

Dated 2nd January 2001

**NORMANDY POWER PTY LTD**

**NP KALGOORLIE PTY LTD**

**NORMANDY GOLDEN GROVE OPERATIONS PTY LTD**

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**APPLICATION FOR DECLARATION OF THE WESTERN POWER  
CORPORATION ELECTRICAL TRANSMISSION AND DISTRIBUTION  
SYSTEMS IN WESTERN AUSTRALIA**

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**Application for Declaration of the Western Power Corporation Electrical Transmission and Distribution Systems in Western Australia**

This application is made under subsection 44F (1) of the Trade Practices Act for a declaration pursuant to s 44G of the Act in relation to the services described herein.

**INFORMATION**

This application for declaration makes reference to each of the matters prescribed in Regulation 6A of the Trade Practices Regulations.

**(a) Applicants' Names**

Normandy Power Pty Ltd  
NP Kalgoorlie Pty Ltd  
Normandy Golden Grove Operations Pty Ltd

**(b) Applicants' Addresses and Contact Details**

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Contact: Mr David Lyne

**(c) Description of the Service and of the Facility Used to Provide the Service**

The **service** for which a declaration is sought is the transmission of electricity from electricity generators, particularly from the Parkeston power station, half owned by one of the applicants (NP Kalgoorlie Pty Ltd), to consumers of electricity in the south-west of WA.

The **facility** used to provide that service is the electrical transmission and distribution systems situated in the South West of Western Australia servicing the area bounded by Kalbarri in the north, Kalgoorlie in the east, Albany in the south and the western coast of Western Australia This facility is widely known as the "South West Interconnected System" (the '**SWIS**').

The SWIS is the only network supplying electricity to customers in the South West region of Western Australia.

(d) **The Name of the Provider of the Service**

Western Power Corporation  
363 Wellington St  
PERTH WA 6000

(e) **The Reason for Seeking Access (or Increased Access) to the Service**

Normandy Power Pty Ltd (**'Normandy Power'**) needs access to the transmission and distribution systems owned and operated by Western Power Corporation (**'WPC'**) pursuant to an effective access regime to allow access to its own customers and to customers located elsewhere in the area serviced by the SWIS.

NP Kalgoorlie Pty Ltd (**'NP Kalgoorlie'**) which owns 50% of the Parkeston power station near Kalgoorlie, needs similar access to enable customers of power produced at Parkeston, who include Normandy Power, to access their customers located in the area serviced by the SWIS.

Normandy Golden Grove Operations Pty Ltd (**'Normandy Golden Grove'**), which operates the Golden Grove mine approximately 145km north-east of Three Springs, Western Australia, need similar access in order for it to source electricity produced at any location within the area serviced by the SWIS.

Normandy Power's current entitlements to supply such customers with electricity distributed by the SWIS derives from two sources.

1. **The Goldfields Gas Pipeline Agreement**

*Firstly*, Normandy Power has rights arising from the construction of a major gas pipeline in WA. An associate company of Normandy Power (Normandy Pipelines Pty Ltd) was a participant in the Goldfields Gas Transmission Joint Venture which developed and built the Goldfields gas pipeline in 1994-1996 to deliver natural gas from the North-West of Western Australia to mining areas in the Pilbara and Northern and Southern Goldfields areas of the state. The development of this pipeline system was the subject of an agreement with the Government of Western Australia in the Goldfields Gas Pipeline Agreement (**The GGPA**), which was ratified by the Parliament of Western Australia in the *Goldfields Gas Pipeline Agreement Act, 1994*.

A further associate of Normandy Power (NP Kalgoorlie) holds a 50% interest in the Goldfields Power Joint Venture, which owns and operates the 120 MW gas-fired power station at Parkeston near Kalgoorlie. This power station was developed as part of the Goldfields gas pipeline project with its commissioning timed to coincide with the arrival of gas in Kalgoorlie in September of 1996. Normandy Power purchases the major portion of the output of the Parkeston power station for supplies to its customers, who are all current or former associates of Normandy Power or of its parent company, Normandy Mining Limited.

Clause 18 of the GGPA includes the following provisions:

(3) *The State [i.e Western Australia] shall ensure that the State Energy Commission, where such access is technically feasible and commercially feasible, shall grant access for electricity transmission to any integrated system of power supply of the State Energy Commission (or portions thereof) for the purposes of enabling the supply of electricity from any associated development approved by the Minister under section 7(1) of the Electricity Act (or other generating facility so approved by the Minister)-*

(a) *to the facilities of any Joint Venturer or its associates in the inland Pilbara and Goldfields regions of Western Australia or in other areas determined by the Minister for the purpose of this subclause; or*

(b) *to other consumers approved by the Minister in areas determined by the Minister'*

*[for approved purposes, which include the transmission of power to and from facilities of the Joint Venturers or their associates];*

(4) *The terms and conditions of any access granted pursuant to subclause (3) shall be subject to arrangements to be agreed between the State Energy Commission and the person seeking access (but subject always to emergency powers of the State Energy Commission and such operational and technical requirements as are necessary for the safe and reliable operation of its electricity grid) or, failing such agreement, such reasonable terms and conditions as shall be determined by arbitration..... under the Commercial Arbitration Act."*

It is noteworthy that the GGPA places no limit on the size of the loads that may be supplied through the SWIS to customers approved for GGPA purposes.

