

# **REVISED PROPOSED ACCESS ARRANGEMENT**

## **Contracted Capacity Rights**

**Submission to the Economic Regulation Authority  
on  
Parsons Brinckerhoff Associates' Report**

**BY**

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## **1 Scope of submission and relevant aspects of the report**

In response to the Economic Regulation Authority's (ERA) request, Parsons Brinckerhoff Associates (PB) has prepared a report on contracted capacity rights, dated 10 January 2007 (**Report**), which addresses a wide range of related issues. The ERA has put out a notice, dated 17 January 2007, calling for submissions from interested parties on the Report (**Notice**). We provide this submission in response to that Notice.

In the Notice, the ERA has made it clear that it invites submissions on the Report in regard to the fundamental question of:

*“whether the right being sought by Western Power to unilaterally determine to reduce the contracted capacity of a network user under the proposed clause 3.2 is:*

- *Reasonable; and*
- *Consistent with the Code objective...”<sup>1</sup>*

As mentioned above, the Report touches on a wide range of issues related to contracted capacity rights. However, to be faithful to the above scope we will not comment on the Report on a section-by-section basis, but will mainly confine ourselves to the core issue as to whether or not Western Power's clause 3.2 of the Electricity Transfer Access Contract (**ETAC**) should be permitted. That is, should Western Power be able to make a subjective decision to reduce a user's capacity, subject to reasonable qualifications, where that capacity is in excess of its reasonable requirements and is being sought by another user.

The appendix to this submission will briefly address the range of recommendations provided in the Executive Summary and particular sections of the Report that, while they may not address the core issue, evoke further comment for clarification and completeness.

## **2 PB's recommendations to the ERA must be given full and proper consideration before adoption by Western Power**

In the Report, PB recommends to the ERA that it should consider the principles upon which the UK model is based.<sup>2</sup> We have taken this on board, and have given special attention to these principles in our submission. However, the Report does not provide the depth of detail necessary to perform a fully informed analysis of these principles. We have therefore had to make some assumptions as to their application. We must, therefore, stress that before any thought can be given to the possible adoption of any of these principles, Western Power and all other interested parties must be given the opportunity to give them full and proper

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<sup>1</sup> Notice, at 3.

<sup>2</sup> Report: Executive Summary, at 2, 3.

consideration. Any discussion in this submission concerning the merits, or otherwise, of these principles must not be interpreted as acceptance by Western Power.

### **3 Western Power's view**

#### **3.1 Clause 3.2 of the ETAC does not provide Western Power with a “unilateral” right to decrease a user's capacity**

In the Notice, and in the Report, clause 3.2 of the ETAC has been described as providing Western Power with the right to “unilaterally” decrease a user's network capacity.<sup>3</sup> We believe it is unhelpful for the ERA and PB to describe Western Power's rights under clause 3.2 in this way. The word “unilateral” and its derivative, “unilaterally”, implies that Western Power has the right to decrease a user's capacity without first considering the user's particular concerns and circumstances. Clause 3.2 does not give Western Power this right. The user's circumstances are taken into account in clause 3.2, and the user is given an opportunity to make its own submissions on the matter. To demonstrate this, we reproduce clause 3.2 of the ETAC, below.<sup>4</sup>

#### *3.2 User must reasonably require Contracted Capacity*

##### *(a) If, with regards to Contracted Capacity at a Connection Point:*

*(i) in the reasonable opinion of Western Power, that Contracted Capacity is not reasonably necessary to satisfy the User's actual requirements (or forecast actual requirements following a temporary disruption to the User's full use of the Contracted Capacity); and*

*(ii) that Contracted Capacity is the subject of an Application from an Applicant who is not the User,*

*then Western Power may determine that the User must reduce that Contracted Capacity, and if it so determines, must give notice to the User of its intention to reduce that Contracted Capacity (including the amount and timing of the reduction).*

##### *(b) When making a determination under clause 3.2(a), Western Power must have regard to:*

*(i) the nature, condition and use of the Facilities and Equipment installed, or to be installed within a reasonable time, at the Connection Point; and*

*(ii) whether the User cannot use the Services because of a Force Majeure Event.*

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<sup>3</sup> Notice, at 1. Report: Executive Summary, at 2, 3. Report, at 18, 19, 21.

