Attachment A

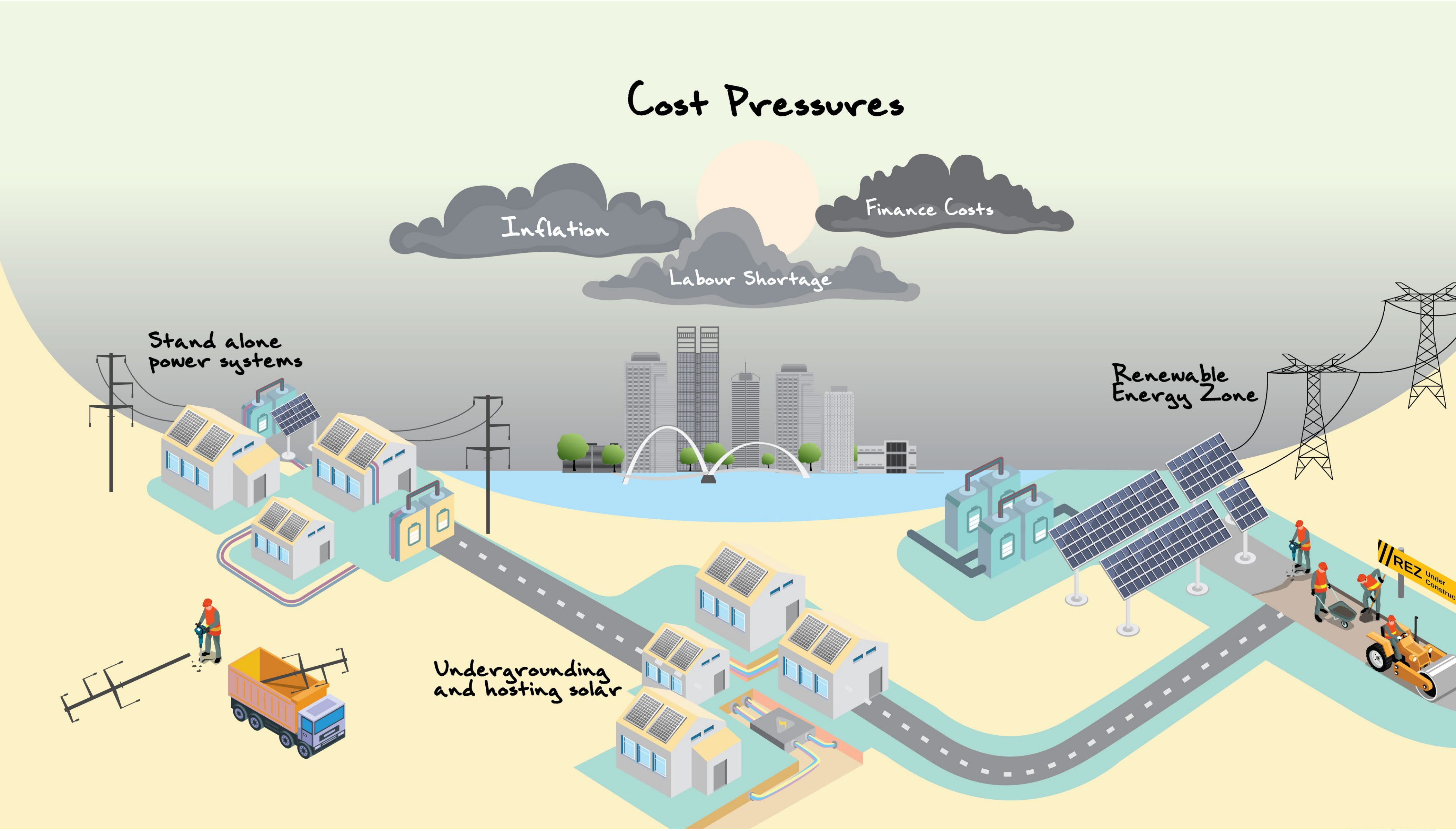
WA 2022-27 Access Arrangement

Summary review of ERA's draft decision and Western Power's revised proposal

Dynamic Analysis
December 2022

Dynamic Analysis

Key issue – Balancing expenditure needs vs rising costs



ERA's draft decision is well balanced

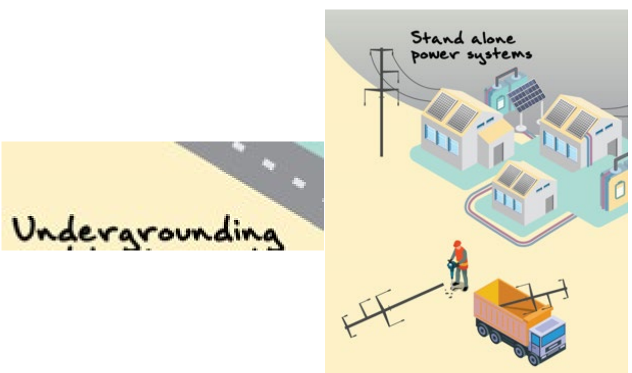
In our view, the ERA's draft decision is pragmatic, balancing the need for increased investment while 'putting the brakes' on areas of investment that can be deferred with tolerable risk.

- **Addresses deliverability concerns with new investment -** Encouraging Western Power to undertake stand alone power systems and underground, but safeguarding customers by only allowing recovery of delivered works. This is a pragmatic solution.