In October 1996, after protracted negotiations, Normandy Power entered into an agreement with WPC (the successor of the State Energy Commission of WA), the Interim Access Agreement (the 'IAA'), which entitles Normandy Power to export up to 15MW of electricity from the Parkeston power station (so long as Parkeston comprises no more than 3 X 40MW gas turbines) to Normandy Power's customers' remote loads at specified locations in the Kalgoorlie area and to purchase or deliver up to 35MW of standby power. As well as limiting the size of the Parkeston power station the IAA limits the quantity of power able to be exported by Normandy Power from Parkeston and the loads that may be supplied by Normandy Power, including their locations.

On 20 October 2000, WPC gave Normandy Power a Notice of Termination of the IAA. The legitimacy of that Notice is the currently the subject of legal proceedings commenced by WPC in

the Western Australian Supreme Court, in which WPC is alleging that Normandy Power's access to the SWIS, at least in order to supply annual loads of more than 1 MWh, must be on the terms of the WA regime for general access to that system. If the efficacy of the Notice is upheld by the Court, however, the IAA will terminate on 20 January 2001, forcing Normandy Power to seek access to the SWIS pursuant to the WA Government's regime for general access to the system, subject to Normandy Power's rights under clause 18 of the GGPA. The difficulties provided by the WA regime for general access to the SWIS for those seeking access to the system are discussed extensively below.

Normandy Power maintains that neither the IAA nor the general access regime provide effective means of access to the SWIS for the purpose of supplying its customers and accordingly seeks to have the service provided by the SWIS declared pursuant to Part IIIA of the *Trade Practices Act 1974* (C'th).

## 2. The WA General Access Regime

**Secondly**, the WA Government has implemented a phased programme of retail contestability and access to the SWIS to deliver electricity to contestable customers.<sup>1</sup>

Goldfields Power Pty Ltd (in which the Normandy group holds a 50% interest) markets the output of Parkeston power station not under contract to Normandy Power, to contestable customers situated elsewhere in the South West Interconnected System of WPC.

Currently, Goldfields Power and Normandy Power in relation to actual or potential customers not approved for GGPA purposes including Normandy Golden Grove<sup>2</sup>, have access to the SWIS pursuant to the WA Government's general access regime. The difficulties provided by that regime for those seeking access to the scheme are discussed extensively below.

In view of those difficulties, Normandy Power, NP Kalgoorlie and Normandy Golden Grove seek to have the service provided by the SWIS declared pursuant to Part IIIA of the *Trade Practices Act 1974* (C'th) in order to secure access to the SWIS pursuant to an effective access regime.

### (f) **Description of how Access Would Promote Competition in at Least One Market and a Description of the Market in Which Competition Would be Promoted**

The applicants contend that access to the SWIS is essential to promote competition in the electricity generation and retail supply markets in Western Australia. Without access to these networks, new entrants into the

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1 The current threshold of contestability is an annual load of 1MWh at a single site. The WA Minister for Energy has recently foreshadowed that 230kW customers will become contestable in July 2001 and 34kW customers will become contestable in July 2003. In relation to the Minister's recent announcement, see further, below in the Answer to question (k), section (2).

2 Normandy Golden Grove is a contestable customer under the current contestability rules.

generation market are unable to transport the electricity they produce to consumers of that electricity. Similarly, without access, new entrants into the retail or trading markets are unable to transport electricity from their source generators to their customers.

The need to transport electricity is, therefore, a substantial barrier to entry into both the upstream and downstream markets for the supply of electricity in the south-west of WA.

Further, as discussed below, (see (g)), it is not economically feasible for present or prospective entrants into either of those markets to duplicate the facility in order to compete in those markets. The SWIS exhibits many of the characteristics of natural monopoly infrastructure<sup>3</sup>, such as

- (i) the existence of substantial fixed costs;
- (ii) the existence of relatively low variable costs;
- (iii) the existence of excess capacity; and
- (iv) duplication not being normal practice elsewhere.

Competition in electricity supply markets in WA is further inhibited by the vertical integration of the owner of the SWIS with the state's largest electricity generator, namely WPC. As the National Competition Council has recently noted, in those circumstances, the generator/network owner 'faces an incentive to inhibit the entry of businesses likely to compete with its own in these markets'<sup>4</sup>.

The need for this type of access to promote competition in electricity markets is commonly accepted by all States of Australia and has recently been acknowledged by the National Competition Council in its Draft Recommendation on the Northern Territory Electricity Networks Access Code.

**(g) The Reason why the Applicants Believe That it Would be Uneconomical for Anyone to Develop Another Facility to Provide the Service**

In the words of the National Competition Council, '[t]his criterion asks if it would be more economical to provide the services from one facility than from two or more competing facilities'.<sup>5</sup>

The transmission and distribution networks comprising the South West Interconnected System have been assigned a valuation by WPC of \$1766 million.

The Kalgoorlie area is connected to the remainder of the South West Interconnected System by a single 220kV transmission line 700km in length.

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3 National Competition Council Northern Territory Electricity Networks Access Code Draft Recommendation (14 September 2000) ('NT Draft Recommendation'), citing the Productivity Commission Submission to the National Competition Council on the National Access Regime: A draft Guide part IIIA of the TPA (1997).

4 NT Draft Recommendation, p 13

5 NT Draft Recommendation, p 13

Duplication of this facility alone is estimated by Normandy to cost in excess of \$150 million, further emphasising that it is uneconomical for anyone to develop another facility to provide even a small portion of the service provided by the South West Interconnected System.