<sup>4</sup> Western Power, Western Power's Access Arrangement Submission to ERA, Volume 1: Electricity Transfer Access Contract: (19 May 2006), at Appendix 4.

*(c) At least 30 Business Days after giving the User a notice under clause 3.2(a), Western Power must make a fresh determination, having regard to any submissions made by the User in response to the notice given under clause 3.2(a) and all relevant material including anything which has occurred, whether the test under clause 3.2(a) is satisfied, and if so, may, by notice to the User, decrease the Contracted Capacity accordingly.*

It is clearly evident from reading this clause that, while the act of reducing a user's capacity is based on the subjective opinion of Western Power, that opinion, apart from having to be reasonable, must take the special circumstances of the user into account.

To ensure there is no doubt that the user's special circumstances are taken into account, we summarise those circumstances, with reference to the relevant paragraph, as follows:

- 3.2(a)(i) The user's contracted capacity must be in excess of what is reasonably necessary to satisfy that user's actual requirements;
- 3.2(a)(ii) The contracted capacity must be the subject of an application from an applicant who is not the user;
- 3.2(b)(i) Western Power must have regard to the nature, condition and use of the user's Facilities and Equipment installed, or to be installed within a reasonable time;
- 3.2(b)(ii) Western Power must have regard to whether the user cannot use the services because of a force majeure event;
- 3.2(c) Western Power must have regard to any submissions made by the user; and
- 3.2(c) Western Power must have regard to all relevant material.

Notwithstanding this, if the user does not believe that Western Power's opinion is reasonable, or that Western Power has not had regard to any of the other qualifications in clause 3.2, it can seek redress through the dispute resolution provisions in clause 28 of the ETAC.

Therefore, clause 3.2 of the ETAC does not give Western Power a "unilateral" right to decrease a user's capacity.

### **3.2 Reasons for including clause 3.2 in the ETAC**

Western Power believes clause 3.2 of the ETAC is necessary for three main reasons:

- to prevent inefficient investment in the network;
- to mitigate anti-competitive behaviour; and
- to avoid the need for "**bilateral**" (user-to-user) capacity trading.

In Western Power’s view, an access arrangement that permits a user to withhold excess network capacity, which if released would avoid the requirement for network augmentation, encourages inefficient investment in the network and anti-competitive behaviour. While we concede that some anti-competitive behaviour may be dealt with under relevant laws and regulations, we believe that any arrangement that could achieve the desired outcome without having to rely on statutory intervention in the first instance would be advantageous to all parties concerned.

Further, we believe that an access arrangement that supports bilateral capacity trading, as a measure to overcome these concerns, creates an economic environment that may lead to a secondary market in which capacity rights may become uncertain and recipient users may be forced to pay a premium for those rights. As will be discussed later, PB effectively endorses this view by confirming that bilateral trading of capacity is not supported in any of the other jurisdictions it surveyed.<sup>5</sup> Importantly, it further states in section 4.2.2 of the report, that the preferred UK model does not support user-to-user capacity trading.<sup>6</sup>

Western Power concedes that some users may be uncomfortable with allowing Western Power the right to make a subjective determination to reduce a user’s capacity. In recognition of this, and as demonstrated in the last section, Western Power has included terms in clause 3.2 which qualify this right in favour of the user. Notwithstanding this, Western Power would welcome alternative terms that would either extend these qualifications, or even shift the clause’s emphasis from a subjective test to an objective test.

However, regardless of the completeness of the qualifications or the subjective nature of the clause, Western Power is still of the firm opinion that the intended purpose of the clause - to avoid inefficient investment in the network and to mitigate anti-competitive behaviour - is both reasonable and consistent with the Code objective.

## **4 PB’s view**

PB recommends that, “Western Power’s ETAC should not contain a right to unilaterally decrease contracted capacity”.<sup>7</sup>

As far as inefficient investment is concerned, in previous discussions and in the third dot point under section 2 of the Notice the ERA concedes that such inefficiencies could occur:

*“If a user was to hold unused capacity, Western Power may need to augment the network to provide services to another user. If the first user was holding unused capacity to hinder access by another user, the further investment would be inefficient.”<sup>8</sup>*

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<sup>5</sup> Report, at 10, 11.

