

# **Coverage of the Horizon Power Electricity Network in the North West Interconnected System**

## **RESPONSE TO THE MINISTER FOR ENERGY'S *DRAFT DECISION***

**Issued by Horizon Power**

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## 1. SUMMARY OF THIS SUBMISSION

### 1.1 Purpose

This submission responds to the Minister for Energy's draft coverage decision in favour of covering the *Horizon Power Network* published on 27 November 2017. In particular to:

- (a) provide further clarification regarding the basis of Horizon Power's financial modelling in Horizon Power's Initial Submission; and
- (b) respond to the Minister for Energy's request for information about when a final coverage decision in favour of covering the *Horizon Power Network* should take effect.

### 1.2 Submission Summary

Horizon Power remains of the position that a decision to cover the *Horizon Power Network* alone will not materially increase competition and is contrary to the public interest<sup>1</sup>. Horizon Power supports the evolution of the electricity industry in the Pilbara and re-iterates that the best approach to delivering public benefit through competition requires:

- an independent system operator to be established within legislation with the rights and obligations that ensure reliable electricity supply and with statutory immunity when it acts to protect the security of the system;
- reform of the Uniform Tariff Policy (**UTP**) and associated subsidy arrangements. Horizon proposes that this reform should be coupled with a staged approach to contestability, as adopted in the *SWIS* and in all other regimes in Australia. This approach would allow covered networks to implement and test the new regime with limited customer numbers and provide time for retailers to change underlying cost arrangements; and
- to effect a third-party access regime that grants consumers connected to all North West Interconnected System (**NWIS**) networks choice of supplier. This will establish a market size more material than the very small market created by covering only the *Horizon Power Network*. This increased participation and market size would support a greater number of competitors and customers, improving the performance of the market and increasing the likelihood of benefits being generated from competition.

In response to the Minister's *Draft Decision*, Horizon Power submits the following:

- In the *HP Initial Submission*, the financial modelling of the impacts of coverage on South West Interconnect System (**SWIS**) customers and taxpayers was undertaken consistent with the then forecasts and calculations that Horizon Power adopted in its State Budget Forecast (**SBF**) FY17/18 submission accepted by the Department of Treasury. Given that Horizon Power's *SBF* FY17/18 submission has been accepted by the Department of Treasury, Horizon Power considers that the Minister for Energy should have confidence that they reflect the best forecast of the impact of coverage on the state budget position.

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<sup>1</sup> As defined by clauses 3.5 (a) and 3.5(c) respectively of the Access Code.

- Horizon Power considers that it would be grossly inefficient and inconsistent with the public interest for Horizon Power to be subjected to two separate third-party access regimes in short succession, being coverage under the *Access Code* followed by the *NWIS Reform Regime*. The cost of establishing compliance with each regime would ultimately be borne by consumers or the taxpayer. This would be the case if the Minister was to set the date for coverage prior to the implementation of the *NWIS Reform Regime*.

### 1.3 Structure of this submission

This submission is structured as follows:

- Section one sets out the structure of the submission, relevant background information, summarises the key points in the submission and provides an explanation of Horizon Power's treatment of information that is cabinet-in-confidence but which it is required to provide to the Minister for Energy.
- Section two contains Horizon Power's response to the Minister for Energy's comments on the financial impacts of a coverage decision over the *Horizon Power Network* by the Minister for Energy in favour of coverage.
- Section three responds to the Minister for Energy's request for submissions about the date from which coverage should take effect by identifying matters that Horizon Power considers must be completed prior to coverage taking effect in order to:
  - resolve material risks to the *NWIS* and consumers in the *NWIS* that are not resolved through coverage of the *Horizon Power Network* alone; and
  - avoid incurring inefficient regulatory and administrative costs associated with preparing for coverage given the possibility of coverage being replaced by a *NWIS Reform Regime*.
- Section four contains a set of defined terms that apply to this submission.

### 1.4 Background

Horizon Power is a government trading enterprise established under the Electricity Corporations Act 2005 (**EC Act**) to provide electricity to customers outside the SWIS. Horizon Power supplies customers as a vertically integrated utility (including generation, network and retail functions) in 40 separate systems. Horizon Power is required to supply customers at tariffs gazetted by the state government, this obligation is referred to as the Uniform Tariff Policy (UTP). Horizon Power's cost of supplying customers across the 40 systems is higher than the revenue generated from customers under the UTP. The shortfall in revenue is provided through two subsidy regimes, the Tariff Equalisation Contribution (TEC) and the Tariff Adjustment Payment (TAP). Horizon Power owns part of the transmission and distribution networks the supply customers on the coastal part of the Pilbara.

On 4 August 2017, Alinta Energy (**Alinta**) applied under section 3.8 of the *Access Code* for coverage of the *Horizon Power Network*. Alinta's application sought to demonstrate how the Minister for Energy should determine an affirmative answer to the coverage criteria contained in section 3.5 of the *Access Code*.