These sums are so large in comparison with the returns available in the WA market for the generation and sale of electricity that no reasonable generator or retailer would contemplate an investment to duplicate the network facilities.

Under the prevailing regime for general access to the SWIS, there are isolated instances in which some duplication of the existing distribution network can appear to justify the cost of the investment, but upon examination, these cases almost always expose the inadequacies of that regime, giving rise to anomalies in network pricing practices, rather than any inherent economic benefits flowing from duplication.

**(h) The Reason why the Facilities are of National Significance**

The SWIS services more than 775,000 customers over 6,250 km of Extra High Voltage transmission lines and 61,000 km of High Voltage distribution lines. The network supplied 11,090 GWh to customers in the year 1999/2000, representing almost the entire quantity of electricity generated and consumed in this region of the State.

The networks deliver some 7.1% of Australia's total electricity production.

Due to the size of the SWIS and the value of electricity carried, the SWIS is a facility of national significance.

In addition, major export industries which are of national importance located within the area covered by the SWIS (for example, substantial gold and alumina mining and processing operations) depend upon electricity supplied through it.

**(j) Description of One or More Methods by Which Access to the Service can be Provided and Risks to Human Health or Safety**

As noted above, since 1996 the Western Australian Government and WPC have provided Normandy Power with access to the SWIS pursuant to the IAA. In the period from October 1996 to the present, Normandy Power has supplied electricity to customers through the SWIS without any danger to human health or safety.

That experience clearly demonstrates that there are no material risks to human health and safety arising from Normandy Power or its associates gaining access or increased access to the SWIS.

**(k) Particulars of the Existing Access Regime and Reasons why the Regime is not an Effective Access Regime**

**1. Particulars of the Existing Access Regime**

On 1 January 1997 and 1 July 1997, respectively, the WA Electricity Transmissions Regulations 1996 and the Electricity

Distribution Regulations 1997<sup>6</sup> came into operation, establishing a general open access regime (“OAR”) for the SWIS pursuant to Part 6 of the Electricity Corporation Act 1994.

The legislative foundation of OAR (insofar as it relates to access to the SWIS) is clause 2(1) of Schedule 6 of the Electricity Corporation Act (“the Act”) that provides that WPC:

*‘must to the extent prescribed under s93 [of the Act], make available spare capacity and new capacity on a non-discriminatory basis and on a first come first served basis to any existing or prospective user seeking access to either or both of these capacities’.*<sup>7</sup>

Section 93 of the Act in turn permits the WA Minister for Energy by Orders published in the Government Gazette to prescribe the manner and timing of the progressive introduction of WPC’s obligations under clause 2(1) of Schedule 6. The Minister has exercised that power on a number of occasions, including on 3 November 1998 by the *Electricity Distribution Access Order 1998*<sup>8</sup> - when he ordered that access could be granted to the SWIS to deliver electricity in the following circumstances:

“4. *Access to electricity distribution capacity*

(1) *Under clause 2(1) of Schedule 6 of the Act, [Western Power Corporation] is to make available access to an existing or prospective user seeking access for the transport of electricity if:*

(a) *the electricity to be transported is to be consumed by a single person at a single premises; and*

(b) *the amount of electricity to be so consumed in the period of 12 months beginning on the proposed access day-*

(i) ...

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6 Annexed as **Annexures B and C** respectively.

7 **‘[S]pare capacity’** is defined to mean ‘any portion of electricity distribution capacity not committed to existing users’ and **‘new capacity’** to mean ‘any increase in firm capacity or non-firm capacity which would arise from any enhancement to or expansion of the electricity transmission system’ (Schedule 6, clause 1). The Act defines **‘electricity distribution capacity’** as ‘subject to any provision made by the regulations, the capacity of the electricity distribution system to transport electricity from or to a particular point, consistent with the need to maintain the continuity and integrity of that system, whether or not that capacity is committed to existing users’ (s 89(1)) and **‘electricity distribution system’** to mean ‘that part or those parts of the system operated by the corporation for transportation of electricity at nominal voltages of less than 66kV and a nominal frequency of 50Hz to which [WPC] is required to give access by virtue of subclause 18(3) of the [GGPA Act 1994]’ (s 89(1)); See **Annexure D**.

8 Attached as **Annexure E**, along with a previous access order. Also included in that Annexure is a subsequent access order, which bears no relevance to this application but is included for information purposes.

- (ii) *is at least 8760 megawatt hours, if the proposed access day is on or after 1 January 2000.*
- (2) *The access to be made available is to be only in respect of the electricity to be consumed by the single person at the single premises referred to in subclause (1)".*

The manner in which WPC is to deal with access applications and the terms upon which it is to grant access are governed by the Electricity Transmission Regulations 1996 and the Electricity Distribution Regulations 1997.

WPC develops open access rules and prices with the Office of Energy providing an oversight role on behalf of the Western Australian Government. WPC's network prices do not require the approval of the Minister of Energy. The Minister for Energy would have to formally direct the Board of WPC to seek to vary its decisions on access and pricing.

The regime for general access to the SWIS was recently the subject of a triennial review by the Office of Energy and WPC. A Public Discussion Paper has been published, as have the comments received and the responses of WPC and the Office of Energy. The Review has now also been completed and published.<sup>9</sup>

Normandy Power participated in the triennial review, and like most other contributors, found a distinct lack of willingness on the part of WPC and the Office of Energy to consider the merits of alternative approaches and improvements, and developed a considerable sense of frustration that the final decision on all matters is made entirely by WPC, the access provider, with no independent review.

