likely to be a significant driver of increased tariffs for the AA3 period, and into subsequent access arrangement periods.

Alinta notes that Western Power underspent its capital allowance in AA2, and that Western Power is proposing a large increase in capital expenditure over the AA3 period. Alinta's principal concern relates to Western Power's internal resources to meet the capital expenditure it has proposed in its submission, specifically its ability to spend the capital in its regulatory proposal.

While there are major distinctions between the current WA regulatory regime under the Electricity Networks Access Code and the National Electricity Law and Rules, Alinta notes that in regulatory decisions under the National Electricity Rules, the AER has taken into consideration the underspend/overspend of capex in previous regulatory decisions when approving capital expenditure for that particular regulatory period. In particular, the AER took into account the past capital expenditure (with particular attention given to the past underspend on capex) of the Victorian Distribution Network Service Providers when approving expenditure for the current access arrangement period. Alinta considers that the Authority should assess Western Power's forward proposed capital program, in particular it should assess whether or not Western Power will have the resources to meet a large expansion of its capital program.

Should you wish to discuss Alinta's submission on this matter, please do not hesitate to contact Adam Lourey on 08 9486 3406.

Yours sincerely

[redacted]

Michelle Shepherd
General Manger Regulatory Affairs