<sup>6</sup> Report, at 17.

<sup>7</sup> Report: Executive Summary, at 1.

<sup>8</sup> Notice, at 4.

PB draws our attention to the UK model, in which inefficient investment in the network is expected to be rare due to the assumption that users are unlikely to pay for services they do not receive. However, PB does concede that even in the preferred UK model it is accepted that inefficient network utilisation may still occur in some instances.<sup>9</sup>

PB concurs with Western Power that anti-competitive behaviour is a possibility<sup>10</sup> and that an approach such as Western Power's would mitigate anticompetitive behaviour.<sup>11</sup>

However, PB proposes that a better solution to these issues can be found by examining the principles employed in other jurisdictions, particularly the UK.<sup>12</sup>

Also, as mentioned in the last section, PB endorses Western Power's view that bilateral, user-to-user, capacity trading is inappropriate by confirming that it is not supported in any of the other jurisdictions it surveyed.<sup>13</sup>

PB concludes by stating that Western Power should not be overly concerned with inefficient investment in the network caused by anti-competitive behaviour, as such behaviour should ideally be dealt with through laws and regulations under the auspices of the competition watchdog.<sup>14</sup> As discussed in the previous section, Western Power does not dispute the role of legislation, but believes all parties would prefer to participate in an arrangement that would only rely on legislative intervention as a last resort.

On closer examination, we believe that PB's analysis of these issues can be grouped into two categories:

- capacity trading between willing users; and
- mitigation of anti-competitive behaviour, where users are unwilling to trade, or release excess capacity to the service provider.

## **5 Capacity trading between willing users**

As far as the trading of capacity is concerned, PB first proposes that the Transfer and Relocation Policy made under the *Electricity Networks Access Code 2004 (Code)* be exploited.<sup>15</sup> It also proposes that the ERA considers the introduction of a capacity rights trading approach similar to that established in the UK.<sup>16</sup>

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<sup>9</sup> Report, at 19.

<sup>10</sup> Report: Executive Summary, at 2.

<sup>11</sup> Report, at 19.

<sup>12</sup> Report: Executive Summary, at 2.3. Report, at 7, 8, 9.

<sup>13</sup> Report, at 10, 11, 17

<sup>14</sup> Report, at 20, 21.

<sup>15</sup> Report: Executive Summary, at 2.

<sup>16</sup> Report: Executive Summary, at 2.

We will consider each of these options in turn.

## 5.1 Exploitation of the Transfer and Relocation Policy

The Report appears to be inconsistent in terms of its interpretation of the operation and purpose of the Transfer and Relocation Policy. At some points it appears to recommend that the policy be exploited to facilitate capacity trading,<sup>17</sup> and at others it appears to imply that the policy has other purposes or is not suited to capacity trading between users.<sup>18</sup>

Western Power’s view is that the Transfer and Relocation Policy does not provide for the trading of network capacity from a donor user’s connection point under its access contract to a recipient users connection point under its access contract. In the following sections we will clarify the operation and purpose of the Transfer and Relocation Policy.

### 5.1.1 Definition of the Transfer and Relocation Policy and description of capacity rights

The following definition of the Transfer and Relocation Policy provides a succinct description of its operation and purpose.

***“transfer and relocation policy”** means a policy in an access arrangement under section 5.1(i) which specifies a user’s rights to transfer its access rights to another person and relocate capacity from one connection point in its access contract to another connection point in its access contract<sup>19</sup>.*

Capacity rights can be described as a requisite element of the *access rights* provided to a user, which are determined by the *covered services* provided to that user at a particular *connection point* under the terms of its *access contract*.

Armed with this definition of the Transfer and Relocation Policy and the explanation of capacity rights in regard to access rights, the following provides clarification as to the correct treatment of capacity rights under the Transfer and Relocation Policy.

### 5.1.2 Right to transfer is restricted to capacity transfers at the donor user’s connection point

The right to transfer under the Transfer and Relocation Policy relates only to the right of one user to transfer (or assign) **its** access rights (inclusive of capacity rights) at **its** connection point to another person at that same connection point.