## **2. Reasons Why the Regime is Not an Effective Access Regime**

The criteria for judging effectiveness of an access regime are expressed in clause 6 of the Competitions Principles Agreement (CPA).

Clause 6(4) enunciates the principles a State or Territory regime for access to services coming within clause 6(3) regime should incorporate to be effective. Each of the broad principles arising from clauses 6(3) and 6(4), other than cross border issues which are not relevant to the SWIS, are referred to below, together with commentary on the incorporation of those principles in the OAR.

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<sup>9</sup> Triennial Review of pricing for access to Western Power's electricity transmission and distribution networks, Public Discussion Paper, May 2000 (**Annexure F**).  
Western Power Corporation and Office of Energy, Triennial Review: Issues, Responses and Recommendations August 2000 (**Annexure G**).

(1) Natural Monopoly Characteristics

6(3): *not feasible to duplicate; facilitate up/downstream competition; safe use of the facility.*

6(4): *periodically assess if facility still meets 6(3).*

These issues have been addressed above in the answer to question (f).

(2) Negotiation Framework

6(4)(a)-(c): *negotiation framework should support right to negotiate.*

6(4)(e): *access provider to facilitate negotiation.*

6(4)(k): *regimes can allow for a contract to be re-opened if there is a material change in circumstances.*

6(4)(l): *provision for negotiation of compensation for the original right holder.*

6(4)(m): *the parties cannot hinder each other from gaining or utilising access.*

The OAR is not supportive of a right to negotiate as is required by clause **6(4)(a)-(c)**. The OAR's negotiation framework is rigidly defined, complex and makes no specific provision for any negotiation. The OAR requires the lodgment of a formal application to which WPC makes a formal offer, which can only be accepted or rejected. It has been Normandy Power's experience that any attempt to have WPC negotiate on specific circumstances has been rebuffed, and the standard OAR rules apply.

Clause **6(4)(e)** requires the access provider to facilitate negotiation. The procedures followed by WPC insist on the standard rules and calculations, with few exceptions. The requirements on WPC to provide relevant information to allow an access seeker to make prompt commercial decisions are inadequate. In addition, time taken to process applications and the costs imposed by WPC are excessive and deter access.

The applicants submit that WPC hinders access to its networks to protect its market share and revenues. This is contrary to the requirements of **clause 6(4)(m)**. In particular, as well as the general refusal to negotiate and the formal processes that WPC follow, unreasonable technical limitations are imposed to create artificial reasons to hinder access.

The applicants also contend that, for a number of reasons, the current WA access framework hinders the access seeker from gaining access.

**Firstly**, the WA Government's provision for retail contestability, until the announcement of the WA Minister for Energy discussed below,<sup>10</sup> made no provision for the extension to customers consuming less than 8760MWh per year — unlike the programmes in all other states. As a result, well over 50% of customers in Western Australia are currently prevented from access to competitive suppliers, remaining captive customers of WPC. WPC gains economies of scale, a greater scope of activities, and opportunities for cross-subsidisation which are not available to other entrants thereby undermining the competitive neutrality of the market. Even taking into account the recently announced extension of contestability, only 50% of the retail customers will become contestable by 2003. The WA Government has also stated that it has no plans to extend contestability any further.

**Secondly**, WPC is allowed to retain earnings to cover the provisions of subsidies to maintain uniform tariffs within Western Australia. These subsidies are hidden and are not available to other entrants in the market who may seek to supply the same customers and could do so more economically than can WPC. Before contestability could be effective for those customers, the Government would need to extract the hidden subsidies from WPC and pay the same subsidy to all willing suppliers.

**Thirdly**, even if an effective open access regime were put into place, the dominant position of WPC in the generation and retail sectors presents a barrier to the benefits of competition being available to customers. WPC owns or controls over 99% of the installed generating capacity in the South West Interconnected System and supplies almost 100% of the contestable loads. Only one major contestable load (Perth Airport) has been supplied by an independent supplier in the three years since open access began, because of this level of dominance. Even that load has now been won back by WPC, having come up for renewal less than two months after WPC attempted to terminate the IAA.

**Fourthly**, WPC accepts no obligation to provide standby power to new entrants, and new entrants are not able to supply standby and other ancillary network services to others — including standby, connection, metering and out-of-balance generation services. The applicants submit that services reserved for WPC should be opened to other suppliers, which may necessitate a system of special licences for the provision of standby and ancillary services in the State.

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10 The Minister's announcement was made on 8 December 2000. A summary of the announcement is referred to in the answer to question (k) section 4, below.

(3) Terms and Conditions

- 6(4)(a)-(c): *the regime should provide for the development of terms and conditions that both encourage efficient use of the infrastructure and provide a fair return to the infrastructure owner.*
- 6(4)(f): *access need not be on the same terms and conditions.*
- 6(4)(l): *issues the arbitrator must consider in dispute resolution should be reflected in terms and conditions.*
- 6(4)(j): *issues the arbitrator must consider when it determines if the access provider should invest in extensions should be reflected in terms and conditions.*
- 6(4)(n): *the access provider is required to keep separate accounts for the access business.*

The OAR does not encourage the efficient use of infrastructure, as is required under clause **6(4)(a)-(c)**. In Normandy Power's experience, the terms, conditions and charges of the OAR are so high as to make feasible the construction of duplicated facilities to a limited extent. In 1996 (prior to the conclusion of negotiations for the IAA), Normandy Power constructed two short 33kV distribution feeders because of the complex conditions and very high charges being sought by WPC at the time. These feeders duplicate the tasks being undertaken by existing WPC infrastructure. The scope for such bypass lines is confined to a very limited area around Kalgoorlie, and this solution is not feasible for more widespread use of the WPC infrastructure.