On 15 September 2017 the Minister for Energy published an issues paper seeking comments from interested parties in relation to various matters associated with Alinta's application.

Horizon Power submitted a response to the Minister's issues paper on 16 September 2017 (**HP Initial Submission**).

In the *HP Initial Submission*, Horizon Power submitted that the Minister should not make a decision in favour of coverage of the *Horizon Power Network* only because this would not result in material increases to competition in a relevant market in the *NWIS*. Further, Horizon Power submitted that increased access to covered services provided by the *Horizon Power Network* would be contrary to the public interest by reason of its adverse financial effect on Horizon Power's revenue which, in turn, would lead to an increase in the State's electricity subsidy arrangements to the detriment of electricity customers in the *SWIS* and Western Australian taxpayers. The net effect of these arrangements is a net financial flow from members of the Western Australian public out of Western Australia.

Further, Horizon Power noted that coverage of the *Horizon Power Network* alone will not resolve fundamental technical and operational challenges that prevent the *NWIS* from operating efficiently. For example, the lack of any central system manager with standard functions and powers of the kind present in the *SWIS* or the National Electricity Market (**NEM**) means that Horizon Power has taken on a default system management role with limited powers to enforce standards of conduct and design that are reflective of industry best practice.

The *HP Initial Submission* concluded the following approach to electricity reform in the Pilbara:

- establish a *NWIS* independent system operator with rights and obligations that ensure reliable electricity supply and with statutory immunity when it acts to protect the security of the system;
- reform the *UTP* and associated subsidy arrangements to allow Horizon Power to compete with retail competitors in the *NWIS*; and
- effect a third-party access regime that grants consumers choice on all networks that constitute the *NWIS*, either via coverage or under a separate regulatory framework, which would also give Horizon Power the opportunity to minimise its financial losses.

On 27 November 2017, the Minister for Energy published his draft coverage decision that the *Horizon Power Network* be covered. In making his decision, the Minister decided that:

- coverage would give prospective retail market participants an enforceable opportunity to access the *Horizon Power Network*, which would substantially improve the likelihood of one or more retailers being able to enter the Horizon Power *NWIS* retail market and compete with Horizon Power;
- it would not be privately profitable for anyone to construct another network to provide the covered services provided by means of the *Horizon Power Network*; and
- irrespective whether coverage of the *Horizon Power Network* results in increased competition, increased access to services provided by the *Horizon Power Network* would not be contrary to the public interest.

The Minister for Energy also sought comment on when coverage ought to take effect in respect of the *Horizon Power Network*. Horizon Power considers that it is crucial that the Ministers

provides opportunity for the *NWIS Reform Regime* to be implemented before coverage under the ENAC has effect.

Preparing for two third-party access regimes in close succession, whether they are intended to operate in parallel or one replacing the other, would be inefficient and costly and, in Horizon Power's view, inconsistent with the public interest.

### **1.5 Horizon Power's statutory obligation to inform the Minister for Energy**

As a government owned corporation, Horizon Power has a number of obligations that are unique to it and the corporations created under the *EC Act*.

In particular, Horizon Power notes its obligation pursuant to section 118 of the *EC Act* to keep the Minister for Energy reasonably informed of the financial performance and financial position of Horizon Power.

This includes notification regarding the assets and liabilities, profits and losses and prospects of Horizon Power and to provide to the Minister for Energy reports and information that the Minister requires in order to make informed assessments of matters relating to the financial performance and financial position of Horizon Power.

In preparing its *SBF* submissions to the Department of Treasury, Horizon Power made a number of assumptions in relation to its future operations, given the likely commencement of retail competition on the *Horizon Power Network*.

As such, Horizon Power's *SBF* submissions have included an assumed "no competition in the *NWIS*" case and a "competition in the *NWIS*" case.

Because *SBF* submissions are prepared for submission to the Economic Reform Committee of Cabinet, they are cabinet-in-confidence documents, which are subject to public interest immunity. Horizon Power is not able to make these documents public.

In view of this, Horizon Power's remarks on financial impact in this submission are high level and Horizon Power will separately provide to the Minister for Energy a confidential submission reflecting Horizon Power's *SBF*, consistent with its obligations under section 118 of the *EC Act*.

## 2. WHAT IS THE LIKELY FINANCIAL IMPACT OF COVERAGE?

### 2.1 Uncertainty in forecasting

In the *HP Initial Submission*, Horizon Power set out in broad terms the likely impact of a *coverage decision* by the Minister for Energy in favour of *coverage*. Horizon Power pointed out, among other things:

- The costs associated with Horizon Power losing customers would ultimately fall to the Tariff Equalisation Contribution (**TEC**) and the Tariff Adjustment Payments (**TAP**), to the extent the latter continues to be paid out of consolidated revenue. Once the *TAP* is phased out (from 1 July 2019 in accordance with the forward estimates in this year's state budget) and absent any change to the calculation of the *TEC*, Horizon Power's revenue shortfall consequent on its loss of customers will be subsidised by parties to whom Western Power provides covered services by means of its distribution network.
- This, in turn:
  - will increase the costs of electricity for consumers in the *SWIS*; or,
  - in the case of Synergy's monopoly customer base, will either increase consumer costs or if tariff increases are insufficient to allow Synergy to pass-through these costs, increase the tariff adjustment payment made to Synergy; or
  - once Synergy's tariff adjustment payment is phased out, reduce Synergy's profitability and the dividends and tax equivalent payments paid to the state government.