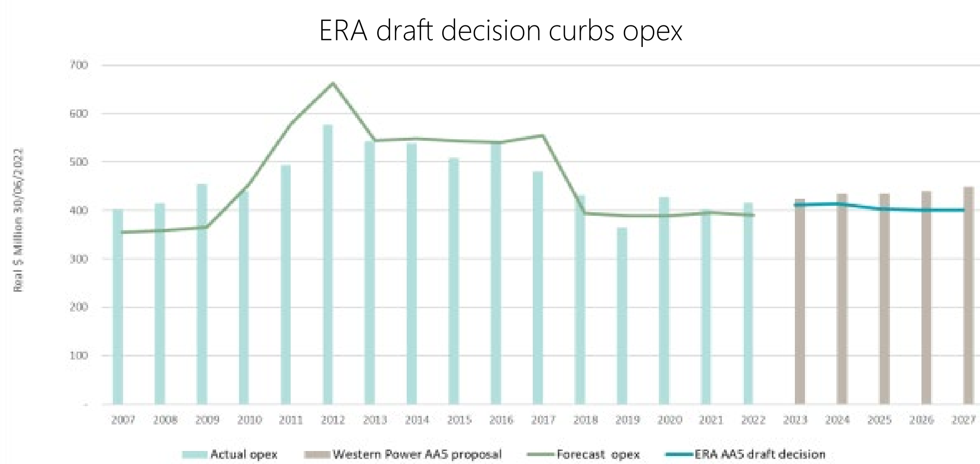
- **Needs-based replacement capital expenditure (capex)**- Allowing a significant portion of the proposed capex but identifying programs where there is insufficient evidence of need such as the replacement of communications.

- **Curbing growth in operating expenditure (opex)** - Ensuring that Western Power are provided with sufficient step changes in operating expenditure to support new investments, but driving efficiency in other operations.

- **Rate of return** - Providing a fair return on investment that has mechanistically applied the rate of return calculations, rather than try to artificially reduce the revenue outcomes. This decision provides for a level of trust.



Investment adjustment mechanism



Dynamic Analysis

Western Power's revised proposal

The revised proposal is responsible and mature and has genuinely considered the feedback from the ERA. We note that the proposed price reductions relative to the ERA decision reflect under-delivery of capital expenditure and higher energy consumption forecasts. We consider the ERA should closely examine new information provided by Western Power including recommendations from the Shepherd report.

- **Lower indicative prices –** While this seems like good news for customers, we note that this relates to under-delivery of capital programs and an updated forecast of energy consumption. We consider that the growth of Electric Vehicles (EVs) may promote greater energy sales, and this can further place downward pressure on prices.

- **Accepted some of ERA's recommendations**– Western Power has accepted some of the proposed reductions to capex and has also applied higher efficiency targets compared to the initial proposal.

- **Provided substantiating information** – Western Power has sought to provide evidence to support some of the programs that have been cut, including high level arguments to show the total expenditure is insufficient to meet their needs. We suggest that while there may be merit to some of these arguments, that the ERA should broadly maintain its draft decision.

- **Provided new information** – Western Power has included new programs not included in the initial proposal. In some cases such as the Shepherd report, there is a clear need to approve additional expenditure to ensure the network better manages extreme weather events. However, scrutiny should be applied by the ERA to ensure that the proposed expenditure is efficient and proportionate.

Parameter	Initial Proposal	Draft Decision	Revised Proposal	
Revenue[4]	$7,933 million	$9,001 million	$8,933 million	
WACC	4.73%	7.10%	7.10%	13% ↑
Net capex[5]	$4,341 million	$3,712 million	$4,210 million	11% ↑
Opex[6]	$2,182 million	$2,032 million	$2,250 million	
Energy volume[7]	150,710 GWh	150,710 GWh	156,356 GWh	
Network Tariffs	One-off increase in 2023/24 of 3.7%, flat thereafter	Average annual increase 2023/24 –2026/27 of ~7.7%	Average annual increase 2023/24 – 2026/27 of ~3.3%	

What could ECP raise with the ERA?

We consider there are opportunities to improve the regulatory framework for customers in terms of decision making. These include re-testing customer preferences, more scrutiny on activities that may be inefficient, a portfolio approach to capital investments, incentivising innovation and promoting electric vehicles.

- **Customer preferences** – Western Power should re-test customer preferences on new areas of investment given the higher than expected indicative prices from changes in financial environment. We note that the ERA has made a commendable effort to reach out to regional areas.

- **Deeper interrogation of efficiencies** - More analysis of operating expenditure functions and activities to identify where efficiency targets could be met by Western Power. Our concern is that efficiency targets are arbitrary, and that a business needs the support of a regulator in uncovering areas of inefficiency.

- **Portfolio ranking** - We would like to see more emphasis on a portfolio approach to capital programs that is able to rank projects based on risk and value. This would help show that the final program is optimal.

- **Delivery incentives** – ERA could consider applying the new 'Investment Adjustment Mechanism' to all capex. We are concerned that Western Power has reported lower actual capex compared to estimates in the original proposal suggesting labour shortages and supply chain issues may be impacting deliverability. Customers should only pay for projects that are completed.

- **Innovation incentives –** We consider there has been minimal demonstration of Western Power showing how improved data and technology can drive better performance. For example, there is little discussion on using smart meter data to make better asset management decisions, or reviewing aspects of planning such as dynamic line ratings. These small improvements help curb long term costs and improve customer service. We strongly consider that Western Power should be provided incentives to pursue innovation.

- **Electric vehicles –** Our analysis in the NEM indicates that electric vehicles provide the greatest opportunity to lower long term electricity prices, through improved utilization. Networks will need to consider how to encourage use in off-peak times of the day.

- **Smoothing price shocks** – The current volatility in financial markets has caused a sudden increase in revenue and prices. We consider there may be mechanisms to avoid recurrences in the future such as an annual cost of equity adjustment.