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<sup>17</sup> Report: Executive Summary, at 2. Report, at 10, 11, 14, 20.

<sup>18</sup> Report, at 13, 14, 17.

<sup>19</sup> *Electricity Networks Access Code 2004 (WA)* s 1.3.



A user cannot, therefore, transfer its capacity rights at its connection point to another user in respect to a connection point specified in that other user's access contract. A donor user can only transfer capacity rights to a recipient user where that recipient user is to take up those rights at the donor user's connection point.

Therefore, the Transfer and Relocation Policy does not provide for the transfer (or trading) of access rights (or capacity rights) from one user at its connection point to another user at that user's connection point.

Accordingly, the right to transfer access rights under the Transfer and Relocation Policy cannot be exploited to facilitate capacity trading.

### **5.1.3 Right to relocation is restricted to capacity relocations between a donor user's own connection points**

The right to relocate only provides a user with the right to decrease capacity at one of **its** connection points and increase capacity at another one of **its** connection points under its access contract, subject to technical and economic qualifications.

The right to relocate does not permit a user to relocate capacity from one of its connection points under its access contract to another user's connection point under that other user's access contract.

Therefore, the right to relocate under the Transfer and Relocation Policy does not provide for the relocation (or trading) of capacity rights from one user to another user.

Consequently, the right to relocate capacity under the Transfer and Relocation Policy cannot be used as a mechanism to facilitate capacity trading.

## **5.2 UK capacity trading principle**

PB recommends that the ERA consider the introduction of a capacity rights trading approach similar to that established in the UK.<sup>20</sup> This principle refers to the concept of "Exchange Rate". However, the meaning of this term is not clear in the Report.

One interpretation is that it is a dollar exchange rate, such as a cost per MW rate (\$/MW): refer to the Report entries in the third, fourth and third past paragraphs of section 5.4.<sup>21</sup>

Another interpretation is that it is a capacity exchange rate, 'recipient MW' per 'donor MW' rate (MW received/MW donated): refer to the Report entry in the second last paragraph of section 3.1.3.<sup>22</sup>

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<sup>20</sup> Report: Executive Summary, at 2

<sup>21</sup> Report, at 19, 20.

The information provided in the Report in regard to the first interpretation is not clear or sufficiently detailed to be able to reach a reasonable understanding as to its application. Therefore, to advance discussion on this principle we will assume that the second interpretation is correct. Accordingly, our summary of this UK principle, and our extended commentary, is based on section 3.1.3 of the Report.

Our understanding of the UK capacity trading principle is as follows:

Upon receipt of a joint access application from both parties (donor and recipient users) detailing their respective capacity rights and requirements, the Service Provider calculates the appropriate (Capacity) Exchange Rate applicable to the donor and recipient connection points. The (Capacity) Exchange Rate identified by the Service Provider is used to calculate the capacity available at the recipient user's connection point as a direct result of a specific capacity reduction at the donor user's connection point.<sup>23</sup>

Therefore, irrespective of the intended meaning of Exchange Rate, the main features of this principle would appear to be:

- the requirement for both parties to make a joint access application to the service provider; and
- determination by the service provider of the capacity to be granted to the recipient user for the capacity surrendered by the donor user – including the corresponding amendments to each user's covered services and access charges.

This would suggest that the movement of capacity from the donor user to the recipient user is not facilitated by a "bilateral" trade in capacity, but rather a re-allocation of capacity between the two users via the service provider – a trilateral trade. This is an important point for Western Power, as our main concern with capacity trading was that such movements of capacity would occur bilaterally between user's, outside of Western Power's Application and Queuing Policy (AQP), and without providing Western Power with the opportunity to determine the technical and pricing consequences of the trade.

In addition to its discussion on the UK principles, PB has made it clear that it effectively endorses Western Power's view that bilateral, user-to-user, capacity trading is inappropriate. As stated previously, PB does this in a number of places in the Report by confirming a lack of support for this principle in all of the other jurisdictions it surveyed.<sup>24</sup> With Western Power and PB in general agreement on this issue, some form of capacity re-allocation between users via the AQP may be possible. Such an arrangement could provide a commercial environment that supports efficient investment in the network through the willing re-allocation of capacity.