In his draft coverage decision, the Minister for Energy acknowledged that it was evident from Horizon Power's submission that coverage of the *Horizon Power Network* could have adverse consequences for Horizon Power, the State and/or customers in the *SWIS*. However, the Minister for Energy considered that at this time it is not possible to predict the quantum of financial consequences with any degree of certainty.

In response to Horizon Power's submissions in relation to the financial impact of coverage of the *Horizon Power Network*, particularly in respect of criteria (c), the Minister responded as follows:

- While it is reasonable to assume that competition in the *NWIS* will result in Horizon Power losing some revenue, the Minister for Energy considers that there is substantial uncertainty regarding the quantum of the loss that may eventuate.
- The Minister did not consider it useful to approach Criterion (c) on a purely quantitative basis on the basis that:

*"many of the costs and benefits associated with access to the Horizon Power NWIS network have a speculative character that it appears cannot be assessed definitively, or even with sufficient certainty to sustain a compelling cost benefit analysis. This is most evident in relation to the purported levels of costs arising from the forecast reductions in*



*Horizon Power's revenue and the resulting impact on the State's electricity subsidy arrangements.*<sup>12</sup>

- Horizon Power's submission contains a number of material uncertainties, each of which has a significant impact on the conclusion which can be drawn with respect to public cost, these include:
  - when competition commences;
  - how aggressively Alinta enters into the Horizon Power retail market;
  - wider electricity demand trends in the Pilbara region;
  - Horizon Power's ability to respond to competition;
  - whether the existing arrangements for calculating the *TEC* continue in a situation where Horizon Power is subject to competition; and
  - whether Synergy is permitted to pass through any increase in network charges arising from an increase in *TEC* to its customers.
- The Minister further notes that the *TEC* is a policy instrument that is subject to change.

In his draft coverage decision, the Minister also referred to a number of mitigating factors which might reduce the adverse financial impact of coverage on Horizon Power.

- Horizon Power's submissions as to the costs of increased competition do not take into account the possibility that Horizon Power may be able to supply wholesale power to Alinta Energy.
- Horizon Power's fixed costs largely arise from power and gas purchase agreements which will expire in the long term.
- To the extent that the costs referred to in Horizon Power's submissions involve a transfer from one entity to another, they may potentially not be considered as costs or benefits to the public. The Minister further notes that the costs to Horizon Power are likely to be matched by benefits to Alinta.

Horizon Power's response:

#### *Horizon Power's forecasting assumptions*

The fact that estimating the value of the loss is difficult and not a straightforward exercise does not relieve Horizon Power of its obligation, including under the *EC Act* as referred to in section 1.4 above, to make an assessment of the likely financial effect as best as it can on the basis of all of the information currently known to it and to so inform the Minister.

In preparing its *SBF* submission to the Department of Treasury, Horizon Power made a number of assumptions and forecasts in relation to its future operations, given the likely

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<sup>2</sup> Minister for Energy "Draft Coverage Decision in application for coverage of the Horizon Power Electricity network in the North West Interconnected System" (27 November 2017), p 27



commencement of retail competition on the *Horizon Power Network*. These assumptions and forecasts have been accepted by Treasury for the purpose of establishing the *SBFs*. These assumptions are based on the existing and unambiguous government policy settings requiring Horizon Power to charge customers tariffs consistent with the *UTP* with the financial impact of this funded by the *TEC* and *TAP*.

As such, Horizon Power's *SBF* submissions have included an assumed "no competition in the *NWIS*" case and a "competition in the *NWIS*" case. Horizon Power used the assumptions and forecasts adopted at the time for its contribution for the *SBF* in the *HP Initial Submission*.

Horizon Power considers that these submissions were based on assumptions, developed in consultation with the Department of Treasury.

