



Landfill Gas and Power

12 December 2008

Access Arrangement Review
Electricity Access
Economic Regulation Authority
PO Box 8469
Perth BC WA 6849

By email: electricityaccessreview@era.wa.gov.au

Dear Sir / Madam

**RE: SUBMISSION ON WESTERN POWER'S PROPOSED ACCESS
ARRANGEMENT REVISIONS**

Thank you for the opportunity to make a submission on Western Power's proposed access arrangement revisions and for the extension to the closing date.

We respond below in detail to the specific issues highlighted in the discussion paper using the numbering of that paper.

In general terms we wish to emphasise that the pricing outcomes of the proposed changes have considerable potential to impact adversely on pricing and competition in the Western Australian electricity market. In particular, we would ask the Authority to have regard to the fact that network charges currently comprise around one third of the bundled cost of delivered electricity and that gazetted tariffs are recognised to be approximately one quarter below cost reflectivity. Further, the competitive aspects of the market are dominated by a state-owned retailer and state-owned generator that are bound contractually in such a way that the profit of the retailer is guaranteed by transferring operating losses to the generator, which then receives compensating subsidies from government.

While LGP is satisfied with the Office of Energy's cost review and recommendations to the previous Carpenter Government, we note that the recommended remedial tariff increases from 1 July 2008 have not been implemented. Further, while the new Barnett Government has been silent on the matter, there are press reports that despite the evidence to the contrary, it may perceive that they price increases are not necessary. Within this context, we wish to emphasise that gazetted tariffs are the competitive benchmark for electricity prices and customers demand discounts to them as a basis for leaving the state-owned retailer. Any increase in the network component of the tariff without a commensurate increase in gazetted tariffs serves only to increase the losses

made by the state-owned generator while impairing the competitiveness of all other retailers.

LGP also wishes to recognise that Western Power should be kept commercially whole by securing proper funding for all obligations placed upon it. In particular, we note that the State Government has committed Western Power to a substantial investment programme amid the resource constraints of the then booming economy, and the community has an expectation of improving reliability levels and quality of supply. From this perspective, we perceive Western Power to have properly proposed a blueprint for expanding the network to meet the needs of the state's forecast economic expansion and to have based its revenues on the credit conditions prevailing at the time of making that proposal. However, the sudden manifestation of a global recession and worsening prognosis by the week, calls into question the appropriateness of the proposed investments levels, costs and required financial returns. In particular, the original proposal was made during a time of rising interest rates, which policy has dramatically reversed to the point that the lowest interest rates in 50 years are now forecast on the back of three consecutive falls in official interest rates.

LGP considers that the original revenue forecasts have been rendered obsolete by recent economic events and advocates that network charges should actually be reduced by appropriate adjustments to the WACC and a reduction in the planned investment to reflect that the resource boom has ceased and the global economy faces a deepening recession.

If you require further information please contact Dr Stephen Gould on 0412 508 291.

Yours faithfully

GRAEME ALFORD
CHIEF EXECUTIVE OFFICER

SUBMISSION BY LGP ON WESTERN POWER'S PROPOSED ACCESS ARRANGEMENT

4. REFERENCE SERVICES

Submissions are invited from interested parties on whether the set of reference services included in the current access arrangement have proven to meet the requirements of users, and the requirements of section 5.2 of the Access Code.

Submissions are also invited from interested parties on the proposed revisions to the list of non-reference services.

LGP is fully satisfied with the existing set of reference services and has no proposed revisions.

5 STANDARD ACCESS CONTRACT

Submissions are invited from interested parties on any practical issues and/or difficulties experienced with the electricity transfer access contract during the current access arrangement period, and whether interested parties foresee any potential issues arising from the revisions proposed by Western Power to the electricity transfer access contract for the second access arrangement period that:

- may impact on a commercially workable access contract, or
- might present difficulties for a user or applicant in determining the value represented by the reference service at the reference tariff.

LGP currently has four access agreements with Western Power, which are being transitioned into a single agreement. We are fully satisfied with the practical day-to-day administration of the agreements and in particular highly value Western Power's proactive account management as a pragmatic and effective component of their customer service. We seek operational clarifications and assistance on a daily basis within a complex and evolving environment and acknowledge Western Power's attention to detail and willingness to learn and evolve.

While our experiences at operational level are very constructive, we are concerned that some aspects of the mid-level "back room" staff often demonstrate a culture of excessive conservatism approaching obstruction, reminiscent of elements of the former integrated utility. From this perspective, we are very concerned about any prospect of

Western Power being given un-reviewable discretion. While we understand the concept behind Western Power seeking power to unilaterally revoke capacity reservations, and under carefully controlled provisions would support it as being in the public interest, we note that LGP itself has capacity reservations that it does not fully utilise, but which we funded and continue to pay for month by month in the expectation of using them in the future. Indeed, we find ourselves obliged to pay now to hold open capacity that is not IMO-certified until October 2010. On this basis, LGP supports Western Power being given a process for revoking a capacity reservation provided that process outlines suitable grounds for such an action (including the applicant unreasonably obstructing a more viable project) and provides a right of appeal to an independent party.