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<sup>22</sup> Report, at 9.

<sup>23</sup> Report, at 9.

<sup>24</sup> Report, at 10, 11, 17.

Further detailed analysis must be undertaken to determine whether the Code, ETAC and AQP can be amended to accommodate this UK principle. However, in broad terms, it would appear to address Western Power’s concerns, and provide an outcome that is both reasonable and consistent with the Code objective.

However, we again stress that this principle must be given full and proper consideration by Western Power and all other interested parties before any decision is made to integrate it into Western Power’s access arrangement.

## **6 Mitigation of anti competitive behaviour by unwilling users**

PB concurs with Western Power that anti-competitive behaviour, by users withholding capacity from competitors, is a possibility.<sup>25</sup> It also agrees that Western Power’s proposal to include clause 3.2 in the ETAC, which allows it to subjectively reduce contracted capacity to circumvent anti-competitive dealings, would mitigate ant-competitive behaviour.<sup>26</sup> However, it also believes that mitigation by this approach would be heavy handed and contrary to the Code objective.<sup>27</sup>

PB’s preferred alternative is to follow the principle used in the UK. PB discusses this approach at a number of points in the Report. Our understanding of the principle can be summarised as follows:

Terms are included in the Standard Access Contract requiring users to provide regular maximum demand forecasts to the Service Provider. Should the Service Provider disagree with the forecasts, a dispute resolution process is available whereby the Regulator can arbitrate over the reasonable capacity needs of the user.<sup>28</sup>

We have compared this principle with the subjective approach set out in clause 3.2 of the ETAC, and accept that, subject to further detailed analysis, it may result in a more objective and transparent method of achieving the desired outcome of mitigating ant-competitive behaviour.

We believe that application of this UK principle, subject to Code and ETAC amendments, may address Western Power’s concerns and provide an outcome that is both reasonable and consistent with the Code objective.

However, we again stress that this principle must be given full and proper consideration by Western Power and all other interested parties before any decision is made to integrate it into Western Power’s access arrangement.

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<sup>25</sup> Report: Executive Summary, at 2.

<sup>26</sup> Report, at 19.

<sup>27</sup> Report, at 19.

<sup>28</sup> Report: Executive Summary, at 3. Report, at 20.

## 7 Conclusion

Western Power does not accept PB's assertion that clause 3.2 of the ETAC provides Western Power with a "unilateral" right to reduce a user's capacity, and believes that to make such an assertion is unhelpful. Western Power accepts that clause 3.2 of the ETAC could be redrafted to extend the qualifications or change the subjective test to an objective one. However, Western Power is still firmly of the opinion that the intended purpose of this clause – to avoid inefficient investment in the network and to mitigate anti-competitive behaviour – is both reasonable and consistent with the Code objective.

PB appears to be inconsistent with its views as to the application of the Transfer and Relocation Policy to capacity trading. Western Power's view is that the Transfer and Relocation Policy has limited functions, which, by definition, do not extend to capacity trading.

PB has recommended to the ERA that a more appropriate arrangement to Western Power's clause 3.2 could be achieved if Western Power's access arrangement was modified to follow the capacity trading and mitigation of anti-competitive principles applied in the UK.

The first UK principle does not appear to support the bilateral trading of capacity between users, which is welcomed by Western Power. Indeed, PB has endorsed Western Power's negative view of bilateral capacity trading by confirming in a number of places in the report that it is not supported by any of the other jurisdictions it surveyed. The UK principle proposed by PB appears to support "non-unilateral" capacity trading by willing users **via** the service provider through a joint access application process, whereby the service provider maintains control over capacity allocation and the technical and pricing consequences of the trade. This arrangement could provide a commercial environment that supports efficient investment in the network through the (trilateral) re-allocation of capacity by Western Power to willing users.

The second principle would appear to provide an objective mechanism to mitigate anti-competitive behaviour (by unwilling users) by employing an independent dispute resolution process. Under this process, the independent party (the ERA) would arbitrate over the reasonable capacity needs of the user. This may provide an environment that would discourage anti-competitive behaviour, which could by natural extension, support efficient investment in the network.