The submissions also required the assumptions to be made about:

- Forecast demand in a given period. Horizon Power's assumptions in this regard are uncontroversial. For example, it is clear that demand growth in the Pilbara coastal (Karratha & Port Hedland) is likely to remain flat for the short to medium term with very few new projects forecast to come online over the next 5 years.
- Revenue available to Horizon Power under the regulated tariffs contained in the *Energy Operators (Regional Power Corporation) (Charges) Bylaws 2006 (WA) (By-laws)*.
- The government policy settings requiring Horizon Power to charge customers tariffs contained in the By-laws consistent with the *UTP*, including a requirement to charge some customers at average cost, not being changed by the decision to cover and therefore remaining as they are.
- The likelihood of customer churn from Horizon Power to new entrant retailers, which Horizon Power considers to be impacted by the following considerations:
  - The number of competitors entering the retail market on the *Horizon Power Network*;
  - The extent of the discounts new entrants make to Horizon Power customers against the regulated tariffs contained in the By-laws; and
  - The extent to which Horizon Power is entitled to compete with new entrants in view of the operation of the *TEC* and the *TAP* and Horizon Power's obligation in section 61 of the *EC Act* to act in accordance with commercial principles and endeavour to make a profit consistent with maximising the long term value of the business.

In Horizon Power's most recent submission to the Department of Treasury, the "competition in the *NWIS*" case adopted the same assumptions as adopted in the *HP Initial Submission* being:

- Horizon Power's obligation to act consistently with the *UTP* and the operation of the *TEC* will preclude Horizon Power from competing against retail competitors on price.

- Without securing wholesale supply from another generator active in the *NWIS*, Alinta would capture 65% of Horizon Power's existing retail market by volume in a linear fashion over the forward estimates period, this forecast is based on the amount of power Horizon Power considers Alinta could supply from its existing units.
- All Horizon Power's cost positions are as accepted by the Department of Treasury for the case that currently forms the basis of Horizon Power's impact on the state budget. This includes the mix of fixed and variable costs.

Further, forecasts contained in budget forecast submissions, and used in the *HP Initial Submission*, have relied upon steady-state assumptions about government policy unless there is a robust basis on which to make alternative assumptions. This means that, in the absence of any clear policy change to the *UTP* or the *TEC*, the *TEC* is assumed to apply in its current state for the duration of the budget year and the forward estimates.

#### *Wholesale power supply arrangements*

Establishing wholesale sales arrangement between suppliers in a two supplier market has the potential to erode customer confidence in competition and would need to be considered carefully in the context of Australian Competition Law.

Under all of the cases modelled by Horizon Power in its Confidential Submission, Alinta has sufficient existing installed generating capacity to meet the customer load it acquires. That is, Alinta has no need to purchase from Horizon Power on a wholesale basis to supply the customers it acquires under any of the modelled outcomes.

Given the lack of market mechanisms of the kind in place in the *SWIS*, the fact that the *NWIS* is in a position of excess generation capacity relative to load requirements and that there are unlikely to be any material increases in load in the short to medium term, Horizon Power considers that wholesale supply opportunities are likely to be low and their inclusion in Horizon Power's forecasts would be speculative.

Further, if a competitor has a more competitive price than Horizon Power to supply a customer (and therefore acquires that customer), it is unlikely that this competitor would then purchase from Horizon Power on a wholesale basis to supply that customer

#### *Horizon Power's fixed costs*

The Minister for Energy is correct that Horizon Power's fixed costs arise principally from long term power and gas contracts, which may expire in the long term. In the short to medium term, however, it is reasonable for Horizon Power to include these costs in its forecasts of costs. Indeed, the basis of costs included in the *HP Initial Submission* are those accepted by Treasury for inclusion in the State Budgets. At the time Horizon Power entered the fixed cost arrangements it was reasonable for it to do so as it had revenue certainty and was able to provide certainty to suppliers to reduce unit costs. Appendix A provides a summary of the expiry dates of the contracts that underpin Horizon Power's key fixed costs. The largest of these commitments extends for another 24 years.

#### *Transfers versus public costs/benefits*

Horizon Power considers that the following outcomes of coverage with respect to Horizon Power's financial position are clear:

- Horizon Power is likely to lose a large number of customers, as explained in the *HP Initial Submission*.
- For the time being, until any change in government policy, the reduced revenue will be met under the *TEC* by the users of the *SWIS* contracted to Western Power who will be required to compensate Horizon Power for the difference between its cost of production and the revenue sourced from regulated income.
- In most cases, these costs will be recovered from consumers in the *SWIS*. In the case of Synergy's customer base, if the state government allows an increase to the *Energy Operators (Electricity Generation and Retail Corporation) (Charges) Bylaws 2006 (WA) (Synergy By-laws)* to recover this compensation, then that compensation will be paid for by those consumers in the *SWIS*.
- If the state government does not allow an increase in charges under the Synergy By-laws, Synergy will suffer reduced profitability and will return lower tax equivalent payments and dividends to the state government.

Therefore, Horizon Power considers that Alinta's participation in the retail market of the *Horizon Power Network* without the coverage<sup>3</sup> of other networks in the *NWIS* will be underwritten by either the consumers in the *SWIS* or the state government. Further, as the Minister for Energy noted "*a loss of revenue for Horizon Power as customers switch to Alinta Energy will result in an increase in revenue for Alinta Energy (the increase will be slightly lower than the loss of revenue if Alinta Energy attracts customers by offering lower prices)*".<sup>4</sup>

This is, ultimately, a wealth transfer from consumers in the *SWIS* and the state government (WA taxpayers) to Alinta and its owners who are not based in Western Australia. Horizon Power submits that the nature of this transfer (to entities that are not members of the WA public) is material in the consideration of establishing the benefit to the public of Western Australia.