WPC insist that access only be granted under the same standard terms and conditions which is inconsistent with clause **6(4)(f)**.

Further, WPC treats past contributions in a manner which the applicants submit is unfair and unreasonable for the following reasons:

- (i) WPC treats Capital Contributions as historical costs while the Optimised Deprival Value ('ODV') valuation of WPC assets results in current replacement values.<sup>11</sup> The applicants contend that capital contributions should be escalated to at least current value to avoid WPC receiving a return on capital which it did not provide. More accurately, capital contributions should be subtracted from the asset value at the time of

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11 WPC's Capital Contribution Policy and a related study by Ernst & Young are attached as **Annexure HI**.

construction before an asset is included in the ODV valuation;

- (ii) WPC's application of a 50% "Shared Asset Recognition Factor" is incorrect. WPC claim that this arises from the CRNP method used in the National Electricity Market, but this is also incorrect. In the application of the CRNP methodology in the NEM, full value arising from the CRNP method is brought to account — but in two components, one affecting Use of System Charges and the other affecting Common Service Charges. In crediting past capital contributions, a credit needs to be given against Use of System Charges for 50% of the value, but a second credit for the other 50% of the value must be given against the Common Services Charge. In failing to do so, the applicants contend, WPC is attempting to appropriate 50% of the value of the applicable credits; and
- (iii) Negative values of capital contribution "credits" are ignored. A company is entitled to be given full value for all past capital contributions, and negative values must either be allowed, or some other compensation mechanism agreed. Currently, those negative values are, the applicants submit simply appropriated by WPC.

The applicants contend that the OAR does not comply with the competitive neutrality standards required by clause **6(4)(n)**. WPC provides its generation and retail arms with access to SWIS without application or cost. Further, this access is provided without public disclosure or registration of the terms of that access.

The applicants also maintain that WPC's arrangements for '**ring fencing**' of the transmission and distribution network entities are deficient by comparison with arrangements implemented in the other States and are not subject to independent scrutiny and monitoring. Consequently, there are inadequate safeguards against WPC, as the owner of the SWIS, favouring its affiliated businesses.

Further, access seekers are not given the option of owning and providing infrastructure within the area covered by the SWIS, instead being required to provide capital towards infrastructure and cede ownership to WPC. Hence, infrastructure cannot be provided by suppliers other than WPC.

There is also no provision for WPC to provide **standby** services or for organised energy exchanges between WPC and other entrants. The applicants submit that WPC also imposes restrictive balancing requirements and expensive

balancing charges. This forces higher costs onto new entrants wishing to provide for their own standby and fails to achieve the lowest cost of providing energy on an hour by hour basis.

In relation to the points raised in the previous paragraph, the applicants note the comments made by the Council in its Draft Recommendation on the Northern Territory Electricity Networks Access Code, after receiving advice from its consultants, that

‘the Council considered [energy] settlement could occur through bilateral contracts if the arrangements included:

- a system controller without conflicts of interest;
- a competitively neutral means of determining, pricing and settling energy imbalances, including accounting for line losses; and
- a generator of last resort (or load following generator) that is constrained by contestability or by imbalance price regulation with efficient cost objectives.<sup>12</sup>

The Council, in its NT Draft Recommendation, also noted that ‘the requirement that generators keep their supply within a small tolerance of customer demand substantially reduces their ability to manage supply risks and, as a consequence, their supply costs..... Imbalance prices should set as their objective the fostering of efficient network usage. To implement this objective, prices should take account of efficient supply costs, including elements such as changes in system risks, the scarcity of spare capacity and the cost of expanding capacity in terms of location and time.’<sup>13</sup>

The applicants contend that these principles are equally applicable to Western Australia.

(4) Dispute Resolution

- 6(4)(a)-(c): *right to enforceable dispute resolution in compliance with CPA.*
- 6(4)(g): *required to appoint arbitrator if no agreement can be negotiated.*
- 6(4)(h): *arbitrator’s decisions should be binding but appeal rights should remain.*
- 6(4)(i): *issues the arbitrator must consider in dispute resolution.*

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12 NT Draft Recommendation, p 39.

13. At p 40.

- 6(4)(j): *issues the arbitrator must consider when it determines if the access provider to invest in extensions.*
- 6(4)(l): *the arbitrator transfers rights only after considering compensation for the original right holder.*
- 6(4)(o): *the arbitrator should have access to financial and accounting information relevant to the services.*
- 6(4)(n): *the access provider is required to keep separate accounts for the access business.*

The OAR does not provide for the right to enforceable dispute resolution procedures as is required by clause **6(4)(a)-(c)**. Disputes under the OAR are referred to an Electricity Referee, whose scope and functions are strictly limited to remain within the parameters of the OAR itself. The Referee cannot consider, for example, matters set out in the CPA.

