



16 October 2017

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Dear Zaeen

**Coverage of the Horizon Power electricity network in the North West Interconnected System – Issues Paper**

Alinta Energy (**Alinta**) welcomes the opportunity to comment on the Public Utilities Office (**PUO**) *Issues Paper: Coverage of the Horizon Power electricity network in the North West Interconnected System (Issues Paper)*. Alinta's detailed submission on the Issues Paper is **enclosed**.

Alinta's Coverage Application, and its submission to the Issues Paper, has demonstrated that the granting of coverage will promote competition in the retail electricity market that exists in the form of those customers supplied with electricity using the Horizon NWIS Network. This will occur through Alinta's economically efficient use of the network and its services, and so aligns with the Code objective.

Further, the benefits provided through lower energy costs and enhanced productivity will support and grow the contribution made by the NWIS geographical region, to benefit those in the region and the State more broadly. Given this and in circumstances where all three coverage criteria are satisfied, Alinta submits that the Minister should decide to cover the Horizon NWIS Network in accordance with the Code.

If you wish to discuss this matter further please don't hesitate to contact me on 08 9486 3709 or Jacinda Papps on 08 9486 3009.

Yours sincerely

**Ken Woolley**  
Executive Director Merchant Energy



# **Issues Paper – Coverage of Horizon Power electricity Network in the North West Interconnected System**

## **Alinta Energy Submission**

**16 October 2017**

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# 1 Introduction

Alinta Sales Pty Ltd (**Alinta**) welcomes the opportunity to provide a submission to the Public Utilities Office (**PUO**) on its Issues Paper relating to Alinta's application of 4 August 2017 for coverage of the electricity transmission and distribution assets owned and operated by Horizon Power (**Horizon**) in the Port Hedland and Karratha region (**Horizon NWIS Network**) under section 3.8 of the *Electricity Networks Access Code (2004)* (the **Code**).

## 1.1 Background

Alinta is seeking to enter the market to supply electricity to customers connected to the Horizon NWIS Network, supported by generation from the Port Hedland Power Station and potentially other sources. Currently, Horizon is the electricity retailer to almost all customers connected to the North West Interconnected System (**NWIS**).

A number of customers with significant sized loads connected to the Horizon NWIS Network have indicated to Alinta a strong interest in the opportunities that competition delivers: price differentiation, innovative and focussed product offers and enhanced customer service.

All of these customers are directly connected to the distribution section of the Horizon NWIS Network<sup>1</sup>, supplied using electricity that is transported on both of Horizon's transmission and distribution networks.

Alinta currently has access to only limited services on a specific section of the Horizon NWIS Network in the Port Hedland region under an existing agreement with Horizon and is for the sole purpose of supplying a single large use customer.

Alinta does not have access to the Horizon NWIS Network to enable it to retail electricity to any other customers. Without access to the Horizon NWIS Network, Alinta *cannot* retail electricity to those customers and a competitive market cannot be created.

As demonstrated in Figure 1 over the page, Alinta has sought to gain access to the Horizon NWIS Network since April 2014 under various mechanisms. This has included:

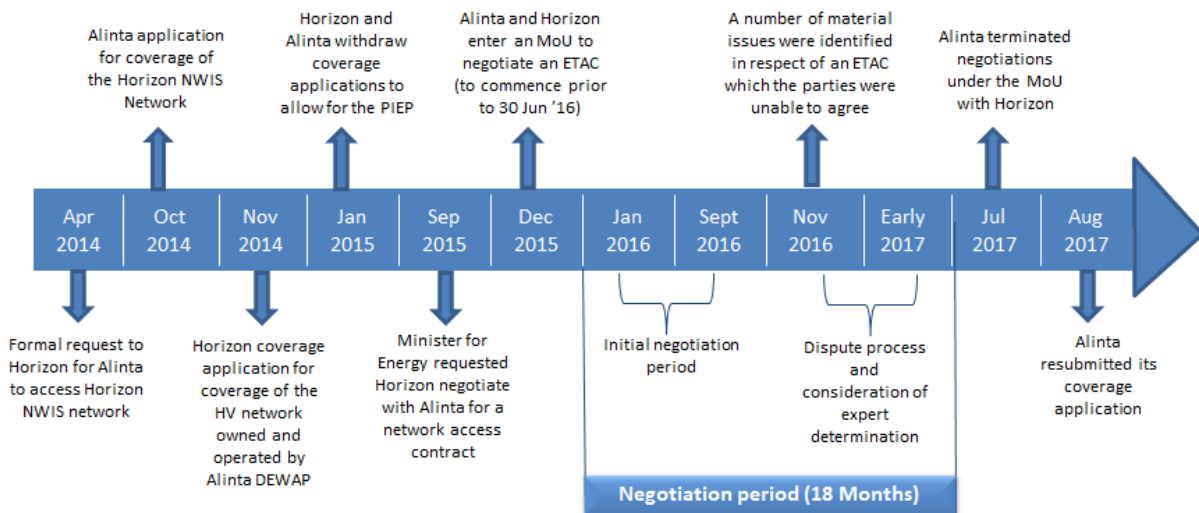
- initial access discussions;
- an application for coverage in 2014 (which was subsequently withdrawn); and
- following a request from the Minister for Energy for Horizon to commence negotiations with Alinta - negotiations under a Memorandum of Understanding which embodied a mutual objective to negotiate an Electricity Transfer and Access Contract (**ETAC**) that would apply on a reciprocal basis and commence prior to 30 June 2016.