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<sup>3</sup> Coverage of other networks provides Horizon Power opportunity to capture other sources of revenue.

<sup>4</sup> Draft Decision at page 31.

### 3. INTEGRATION WITH THE PILBARA REFORM – TIMING OF COVERAGE

The Minister for Energy sought comment on when coverage ought to take effect in respect of the *Horizon Power Network*. Horizon Power submit the following comments.

If the Minister was to set an effective date of coverage before the implementation of the NWIS Reform Regime, Horizon Power, and any other operators of, would be required to establish the following:

- a proposed Access Arrangement; and
- arrangements consistent with the ring fencing obligations contained in the *Access Code*.

The *Access Code* contemplates that these elements be established, approved by the ERA and implemented in a 6 to 9 month period. At the Regulatory Reform in the North West Interconnected System Stakeholder Reference Group meeting on 11 December 2017, the reform team indicated that this *NWIS Reform Regime* was likely to be implemented sometime in 2019. This reform regime will likely be very different to an Access Arrangement under the *Access Code*, in particular with regard to supplementary matters and ring fencing obligations. Thus, if the Minister was to set the effective date for Coverage at the beginning of 2018, Horizon Power would be required to establish, have approved and implement an access regime to have it largely replaced within 12 months.

Horizon Power submits that it would be costly and inefficient, and therefore inconsistent with the public interest, for Horizon Power to be subjected to two separate third party access regimes in close succession, being coverage under the *Access Code* and the *NWIS Reform Regime*.

The cost of establishing compliance with each regime, and undoing compliance with the first regime, would ultimately be borne by consumers, Horizon Power itself and/or the state government and the extent of regulatory compliance is likely to be onerous. Based on experience in establishing similar regimes (including Western Power under the *Access Code*), the costs of establishing each regime will \$1-5 million.

The challenge, therefore, is to ensure that Horizon Power is only subject to one form of third party access regulation. Given the Minister is required to make a final coverage decision, Horizon Power suggests the following approach:

- in the Final Decision, the Minister rejects the coverage of the *Horizon Power Network* in the Pilbara as it contrary to public interest; and
- the Minister then support the establishment of the *NWIS Reform Regime* in a prompt and efficient manner.

Horizon submits that the above process would be the simplest and most cost-effective approach to implementing a access regime in the Pilbara that will deliver to the public interest<sup>5</sup>.

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<sup>5</sup> If reform does not progress as desired the Minister can arrange to have the coverage process revived.

Alternatively, the Minister could set the date that the final coverage decision would have effect sufficiently far in the future to allow the development and implementation of the *NWIS Reform Regime*. This approach does have the complexity of having to effectively estimate the time required to effectively deliver reform including the required changes to existing government policy.

In addition, the government needs to have had the opportunity to properly consider the issue of reform of the *UTP*, existing subsidy arrangements, and to progress any strategy for minimising any adverse financial impact likely to result from coverage of the *Horizon Power Network* including consideration of a staged approach to contestability.

Further, Horizon Power will make an application for coverage of other networks in the *NWIS*. In the *HP Initial Submission*, Horizon Power noted that a decision to cover the *Horizon Power Network* was likely to result in such an application but deferred the decision to apply for coverage on the basis that it considered the public benefit test was not satisfied under Alinta's application and did not want to incur the cost of making an application which may prove unnecessary. The Horizon Power applications for coverage will lay out the evidence required by the Minister to consider the coverage of other networks. Ideally, the effective date for all the covered networks would align and / or be captured through the *NWIS Reform Regime*.

Horizon Power identifies two material issues that can be effectively resolved by allowing the reform process and supporting legislation to be implemented in favour of, or advance of, coverage under the *Access Code*:

- Reform and legislation can address material operational and technical issues that are not addressed by coverage of networks alone;
- Horizon Power notes that preparing for coverage and submitting a proposed *Access Arrangement* to the Economic Regulation Authority is likely to be a complex and time-consuming process, including:
  - Horizon Power will be required to comply with the relatively onerous ring fencing obligations set out in Chapter 13 of the *Access Code*; and
  - Horizon Power will be required to address the supplementary matters under section 5.27 of the *Access Code* without legislative support and possibly in isolation from other networks that are required to address these matters at around the same time.

Both of the above issues will add significant cost and risk to customers in the Pilbara and the *SWIS* if they are required to be addressed as part of coverage before the implementation of *NWIS Reform Regime* and supporting legislation.

Each of the above items is expanded further in this section.