Regarding the sunset clauses on invoicing errors, LGP supports consistency between the equivalent arrangements for network and gazetted tariffs; ultimately, the customer pays and retailers need the ability to pass through mistakes.

LGP has no objection to the 'clarification' based revisions and in particular supports the increased invoicing flexibility and temporary provision of modified services. It is desirable that Western Power should be encouraged to modify its systems to meet the individual needs of its customers.

6 SERVICE STANDARD BENCHMARKS

Submissions are invited from interested parties on Western Power's proposed revisions to the service standard benchmarks, including:

- the level of service standard benchmarks proposed by Western Power for the second access arrangement period;
- the proposed exclusions for the measures of SAIDI, SAIFI and circuit availability; and
- whether the supporting information provided by Western Power is sufficiently detailed to enable users or applicants to determine the value represented by the reference service at the reference tariff.

Submissions are also invited on whether Western Power's service standards are reasonable, given the levels of actual and forecast expenditures for the current and second access arrangement periods.

LGP supports the appropriateness of service standard benchmarks as a basis for assessing Western Power's performance and the desire of the community for continuous improvement. However, it must be expressly recognised that improving standards, or maintaining them in an aging network, has a cost attached and it is important to apply a value-for-money perspective. Further, it is not appropriate to place on Western Power onerous targets unless they are expressly funded. In this respect, and as detailed in our initial comments, LGP is very concerned at the proposed high level of overall cost increases in general and advocates that cost economy be prioritised over improvements in standards. In particular, LGP advocates more transparency and communication of the

relationship between service levels and cost and in the absence of compelling reasons for improving or maintaining standards advocates that economy should be prioritised.

7 REFERENCE TARIFFS AND THE PRICE CONTROL

Submissions are invited from interested parties on the level of actual non-capital costs for the current access arrangement period, and whether or not the actual costs are consistent with a service provider efficiently minimising costs.

Submissions are also invited from interested parties on the forecast non-capital costs, and the adequacy of Western Power's supporting information for this forecast.

LGP notes that the current distribution costs are substantially higher than budget and that the forecast costs for both transmission and distribution are substantially higher than the current levels.

While LGP does not have expertise specific to this area, we are concerned at the proposed level of cost increases and, per our comments above, advocate an emphasis on cost economy. That said, we recognise that labour and material costs have increased substantially in the first regulatory period and that the forecast increases were prudent at the time and in the context in which they were made. Further, Western Power must be properly resourced for the standards placed upon it. However, we note that in recent weeks, the global economy has declined substantially, commodity prices have collapsed, inflation has reversed into the prospect of deflation, and the full extent of the prognosis for WA has not yet unfolded. From this perspective, it is likely that not only will Western Power not be subject to the cost imposts it has forecast, but activity levels may also be much lower than forecast. On this basis, LGP advocates an incremental change to planned expenditure.

7.2.2.3 Capital Base and New Facilities Investment

Submissions are invited from interested parties on the substantial increases in new facilities investment recorded by Western Power for the current access arrangement period (as actual investment over forecasts for the period), and for the second access arrangement period (as forecast investment over actual investment for the current access arrangement period).

LGP notes that Western Power's actual new facilities investment for the current access arrangement period was 58% above forecast for the transmission network and 55% greater for the distribution network. Western Power has also forecast further real increases in new facilities investment of 105% for transmission and 51% for distribution. LGP reiterates the above concern that the focus should be on cost economy in a low-growth context rather than planning for continuity of the economic boom.

Submissions are invited from interested parties on Western Power's calculation of the capital base values at the start of the second access arrangement period and, in particular, on whether Western Power has adequately demonstrated that new facilities invested in the first access arrangement period meets the requirements of the Access Code to be added to the capital base.

LGP supports the ERA in its concerns that the increase in the capital base must have proper regard to the method of its funding (new facilities investment test versus capital contributions), the lack of substantiation, and the limited applicability of a supporting consultant's report. We note that increases to the capital base are a direct driver of the proposed increases in network tariffs and advocate that all reasonable means be used to minimise the capital base.

Submissions are invited from interested parties on whether information provided by Western Power in the revised access arrangement information is sufficient for the Authority to be satisfied that the forecast new facilities investment may be reasonably expected to either meet the new facilities investment test, or the test under section 6.51A(b) of the Access Code where the new facilities investment has been financed by contributions.

LGP reiterates its concern that the forecasts were made from a now-outdated perspective of a booming economy maintained by high demand for resources, and consequent high investment and development of resources projects and increasing population. LGP advocates that this be reconsidered from a low growth, deflationary, commodity-collapse perspective.

Submissions are invited from interested parties on the change in treatment of capital contributions that is proposed by Western Power.