Regulations have been promulgated to allow the appointment of an Electricity Referee in WA<sup>14</sup>, but no appointment has been made to this position.<sup>15</sup> The scope of the Referee's responsibilities fall well short of those normally allocated to an independent regulator, and any appointment to the position is to be made by the same Minister responsible for both the Office of Energy and WPC. This gives the applicants serious concern as to the transparency and independence of the process.

Under the Electricity Referee Regulations, appeal rights are either not available or are strictly limited to matters of law. This does not comply with clause **6(4)(h)**. Neither does the Referee have access to financial and accounting information relevant to the services as is required by **6(4)(o)**.

Further, the applicants contend that where, as in Western Australia, access is being offered by a Government-owned vertically integrated utility, the possible harm that may flow to the utility and to Government revenues from granting that access necessitates **independent oversight** of the manner in which access is granted and administered.

Oversight of the WA OAR is the responsibility of an "Electricity Access Steering Committee", which consists only of the Office of Energy and WPC representatives. Any submissions are considered by a "Triennial Review Working Group", which consists only of Office of Energy and WPC representatives. Recommendations are then

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14 Electricity Referee Dispute Resolution Regulations 1997, see **Annexure K**.

15 Reg 10(2) permits the Minister to delay the appointment of a person to the office of referee until he or she receives notice of a dispute pertaining to access

passed back to the Electricity Access Steering Committee which, as noted previously, consists only of Office of Energy and WPC representatives. The WPC Board of Directors then have complete discretion whether to accept or reject any recommendations of the Electricity Access Steering Committee.

The applicants submit that this arrangement provides no opportunity for effective oversight of the OAR as the Office of Energy and WPC are given the simultaneous roles of “judge, jury and expert witness”.

In relation to the elements of the “building block approach” to revenue determination, the OAR permits WPC to depart from accepted practice and the decisions of independent regulators in the other States and the ACCC in the following major respects and thereby fails to comply with the requirements of clause **6(4)(i)** of the CPA:

- (i) Regulatory Asset Base. WPC uses its own variation of an Optimised Deprival Value method of setting the initial Regulatory Asset Base (RAB), which is unpublished and not subjected to independent regulatory scrutiny.
- (ii) Roll-Forward. Once the RAB is determined, WPC rolls it forward by full CPI escalation.
- (iii) Review Period. WPC proposes not to review the RAB for a full ten year period.
- (iv) WACC. WPC use a “pretax and real” approach which has been shown by the ACCC to overstate the effects of tax to the benefit of the network owner. Further, WPC suggests that the WACC should then be increased to account for their “increased risk” if any bonus/penalties are applied to them.
- (v) Glide Path. WPC proposes to use a “glide path” approach to keep some of any increased profit for a longer period than the first regulatory period. Since existing network tariffs are too high, this will delay the granting of lower tariffs to customers for several years.

The use of a combination of these practices in other States has been found to lead to transmission and distribution prices that are well above those that would be charged by an efficient supplier of the same services.

The translation of the average annual revenue (or average price levels) into actual tariffs is left entirely to WPC and is not subject to independent regulatory review.

Issues such as the split of charges between generators and customers, the split into demand and energy components, use of maximum demand or energy to allocate charges, the level of standby charges and balancing charges, should be exposed for comment and supervision by an independent regulator.

### 3. The Triennial Review of the OAR

As noted above, the OAR has recently been the subject of a review by the Triennial Working Group ('**the TWG**').<sup>16</sup> A number of the concerns raised above about the effectiveness of the OAR were raised during the review. The applicants contend that the outcome of the review confirms that the current regulatory framework lacks effective oversight. Some general commentary concerning the review is offered below, lest it be thought that the applicants have not taken the review into account in making this application.

#### (1) Lack of an Independent and Transparent Regulatory Process

In its Triennial Review of the OAR, the TWG, noted that, unlike the regime for access to natural gas pipelines in Western Australia and the regimes for electricity access in other Australian states, there is no independent electricity access regulator in Western Australia to oversee the regime for access to electricity transmission and distribution infrastructure.<sup>17</sup>

The TWG acknowledged that the Office of Energy is not an independent regulator and nor does it have the power of an independent regulator, but is a government department that provides advice to the Minister of Energy and implements government policy. The pressing need for an independent regulator expressed to the TWG by the stakeholders who made submissions, including Normandy Power, was said by the TWG to be outside the scope of the review but would be communicated to the Minister through the Electricity Access Steering Committee. The TWG did comment, however, that establishment of an independent electricity access regulator was currently under consideration by the government.<sup>18</sup>

The recent announcement by the Minister included a statement that the Government will establish an independent electricity access regulator. The role of the proposed regulator, will, however, apparently be limited to access and to date there has been no further detail provided as to the scope of the functions of the regulator, nature of independence or timetable for implementation of the position.

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16 See above, answer (k), section 2 and **Annexures F and G**.

17 Triennial Review, at p 6.

18 Op cit.

(2) Lack of Transparent Valuation Principles to Which the Independent Regulator Might Have Regard

Presently, network assets are valued by an independent consultant and the valuation is then checked by a consultant employed by the Office of Energy. The results are referred to the Electricity Access Consultation Committee for discussion and review. The assets are valued using the Optimised Deprival Value which is the lesser of the Optimised Depreciated Replacement Cost and the economic value.<sup>19</sup> Concerns were raised during the triennial review by the stakeholders making submissions, including Normandy Power, as to the subjectivity of the method and it leading to excessive profits for WPC. In response the TWG stated that as there is no independent electricity access regulator, the ODV approach is to be preferred as it eliminates subjectivity as much as possible and has been demonstrated to provide a reasonable outcome.<sup>20</sup>

(3) Imposition of a Posted Tariff Regime as Opposed to a Regime of Negotiation and Arbitration for Settling Pricing Issues

WPC proposes to implement an Average Revenue Yield price control mechanism on the basis of incentive efficiency and simpler regulatory control,<sup>21</sup> with an initial regulatory period of three years.