### **3.1 Material Technical and Operational Risks not addressed by coverage**

#### **3.1.1 Coverage still leaves material risks**

There are a range of technical and operational risks to the reliability and security of the *NWIS* that arise from the fact that the *NWIS* is constituted by a number of independently owned and operated interconnected networks without a regulatory framework sufficient to address the coordinated operation of those interconnected networks. These material risks to the effective



and efficient operation of the *NWIS* will not be addressed by coverage of the *Horizon Power Network* and, in some cases, coverage may exacerbate the existing problems.

These technical and operational risks threaten the reliable and secure supply of power to some of Australia's most economically significant projects, community groups, government agencies, commercial and industrial consumers as well as residential consumers.

#### **Case study: 1 December 2017**

At 12:52pm on 1 December 2017, one of Alinta's Frame 6 generators at Hedland Power Station, which is located on the *Alinta Network*, tripped causing immediate loss of 31MW of Alinta generation capacity. Alinta subsequently failed to maintain frequency on the *Alinta Network* within the required parameters in accordance with the arrangements between Alinta and Horizon Power (**Event**).

As a consequence of the Event, over 3,200 residential and industrial Horizon Power customers, representing up to 40% of customers connected to the Port Hedland part of the *Horizon Power Network* were automatically disconnected by means of the *Horizon Power Network's* Under Frequency Load Shedding (**UFLS**) response. The UFLS response is one mechanism built into the *Horizon Power Network*, which effectively disconnects load to reduce the likelihood of a total system collapse.

Horizon Power is unaware of a regulated network that could allow the circumstance above to occur whilst meeting relevant legislative obligations.

The Event demonstrates how two of the material risks Horizon Power identified in its *HP Initial Submission* can result in a loss of power to customers:

- First, the risks associated with not having a coordinated approach to frequency control on an interconnected network that has direct implications for frequency control on the *Horizon Power Network*.
- Second, the inability for any party to effect and enforce a uniform set of Technical Rules with application across the whole of the *NWIS* or each component interconnected network.

### **3.1.2 Resolution of material risks**

Currently there is no legislation or policy that requires interconnected networks in the Pilbara to comply with a common set of rules regarding the operation of their networks. This and a lack of communication can result in network operators inadvertently causing system instabilities as well as cause potentially dangerous situations to arise.

Horizon Power considers that the risks described in the above case study cannot be satisfactorily abated unless:

- uniform Technical rules are established for the *NWIS* and can be effectively enforced;
- there is consistent application of all regulatory obligations across network owners (such as the Electricity Network Safety Management System (ENSMS)); and

- an independent system operator is established by legislation, with:
  - the rights and obligations to affect the safe, secure and efficient operation of the *NWIS*; and
  - immunities of the kind granted in the *SWIS* pursuant to section 126 of the *EI Act*.

In Horizon Power's view, addressing these matters are a matter of state and national significance, given the financial implications of interrupting the supply of power to particularly large commercial users in the Pilbara.

### 3.1.3 Risk allocation and statutory immunities

In the *HP Initial Submission*, Horizon Power noted that it is essential that a party acting as system operator in the *NWIS* has sufficient rights to manage its network in accordance with the rights and obligations that are routinely granted to other network and system operators in Western Australia and in other jurisdictions. Ordinarily, parties carrying out system operator functions have the benefit of a statutory immunity that excludes, or caps, liability as a matter of law for civil damages claims from third party users and customers.

The primary aim of these statutory immunities is to ensure that system operators with responsibility for securing the safety and integrity of the power system can carry out system operations without being subject to legal action. For example, the system operator would be protected against liability if it took steps in good faith to disconnect power supply to a group of customers to protect the integrity of the system in circumstances where the disconnection results in economic harm to the affected customers.

Granting third parties access to the *Horizon Power Network* further complicates the technical operations and the risk of operator error because the system becomes more complex to manage.

For this reason, Horizon Power submits that it is critical that the state government amends the *EI Act* to allow for appropriate risk allocation and statutory immunities whether third party access regulation arises under the *Access Code* or under the *NWIS Reform Regime*. Horizon Power proposes that the immunities provided to AEMO under section 126 of the *EI Act* should be granted to Horizon Power.

Given the economic importance of the financial in the Pilbara, the implications of power outages in the Pilbara are material with any one event resulting in potential financial impacts in excess of \$50 million<sup>6</sup>. Implementing coverage without the appropriate supporting legislation will require these risks to be insured at significant cost to open access customers or; for the taxpayers to assume these new financial risks.

### 3.1.4 Uniform Technical Rules

Contrary to best practice in electricity systems, there is no single set of Technical Rules applying equally to all participants in the *NWIS*, irrespective of the interconnected nature of the Pilbara networks.

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<sup>6</sup> Based on modelling completed by EY in 2017.



Horizon Power's Technical Rules have been developed separately to the rules developed by Alinta and Rio Tinto in relation to their networks. None of the rules are enforceable under the *El Act* or other legislation. The rules are only implemented through bilateral contracts with generators and major loads, many of which contain specific derogations.