LGP notes the ERA's estimate that other things being equal, the proposed change in Western Power's treatment of capital contributions increases the target revenue 15 to 17% for transmission and 17 to 28% for distribution, with corresponding increases in reference tariffs. Bearing in mind that this is an accounting treatment with no underlying substance in terms of plant on the ground or reliability improvements, LGP strongly

advocates that this proposal be disallowed. Regardless of whatever merit this proposal may have, the emphasis must be on minimising tariffs, from which perspective this proposal is wholly inappropriate.

Submissions are invited from interested parties on the rate of return (WACC), and various parameters, proposed by Western Power.

LGP notes that the proposed WACC analysis was determined on the basis of a nominal risk free rate and a debt margin established from capital market data over a 60 trading-day period to 23 June 2008. Further, the determination is subject to revision to apply the optimal sampling period and updated inflation outlook at a time closer to the approval of the proposed revised access arrangement.

LGP proposes that recent events in the global capital markets has rendered the proposed figure obsolete. In particular, interests rates have been substantially reduced and further dramatic reductions are expected, driving the risk-free rate to its lowest value in fifty years. Further, the inflation rate is forecast to drop substantially and equity markets have collapsed. We note that the proposed figure of 8.95% represents a 32% increase in the current value and propose that a substantial reduction would be more appropriate. Further, we would advocate that a figure at the bottom of the calculated range be chosen to capture the likelihood of a sustained recession and deflationary investment environment over the regulatory period.

7.3 Price Control

Submissions are invited from interested parties on changes proposed by Western Power to the price control, including:

- application of the price control only to revenue from reference services; and
- the revised side constraint on year-to-year changes in reference tariff charges.

LGP notes that Western Power has proposed real increases in network charges of 40% from 2008/09 to 2009/10 and subsequent annual real increases in 2010/11 and 2011/12 of 37.2 per cent for transmission charges and 30.0 per cent for distribution charges. Further, Western Power has proposed a revised side constraint for year-to-year changes in reference tariff charges $CPI + 37.2\%$ for transmission and $CPI + 30.0\%$ for distribution.

We reiterate our concerns that the increases are far too large by any reasonable standard regardless of the substance that they intend to achieve. Further, this is exacerbated by the prospect of further large increases as the regulatory period unfolds.

Given that one of the primary benefits of the side-constraints is to facilitate tariff design and planning, the proposed side constraints serve only to support our concerns expressed in Section 5 that Western Power's judgment is sometimes questionable; the proposed levels indicate that Western Power is effectively proposing that the side constraints be abolished.

7.5.2 Current Access Arrangement and Proposed Revisions

Submissions are invited from interested parties on proposed revisions to the access arrangement to allow adjustments to target revenue in the next access arrangement period, including by:

- the proposed gain sharing mechanism;
- the proposed service standards adjustment mechanism;
- the deferral of revenue; and
- the "D factor Scheme".

LGP supports the proposition that Western Power should not be disadvantaged by improving its efficiency and we support the principle of a gain sharing mechanism. However, we would advocate proper safeguards to ensure that forecast costs aren't "padded" so as to make efficiencies easier to achieve.

LGP is concerned about the proposal for service standards as we perceive it to overly incentivise investment in the network (that is, increasing costs) while we perceive that the focus should be on cost economy.

LGP reiterates its comment above on the deferral of revenue; we see no justification for increasing costs via accounting treatments.

LGP understand the D Factor proposal to remove obstacles to non-network solutions by compensating Western Power for expenses incurred to that end. We support this proposal.

8 APPLICATIONS AND QUEUING POLICY

Submissions are invited from interested parties on the operation of the applications and queuing policy in the current access arrangement period and whether any revisions to this policy, in addition to those proposed by Western Power, are required to meet the requirements of the Access Code.

LGP understands Western Power's proposal to require a higher standard of "completeness" of access applications before they can be considered part of the "queue". We support this proposal as it prioritises substantive projects and avoids queue-blocking.

9 CONTRIBUTIONS POLICY

Submissions are invited from interested parties on operation of the capital contributions policy during the current access arrangement period and on Western Power's proposed revisions to the capital contributions policy.

LGP has no objection to Western Power's proposed capital contribution revisions.

Other Matters

LGP proposes that provision should be made in the Access Contract for Western Power to be required to cooperate with a User seeking to claim damages from a third party that has damaged Western Power's network and thereby caused loss to the User. In particular, Western Power should be required to provide details of the nature of the damage, the events that caused it and the identity of the party responsible insofar as it is known to Western Power.

In discussion with Western Power in respect of our new ETAC, Western Power have agreed to support the following wording for an additional clause:

21.7 If a party ("First Party") suffers loss or damage due to a Force Majeure Event that is caused by a third party (not being an agent or contractor of either party) then the other party ("Second Party") will, subject to any obligations of confidentiality or privacy, cooperate with the First Party and, where reasonably possible, will disclose to the First Party the identity of the third party and details of the Force Majeure Event.

However, in two previous incidents in respect of LGP, Western Power have been unable to provide details of the third party because of privacy and confidentiality obligations. Perhaps these provisions need to be looked at as well.