The stakeholders making submissions to the triennial review had diverging views as to the fairness of the proposed regime. However, Normandy Power submitted that a basket of tariffs approach, in which the independent regulator approves the detail of tariffs applying to classes of customers and to WPC itself, was needed in Western Australia. This type of regulatory system is in place in New South Wales and Victoria.<sup>22</sup>

The TWG concluded that the regulatory burden for revenue yield regulation is less than for tariff control regulation as there is a single control variable providing a simple and transparent process for forecasting and independent review of annual performance. In the case of tariff control regulation, forecasting and review must be related to each tariff resulting in a more complex process.<sup>23</sup>

It would seem, therefore, that the TWG favoured revenue yield as the appropriate approach rather than a basket of tariffs. The TWG noted that both regimes are variants of

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19 Ibid, at p 18.

20 Ibid, at p 19.

21 Ibid, at p 11.

22 Ibid, at p 10.

23 Ibid, at p 11.

price regulation and the benefits of the yield regime will not become evident until the regime has been in place for some time.<sup>24</sup> The TWG also noted that manipulation of tariffs can occur at the outset when tariffs are set for a regulatory period and at the annual re-setting.<sup>25</sup>

(4) Inadequate Ring-fencing Between the Various Divisions of the Vertically Integrated Utility

During the triennial review various stakeholders making submissions, including Normandy Power, were of the opinion that WPC has an inappropriate level of market power, and that de-regulation should divide vertically integrated monopolies, separating transmission, distribution and generation. Normandy Power submitted that any access arrangements offered by a vertically integrated government owned organisation could not be expected to be satisfactory without an independent regulator in a supervisory role.<sup>26</sup> In the Triennial Review, the TWG noted that this issue was outside the scope of the review but that the Minister was seeking government approval to improve ring fencing (which has subsequently been announced, albeit without any statement as to the manner in which the enhancement is to be effected). However, the TWG did note that 'the desegregation and total privatisation of Western Power is not government policy and is not under consideration'.<sup>27</sup>

The Minister for Energy has recently announced that the Government would enhance ring fencing arrangements but the announcement provided no specifics or indeed any detail as to how ring fencing will be enhanced. The Government has made no commitment to the structural separation of the networks from the rest of WPC, but in any event in both the United Kingdom and New Zealand experiences, ring fencing has proved unsatisfactory and those countries have moved to structural separation.

#### **4. The Recently Announced Changes to the Current Regime**

On 8 December 2000, The Hon. Colin Barnett, the Minister for Resources Development, Energy and Education released a media statement advising of a \$2 Billion energy package including new power generation, de-regulation of the electricity sector, expansion of the power line system and broad structural change to the industry itself.<sup>28</sup>

Full details of the package have not yet been released.

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24 Ibid, at p 10.

25 Op cit.

26 Ibid, at p 3.

27 Ibid, at p 5.

28 Media Statement, The Hon. Colin Barnett M.Ec, MLA, Minister for Resources Development; Energy; Education dated 8 December 2000 attached as **Annexure L**.

The announcement identified a three stage package for generation of power, on the basis that demand will grow at between 3-4% annually to the end of the decade, thus requiring an additional 1,000 megawatts over the same period. The three stage package is understood by the applicants to be as follows:

- WPC will replace two generating units at Kwinana Power station with a 240MW gas fired combination cycle power plant by 2004;
- Public power procurement process stage one, to secure 240MW in 2005 and a further 120MW in 2006 (WPC not to bid but will sit on the procurement committee); and
- Public power procurement process stage two, to secure 360MW in 2007 (WPC can bid AND will sit on the procurement committee)

The Minister has also added to the existing levels of retail contestability – by making 230kW customers contestable in July 2001 and 34kW demand customers contestable in July 2003. At the latter date 50% of WPC's demand will be contestable (40% of its revenue).

Structural change is to be effected by the existing Gas Access Regulator becoming an Energy Access Regulator and enhancing ring fencing within WPC.

In the brief time available since the announcement, the applicants have identified a number of aspects of the proposed changes that threaten to hinder, rather than enhance, competition in electricity markets in WA, including the following:

- The regulator to be established appears to be limited to access only.
- WPC will be represented on the Committee with the Independent Chairman and Auditor to oversee the public procurement process, in circumstances where it may also bid itself (public stage 2).
- The public process is designed to take place in two stages, having first completed non-public generation by way of building new WPC owned and developed power stations. In the first stage WPC is not permitted to bid (procure 240MW in 2005 and a further 120MW in 2006). The second stage to secure 360MW in 2007 enables WPC to bid, as well as oversee the process. The second stage bids are called for in 2002. As WPC will be represented on the panel at both stages, it becomes privy to the detailed commercial position of its major competitors.
- 50% of the retail market is declared contestable by July 2003, impacting on only 40% of the revenue of WPC. The WA Government has also stated that it has no plans to extend contestability any further.
- The programme of generation construction and contracting is sufficient to give WPC effective control over all future growth in electricity load in the South West until after 2007.