Coverage of Horizon Power alone will not enable a uniform set of rules to be enforced across all interconnected Pilbara networks.

### 3.1.5 Establishment of an Independent System Operator

Coverage of Horizon Power does not address the issues arising from the lack of a single body in the *NWIS* responsible and accountable for the security and reliability of electricity supply across the *NIWS*. As a result, notwithstanding coverage, power system stability will continue to be marginal under existing arrangements and ancillary services, such as frequency control services and network control services, will continue to be replicated in individual networks rather than being optimised across the whole Pilbara network.

A full description of the core and potential functions of an effective independent system operator was provided to the Public Utilities Office in Horizon Power's response to the Issues Paper "Improving access to, and operation of, the Pilbara electricity network – the North West Interconnected System" dated 14 November 2017.

### 3.1.6 Universal coverage would allow uniform regulation across interconnected networks

Supplementary matters are defined in section 5.27 of the *Access Code* to include:

- balancing;
- line losses;
- metering;
- ancillary services;
- stand-by;
- trading;
- settlement; and
- any other matter in respect of which arrangements must exist between a user and a service provider to enable the efficient operation of the covered network and to facilitate access to services in accordance with the code objective.

Clause 5.28 of the *Access Code* provides that an *Access Arrangement* must deal with a supplementary matter in a manner which:

- to the extent it is dealt with in an enactment under Part 9 of the *El Act*, which relates to the Wholesale Electricity Market (**WEM**), or in the WEM Rules, applying to the covered network is consistent with and facilitates treatment of the supplementary matter in the enactment or the WEM Rules;

- if the supplementary matter is dealt with in another written law, then in accordance with that written law provided it does not conflict with the WEM Rules or the enactment under Part 9 of the *El Act*; and
- otherwise in accordance with the Technical Rules applying to that covered network and the code objective.

If all networks interconnected to the *Horizon Power Network* are covered, this would give the access regulator the opportunity to consider supplementary matters in a way that would enable their application across each network consistent with the respective Technical Rules for those networks, which would certainly be uniform, in order to comply with the code objective.

### **3.2 Incremental Cost and Complexity of establishing an Access Regime in advance of a Reform Framework and Supporting Legislation**

As flagged above, responding to two regulatory frameworks in respect of the *Horizon Power Network*, being coverage under the *Access Code* and regulation under the *NWIS Reform Regime*, would be grossly inefficient. In Horizon Power's view, the proposed *NWIS Reform Regime* has the potential to efficiently address the following matters required by coverage:

- the ring fencing requirements of the *Access Code* in a manner that does not materially increase the cost or complexity of Horizon Power's core business; and
- the supplementary matters in the *Access Code* through legislation in a manner that does not materially increase the risks to any party (and therefore the cost of service provision that will be passed through to all customers).

#### **3.2.1 Compliance with ring fencing obligations**

Chapter 13 of the *Access Code* requires Horizon Power to undertake the following steps:

- by three months after the *Access Arrangement* start date, Horizon Power's network operations in the Pilbara (**HP Networks**) and Horizon Power's retail and generation operations in the Pilbara (**HP Retail and Generation**) must record in writing the full terms and conditions of access under which HP Networks provides covered services to HP Retail and Generation: section 13.4 of the *Access Code* (defined in the *Access Code* as a deemed access contract);
- by three months after the *Access Arrangement* start date, HP Networks must record in writing the full terms and conditions of any contract, arrangement or understanding by which it provides covered services to HP Retail and Generation (defined in the *Access Code* as an associate contract); and
- Horizon Power must put in place arrangements to achieve the ring fencing objectives and ring fencing rules if the Authority determines that it should make ring fencing rules.

It is likely that these ring fencing requirements will add material cost and complexity to Horizon Power's core business of being a vertically integrated supplier of energy to regional centres.

### 3.2.2 Establishing solutions to Supplementary Matters

Requiring Horizon Power to submit an *Access Arrangement* that addresses all of the supplementary matters before the Pilbara energy reform process was complete would result in a significant duplication of effort as Horizon Power would be required to submit two very different *Access Arrangements* before and after implementation of the *NWIS Reform Regime* (including implementing and then undoing ring fencing activities). These costs would be funded by either electricity customers in the Pilbara, the SWIS or Western Australian taxpayers.