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<sup>1</sup> With the exception of the customer that Alinta currently supplies, Alinta has not identified any customers that are directly connected to the transmission section of Horizon's NWIS Network who are interested in being supplied electricity by Alinta.

Following protracted access discussions between Alinta and Horizon, and absent any formal framework as to process, in August 2017 Alinta applied under section 3.8 of the Code to the Minister for Energy for coverage of the Horizon NWIS Network to facilitate Alinta’s entry into the market to supply electricity to customers connected to the Horizon NWIS Network under its Electricity Integrated Regional Licence (EIRL)<sup>2</sup>.

**Figure 1 – Timeline of access negotiations**



## 1.2 Structure of this submission

To assist the PUO in its consideration of Alinta’s coverage application this submission is structured as follows:

- Section 2 – The network that is subject to the coverage application
- Section 3 – The coverage criteria
- Section 4 – Material increase in competition in a dependent market (Criterion (a))
- Section 5 – Uneconomic to duplicate (Criterion (b))
- Section 6 – Not contrary to the public interest (Criterion (c))
- Section 7 - Geographical location of the network and extent of interconnectedness

Details of Alinta’s response to Horizon’s claimed costs of access from its 2014 Discussion Paper<sup>3</sup> have been provided in Appendix 1<sup>4</sup>.

<sup>2</sup> EIRL8, dated 12 August 2014, available: <https://www.erawa.com.au/electricity/electricity-licensing/licence-holders>

<sup>3</sup> Horizon Power Discussion Paper on coverage of networks in the Pilbara (26 November 2014) (“Discussion Paper”).

<sup>4</sup> Alinta recognises that these costs may have changed since the 2014 Discussion Paper, however an updated Discussion Paper has not been provided.

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Appendix 2 details Alinta’s estimate of the potential increase to Horizon’s average costs as a result of access.

Alinta’s views on the treatment of public policy in assessing Criterion (c) and on the issues with Horizon’s current ETAC and Pricing Model are provided in Appendix 3 and 4 respectively (although, for the reasons outlined in this submission, Alinta does not consider it to be relevant to the coverage criteria to consider the extent to which, or the terms on which, Horizon claims that it currently provides access).

## 2 The network that is subject to the coverage application

There are multiple owners of electricity network infrastructure within the NWIS. Alinta seeks access to the network that comprises the electricity transmission and distribution assets currently owned and operated by Horizon that form part of the NWIS, which herein is referred to as the Horizon NWIS Network.

For the avoidance of doubt, the Horizon NWIS Network includes the Horizon-owned transmission and distribution network assets in the Port Hedland and Karratha region, including the 220 kV transmission line connecting Port Hedland and Karratha but does not include the infrastructure owned by the following parties and their related bodies corporate:

- BHP Billiton Iron Ore Pty Ltd;
- Rio Tinto Limited; and
- The Pilbara Infrastructure Pty Limited.

Alinta has requested that the whole of the Horizon NWIS Network be covered.

### 2.1.1 PUO question for stakeholders relating to the network that is subject to the coverage application

*Question 1: Does Alinta Energy’s coverage application define the network for which coverage is sought with sufficient clarity?*

The network for which coverage is being sought by Alinta is limited to the Horizon-owned transmission and distribution network assets in the Port Hedland and Karratha region. Alinta has provided sufficient clarity in defining the network that is subject to the coverage application.