(l) **Description of the Efforts that have been made to Negotiate Access to the Service**

Normandy Power began seeking access to the transmission and distribution systems of WPC (then SECWA) in early 1994, when it became apparent that the Goldfields Gas Pipeline project would proceed. Negotiations were difficult and protracted, and continued through 1994, 1995 and most of 1996.

In late 1995, NP Kalgoorlie took the decision, along with its Joint Venture partner, to install a third generator at Parkeston in order to avoid WPC's high charges and unreasonable conditions for standby supplies, and to begin construction of some 60km of duplicated 33kV distribution lines to bypass WPC's distribution system in the Kalgoorlie area in order to avoid the unreasonable access charges being offered at the time by WPC.

A more reasonable access offer was tabled by WPC in early 1996, which allowed the construction of bypass lines to be halted. 14 km of line was constructed however, before the halt took effect.

Following further difficult and protracted negotiations, an Interim Access Agreement was finally signed one day before Normandy began commercial deliveries of electricity to its customers in early October 1996 — more than two years after the first approach had been made.

The Interim Access Agreement places significant limits on the size of the Parkeston and the location and size of the loads that can be supplied from Parkeston (in relation to that issue, see, further, above, answer to question (e)).

The circumstances of these negotiations and other actions taken by WPC to contract all available contestable customers in the Kalgoorlie area before the commercial operation of Parkeston began, are the subject of a legal action instigated by Normandy Power, NP Kalgoorlie Pty Ltd and Normandy Pipelines Pty Ltd in the Federal Court alleging that WPC breached s 46 of the Trade Practices Act.<sup>29</sup>

Because of the difficulty in gaining access to the South West Interconnected System only one supply contract to a contestable customer has been able to be concluded by Normandy Power's associated company, Goldfields Power Pty Ltd, in the four years since gas became available at Kalgoorlie, that being a contract for the supply of electricity to Perth Airport. That contract relied in part upon the special conditions negotiated by Normandy Power under the Goldfields Gas Pipeline Agreement Act and included in the Interim Access Agreement, rather than on the OAR. It is most unlikely that the contract could have been concluded had the full costs and conditions of the open access regime been applied.

In September of 2000, WPC initiated fresh discussions to seek to have Normandy Power transfer to the open access regime, demanding considerably increased annual costs and seeking to impose unacceptably onerous conditions. This followed an earlier attempt of the same nature in

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<sup>29</sup> Action No WAG 156 of 1998.

September of 1999, which was discontinued by WPC without explanation to Normandy Power.

In September and early October 2000, Normandy Power participated in without prejudice negotiations with WPC in an attempt to reach a permanent agreement concerning the terms of Normandy Power's access to the SWIS. Those negotiations also failed to reach such an agreement.

On 20 October 2000, WPC gave Normandy Power a Notice of Termination of the IAA. While the legitimacy of that Notice is the currently the subject of legal proceedings commenced by WPC in the Western Australian Supreme Court,<sup>30</sup> if the issue of the Notice is upheld by the Court, the IAA will terminate on 20 January 2001, forcing Normandy Power to seek access to the SWIS pursuant to the WA Government's regime for general access to the system, subject to Normandy Power's rights under the GGPA.

In November 2000, when the original contract came up for renewal, Perth Airport elected not to renew its supply contract with Goldfields Power and instead chose to enter a new supply contract with WPC. The impact of WPC's attempts to terminate the IAA on the Airport's decision is not known, but it added unwelcome doubt and confusion to the negotiations for a contract extension.

The recent discussions between Normandy Power and WPC have been held on a 'without prejudice' basis and, hence, the details of those discussions cannot be revealed in this application. A flavour of those discussions is, however, apparent from an affidavit sworn by a senior officer of WPC in the Supreme Court proceedings which states that WPC seeks to charge Normandy Power \$1.7 million per annum for the same services it has provided to Normandy Power pursuant to the Interim Access Agreement since 1996 for a significantly smaller fee. Were WPC to succeed in the Supreme Court proceedings and, to thereby be able to impose charges of that magnitude on Normandy Power, Normandy Power's calculations suggest that the option of building lines that duplicate those of WPC may well be a less expensive option for Normandy Power to supply some of the loads it currently supplies pursuant to the Interim Access Agreement.

Normandy Power's negotiations to gain access to the transmission and distribution networks of the SWIS of WPC pursuant to an effective access regime have thus been in train since early 1994, without an acceptable outcome being reached.

Normandy Power will not hesitate to invoke its rights under the GGPA in relation to the terms of its access to the SWIS to supply the limited number of customers who have been approved by the Minister to be supplied pursuant to the GGPA. In relation to other potential customers, though, Normandy Power currently has no alternative but to seek access to the SWIS pursuant to the OAR. Even in relation to customers able to be supplied pursuant to the GGPA, Normandy Power regards the clause 18 arbitration mechanism as inadequate because an arbitrator appointed pursuant to that clause is not expressly required to take account of the principles expressed in clause 6(4) of the Competition Principles Agreement.

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30 Action No CIV 2577 of 2000.

Normandy Golden Grove is currently engaged in negotiations with WPC concerning the supply of power to the Golden Grove mine. To date, those negotiations have not led to an acceptable outcome.

**(m) The Public Interest**

The applicants contend that there is no reason why declaration of the service provided by the SWIS would be contrary to the public interest.