## 4. DEFINITION OF TERMS

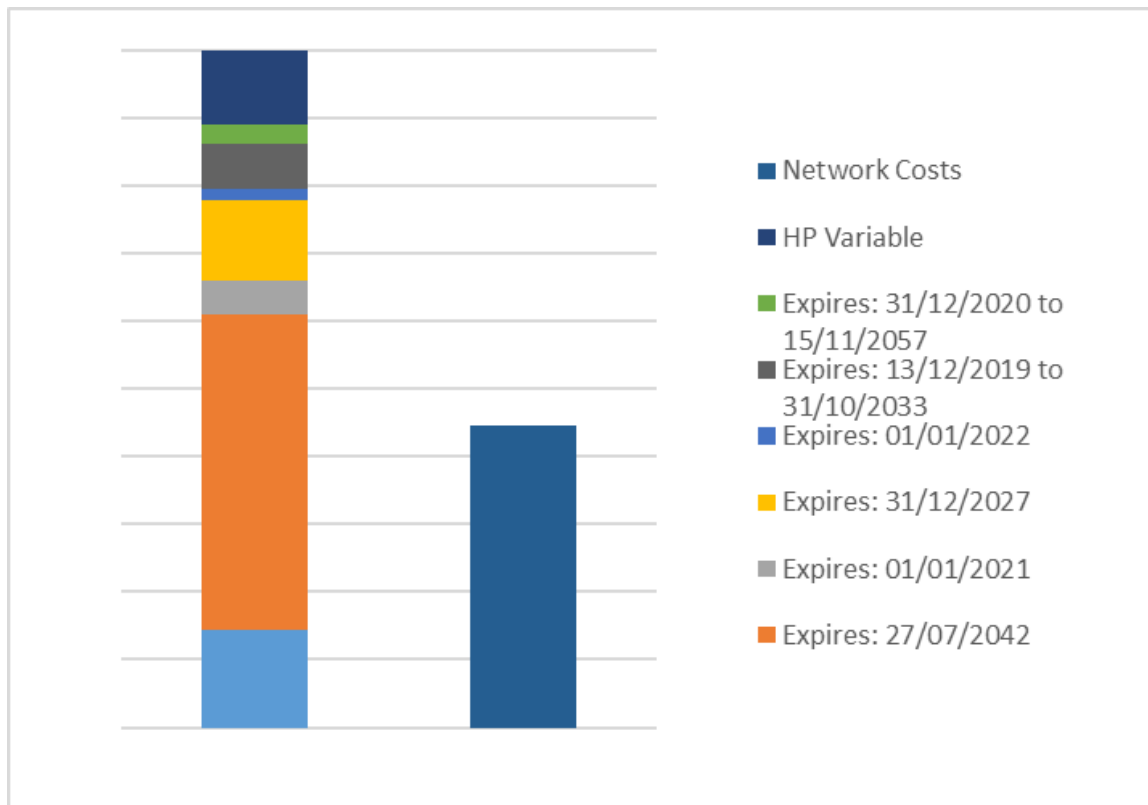
Terms that are italicised in this submission have the meaning given to those terms in the below table unless the context requires otherwise.

Term	Definition
<i>Access Code</i>	<i>Electricity Networks Access Code 2004 (WA)</i>
<i>Access Arrangement</i>	The documentation required to be submitted to the Economic Regulation Authority as a result of being covered under the <i>Access Code</i>
<i>Alinta Network</i>	The Alinta Energy owned and operated network infrastructure that forms a part of the <i>NWIS</i> .
<i>Draft Decision</i>	The <i>draft coverage decision</i> of the Minister for Energy titled "Coverage of the Horizon Power electricity network in the North West Interconnected System" and published on 27 November 2017.
<i>EC Act</i>	<i>Electricity Corporations Act 2005 (WA)</i>
<i>EI Act</i>	<i>Electricity Industry Act 2004 (WA)</i>
<i>ETAC</i>	Electricity Transfer Access Contract
<i>FY</i>	Financial Year.
<i>Horizon Power Network</i>	The electricity transmission and distribution assets owned and operated by Horizon Power which form a portion of the <i>NWIS</i> .
<i>HP Initial Submission</i>	Horizon Power's submission in response to the Issues Paper – Coverage Alinta's application for coverage of the Horizon Power transmission and distribution network in the Pilbara – 16 October 2017.
<i>NEM</i>	The National Electricity Market
<i>NWIS</i>	The North West Interconnected System located in the Pilbara region of Western Australia.
<i>NWIS Reform Regime</i>	The state government's current <i>NWIS</i> reform agenda which proposes establishment of an independent system operator established in regulation and consideration of "light-handed" third party access regime.
<i>SBF</i>	State Budget Forecast.
<i>SWIS</i>	The "South West interconnected system" as that term is defined in section 3 of the <i>EI Act</i> .
<i>TAP</i>	Tariff Adjustment Payments.
<i>TEC</i>	The Tariff Equalisation Contribution paid by Western Power to Horizon Power which is collected from <i>users</i> in the <i>SWIS</i> .
<i>UTP</i>	The "uniform tariff policy", which is a state government policy under which consumers can access electricity supply on regulated tariffs that are the same wherever they live in Western Australia.

## Appendix A. Horizon Power Cost Structure

Horizon Power entered into these contracts when the highest priority was to provide security of supply in the best interest of the state as opposed to considering implications of competition.

An overview of the timing of these contracts is found in the figure below.



**Figure 1: Expiry date of long term contracts**