## 3 The coverage criteria

Under section 3.5 of the Code, the Minister must make a decision that a network be covered if the following three questions are answered in the affirmative:

- “(a) Would access (or increased access) to covered services provided by means of the network promote a material increase in competition in at least one market (whether or not in Western Australia) other than the market for the covered services provided by means of the network?”*

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- (b) *Would it be uneconomic for anyone to develop another network to provide the covered services provided by means of the network?*
- (c) *Would access (or increased access) to the covered services provided by means of the network not be contrary to the public interest?"*

In making the decision, the Minister must have regard to the objective of the Code in section 2.1:

*"The objective of this Code ("Code objective") is to promote the economically efficient:*

*(a) investment in; and*

*(b) operation of and use of,*

*networks and services of networks in Western Australia in order to promote competition in markets upstream and downstream of the networks."*

In its issues paper, the PUO has questioned whether consideration:

- should be given to whether the covered services may differ between transmission and distribution network services; and
- might need to be given to whether the Horizon NWIS network is effectively a set of interlinked networks given physical constraints, and so the services differ between those markets.

### 3.1 Alinta's views



**Key Consideration: While the Horizon NWIS Network may be viewed as a set of interlinked networks, they are all part of the Horizon regulated asset base and should be treated a single asset for the purposes of this coverage application.**

Alinta seeks access to the network that comprises the electricity transmission and distribution assets currently owned and operated by Horizon that form part of the NWIS, which in this application is referred to as the Horizon NWIS Network. For the avoidance of doubt, this is the Horizon-owned transmission and distribution network assets in the Port Hedland and Karratha region, including the 220 kV transmission line connecting Port Hedland and Karratha, and **does not** include the infrastructure owned by the following parties and their related bodies corporate:

- BHP Billiton Iron Ore Pty Ltd;
- Rio Tinto Limited; and
- The Pilbara Infrastructure Pty Limited.



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Alinta recognises that the Horizon NWIS Network could be viewed as a set of interlinked transmission and distribution networks.

As outlined in the Issues Paper:

*“The Horizon Power NWIS network extends from Dampier to Goldsworthy, via Karratha and Port Hedland. A lattice tower 220KV transmission line interconnects Cape Lambert Terminal, South Hedland Terminal and Hedland Terminal. A 132KV network interconnects Cape Lambert Terminal, Karratha Terminal, Bulgarra Substation, Pegs Creek Substation and Dampier Substation. A 66KV network interconnects Hedland Terminal, Wedgefield Substation, Anderson Street Substation, Murdoch Drive Substation and the Goldsworthy supply point.”*

Alinta is of the view that, while the Horizon NWIS Network may be viewed as a set of interlinked networks, they are all part of the Horizon regulated asset base and should be treated a single asset for the purposes of this coverage application. This is consistent with the treatment of the Western Power network in the South West Interconnected System (**SWIS**).

Further to this, most customers connected to the Horizon NWIS Network that are seeking to secure electricity from alternative retailers are directly connected to the distribution section of the Horizon NWIS Network, and are therefore supplied electricity that is transported on both the transmission and distribution components of the Horizon NWIS Network. Accordingly, to allow competition to occur, coverage is required on the entire Horizon owned transmission and distribution networks that comprise the Horizon NWIS Network.

The Code defines a covered service as follows:

*“covered service” means a service provided by means of a covered network, including:*

*(a) a connection service; or*

*(b) an entry service or exit service; or*

*(c) a network use of system service; or*

*(d) a common service; or*

*(e) a service ancillary to a service listed in paragraphs (a) to (d) above.*

*but does not include an excluded service.”*

If the Horizon NWIS Network is covered, Alinta proposes to acquire at least the ‘covered services’ (a) to (d) stated above on the Horizon NWIS Network as a whole – that is the electricity transmission and distribution assets currently owned and operated by Horizon.

Alinta does not consider that the covered services should differ between transmission and distribution network services given that, while Alinta seeks network access to supply customers that are distribution connected, the supply of these distribution connected

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customers is not possible without also being able to also transmit electricity through the transmission network.

### 3.1.1 PUO questions for stakeholders relating to the coverage criteria

The following section directly addresses the PUO's questions for stakeholders relating to the coverage criteria.

*Question 2: Are there effectively different networks within the Horizon Power NWIS network for which access is being sought?*

As outlined in section 3.1 above, Alinta considers that the electricity transmission and distribution assets currently owned and operated by Horizon should be treated a single asset for the purposes of this coverage application given they all form part of Horizon's regulated asset base.

*Question 3: Should covered services be split into a transmission network use of system service and a distribution network use of system service?*

While Alinta does not consider that the covered services themselves should differ between transmission and distribution network services, Alinta agrees that there is merit in splitting the Network Use of System (**NUOS**) charges into two principal components – Distribution Use of System (**DUOS**) and the Transmission Use of System (**TUOS**) charges.

Typically:

- The DUOS component covers the operations and maintenance cost and investment return on network assets, including zone substations, distribution lines and distribution transformers; and
- The TUOS component covers the use of transmission power lines/towers and terminal stations.