Western Power does not dispute the role of legislation in enforcing appropriate competitive behaviour, but believes that all parties would prefer to participate in an arrangement that would only rely on legislative intervention as a last resort.

As stated above, we believe that clause 3.2 of the ETAC does not give Western Power a unilateral right to decrease a user's capacity, and that its intention is both reasonable and consistent with the Code objective. We do not resile from this position. However, the two UK principles proposed by PB may provide a satisfactory, alternative solution. Applied together, they appear to address Western Power's three major concerns: inefficient investment in the network; anti-competitive behaviour; and the introduction of a bilateral capacity trading regime.

However, these conclusions are based on our interpretation of the high level principles set out in the Report. Therefore, we can not emphasise enough that the adoption of either of these principles cannot occur without first giving Western Power and all other interested parties the opportunity to give them full and proper consideration.

## **8 Recommendation**

PB has recommended to the ERA that a more appropriate arrangement to Western Power's clause 3.2 of the ETAC could be achieved if Western Power's access arrangement was modified to follow the capacity trading and mitigation of anti-competitive principles applied in the UK.

We recommend that any modifications to Western Power's access arrangement (or the Code) be deferred until such time as all interested parties have been consulted and given the opportunity to consider the full consequences of adopting these principles. We would anticipate that this consultation process could not be completed before the proposed date for approval of the revised access arrangement.

Therefore, in the meantime, we would welcome any reasonable proposal by the ERA in regard to appropriate amendments to clause 3.2 of the ETAC.

## 9 Appendix

In this appendix we address the recommendations provided in the Executive Summary and particular sections of the Report that, while they do not necessarily address the core issue, evoke further comment for clarification and completeness.

### 9.1 Section 4.1

PB appears to claim that the assignment of capacity rights to a user is a function of the type of works or assets required to satisfy that user's new connection requests.

This view is not entirely correct. Irrespective of the requirement, or otherwise, to construct particular network assets, capacity rights are a requisite element of the access rights provided to a user, which are determined by the covered services provided to that user at a particular connection point under the terms of its access contract. This appears to be acknowledged by PB in other parts of the Report. Refer to section 3.4.3.

### 9.2 PB recommendations made on the first page of the Executive Summary

- *Western Power's ETAC should not contain a right to unilaterally decrease contracted capacity;*

We have addressed this comment in the body of the submission. Clause 3.2 of the ETAC does not give Western Power a "unilateral" right to decrease a user's capacity. The clause includes a number of qualifications that are in the user's favour.

- *The question of who should determine the maximum contracted demand in the first instance is resolved by means of a good faith negotiation between Western Power and a generator or user in line with sound commercial practice;*

We do not disagree with this approach. It reflects our current practice.

- *Western Power's approach to subsequent capacity adjustments should recognise that Generators have a need for firm capacity and users are faced with commercial pressures and should have a right of veto over unilateral adjustments proposed by Western Power;*

As stated above, we have addressed this comment in the body of the report. Clause 3.2 of the ETAC does not give Western Power a "unilateral" right to decrease a user's capacity. The clause includes a number of qualifications that are in the user's favour.

- *Western Power should have a right to recover fair and reasonable costs included in connection agreements, consistent with the practice in other jurisdictions - such a right is supported by the Access Code.*

We do not disagree with this comment.

### **9.3 PB recommendations made on the second page of the Executive Summary**

These recommendations are all related to the application of the Transfer and Relocation Policy to capacity trading.

- *Exploit the transfer and relocation policies of the Access Code in relation to connection point capacity in the interests of economic efficiency;*
- *Ensure that Western Power specify clearly in the proposed ETAC how they propose to facilitate the transfer of contracted connection capacity between generators and users in order to maximise the economic benefits of all grid investment consistent with the role of a facilitator of access; and*
- *The ERA role should include monitoring of the effectiveness of the transfer and relocation policy to ensure that Western Power is meeting their obligations.*

Section 5.1 of this submission deals with the correct operation and purpose of the Transfer and Relocation Policy. In this section, it is concluded that the Transfer and Relocation Policy is not suited to the facilitation of capacity trading. We believe this conclusion addresses these recommendations.