## 4 Material increase in competition in a dependent market (Criterion (a))

Criterion (a) of section 3.5 of the Code asks:

*“Would access (or increased access) to covered services provided by means of the network promote a material increase in competition in at least one market (whether or not in Western Australia) other than the market for the covered services provided by means of the network.”*

In its Issues Paper, the PUO has set out a three-step process for assessing whether the Criterion (a) is satisfied, namely that:

*“... it will be necessary to:*

- *identify the relevant dependent market or markets where access (or increased access) to the Horizon Power NWIS network may increase competition;*

- confirm that the dependent market(s) are separate from the market(s) for the covered services provided by means of the Horizon Power NWIS Network; and
- determine if access (or increased access) to the Horizon Power NWIS network would promote a more competitive environment in each dependent market in order to determine whether such access would materially promote competition in those markets.”

Further, the PUO also raises the matter of whether effective competition in the dependent markets is already provided by other means, noting that:

“...it could be relevant to consider the extent of competition in the broader energy market that includes electricity services provided by means of the network as well as other significant energy sources such as gas and electricity supply from self-generation.”

#### 4.1 Alinta’s views



**Key Consideration: Enabling access to the Horizon NWIS Network will promote a material increase in competition in the dependent market for retail supply of electricity to customers currently connected to and serviced by the network.**

Alinta maintains that enabling access to covered services provided by means of the Horizon NWIS Network would promote a material increase in competition in the market for the retail supply of electricity to customers supplied using the Horizon NWIS Network. In this submission, Alinta uses the term ‘retail’ in the sense it is used in the *Electricity Industry Act 2004* (WA), being the general concept of selling electricity to a customer, rather than to make a distinction between retail and wholesale. Alinta notes that its retail licence (EIRL 7) allows it to retail electricity to customers with loads of 160 MWh per annum or greater.

Despite the existence of a regulatory environment<sup>5</sup> that allows for Full Retail Contestability (FRC) in electricity in the NWIS since the introduction of the integrated regional licence under the *Electricity Industry Act 2004* on 31 December 2004, there has been and is no effective competition in this market due to:

- Horizon’s control and operation of its network assets, in conjunction with its effective monopoly in the retail supply of those customers connected to Horizon’s NWIS Network; and

<sup>5</sup> Since the commencement of Part 2 the *Electricity Industry Act 2004* (WA), a person could apply for an integrated regional licence to (among other things) retail electricity outside the SWIS. Unlike the SWIS, there is no restriction on Horizon from supplying distribution services for the purposes of allowing the licensee to retail to any prescribed class of customers. The restriction to retailing to customers who consume less than 50 MWh in the SWIS is effected by the *Electricity Corporations (Prescribed Customers) Order 2007*, made under section 54 of the *Electricity Corporations Act 2005* (WA). This, in effect, only applies to the Western Power Network. Alinta notes that this order may need to be amended if the Horizon NWIS Network is covered because, as the order is currently framed, the restriction applies to all covered networks.

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- The difficulties faced by prospective new entrant retailers in entering into an access arrangement with Horizon.

To date no new competing retailer has been able to negotiate access to the Horizon NWIS Network with Horizon.

Horizon is a vertically integrated, State Government owned business. Vertical integration creates a conflict of interest because Horizon is incentivised to operate its network business in a manner that is to the advantage of its retail business and to the disadvantage of potential retail competitors. Horizon has no incentive to enter into transmission and distribution access arrangements with any third party since, to do so would enable new entrants to supply electricity to retail customers, undermining Horizon's monopoly position as the retailer of electricity to all customers in the NWIS region other than the large load customers that Alinta currently supplies<sup>6</sup>. Prospective new entrant retailers have generally not been able to access the Horizon NWIS Network and Horizon remains the electricity retailer to almost all customers in the NWIS.

Under section 62 of the *Electricity Corporations Act 2005 (WA)*, regulations may be made that provide for 'segregation arrangements', the effect of which is to segregate the network segment from the other functions and operations of Horizon. No such regulations have been made, and so Horizon continues to operate as a fully vertically integrated business. This stands in contrast to the strict regulatory segregation requirements on Synergy, imposed after the re-integration of Synergy and Verve Energy,<sup>7</sup> and its structural separation from Western Power (which operates the vast majority of transmission and distribution network in the SWIS).

Alinta's views on the considerations that the PUO has identified as being relevant to the Minister's assessment against Criterion (a) are presented below.

#### **4.1.1 Definition of the relevant dependent market**

Alinta has identified the relevant dependent market as the market for retail electricity customers supplied by means of the Horizon NWIS Network.

Without access to the covered service there is no ability for a person, other than the owner of the covered service, to supply electricity to customers through a retail offering. The retail supply of electricity is dependent on the covered service and there is no other physical, statutory, regulatory or legal impediment to the retail supply of electricity. As noted above, the networks owned by other parties in the region do not provide access to any substantive customer base, with Horizon being the only entity that has a distribution network that provides access to approximately 99%<sup>8</sup> of all customers (distribution and transmission connected) in the region.

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<sup>6</sup> These concerns are underlined by the fact that Horizon is statutorily required to endeavour to make a profit (*Electricity Corporations Act 2005*, section 61).

<sup>7</sup> Refer to *Electricity Corporations (Electricity Generation and Retail Corporation) Regulations 2013*

<sup>8</sup> Horizon supplies 100% of distribution connected customers in the NWIS. Of the transmission and distribution connected customers in the NWIS, Alinta's understanding at the time of writing is that only two large customer loads are not supplied by Horizon.

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Alinta also notes that the market for the generation of electricity supplied by means of the Horizon NWIS Network may also be a dependent market. Access to the Horizon NWIS Network, and associated increase in the potential customers able to be supplied by other retailers is also likely to lead to increased competition in that generation market, since there will be more retailers for generators to sell electricity to.

Notwithstanding, Alinta has focused the bulk of the material presented in its application for coverage and in response to the Issues Paper on the prospects for increased competition in the retail market.

#### 4.1.2 Is the dependent market separate from the covered service

The market for the retail supply of electricity is separate from the market for covered services. As described in the Issues Paper the covered service is the service in relation to the transportation of electricity provided by means of the *covered network*, including a network use of system service. In all jurisdictions in Australia, and the Pilbara region is no exception, there are three distinct markets associated with the provision of electricity to customers:

1. the generation of electricity and ancillary services;
2. the transportation of electricity through transmission and distribution networks; and
3. the retail sale of electricity.

#### 4.1.3 Material promotion of competition

The notion of promoting competition involves considering whether access will create or improve the environment in which competition in dependent markets may then flourish.<sup>9</sup>

Assessing whether access will materially promote competition in dependent markets has generally been approached in other access regimes (including under Part IIIA of the *Competition and Consumer Act 2010* (Cth) (**CCA**)), using a “future with and without test”. This requires a comparison of the future state of competition in the relevant dependent market:

- with a right or ability to use the service; and
- without any right or ability (or with a restricted right or ability) to use the service.<sup>10</sup>

In the recent case of *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124, the Full Federal Court held that this analysis is undertaken without taking into account the extent to which access is currently being provided, or the terms on which it is currently provided. Rather, the more natural construction of this criterion involves a comparison between access and no access, and in the case of increased access, between increased access and restricted access.<sup>11</sup> In other words, the test under criterion (a) does

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<sup>9</sup> *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 at [182]. See also *Sydney Airport Corporation Ltd v Australian Competition Tribunal* [2006] FCAFC 146.

<sup>10</sup> *Sydney Airport Corporation Ltd v Australian Competition Tribunal* [2006] FCAFC 146 at [83].

<sup>11</sup> *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 at [139].

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not involve an assessment of the future state of competition in the market by reference to any access that the service provider already does provide, or will voluntarily provide.

Alinta's view is therefore that, when assessing the effect of access to the Horizon NWIS Network on competition, the Minister may not take into account the extent to which Horizon claims that it currently provides access, or the terms on which it claims to provide access. Rather, the Minister must assess the future state of competition in dependent markets with a right or ability to use the Horizon NWIS Network, and without any right or ability at all to use the Horizon NWIS Network.

In accordance with these principles, Alinta submits that access to covered services provided by means of the Horizon NWIS Network would promote a material increase in competition in the market for the retail supply of electricity to customers supplied using the Horizon NWIS Network.

Alinta possesses a retail licence and has access to generation capacity to supply electricity to customers connected to the Horizon NWIS Network, but the ability to do so depends on having access to the Horizon NWIS Network. Access to services provided by the Horizon NWIS Network is essential to supply those customers.

Electricity customers supplied using the Horizon NWIS Network have expressed an interest in the opportunity to choose between electricity retailers. If coverage of the Horizon NWIS Network is granted, Alinta will be making offers to supply retail electricity to these customers, thereby actively promoting competition. This will enable distribution connected customers with the ability to choose Alinta as their retailer (or other new entrants) and to benefit from Alinta's exceptional customer service<sup>12</sup> and innovative retail products, as provided in the SWIS and the WA gas market<sup>13</sup>.

As outlined in Alinta's application for coverage, these benefits to the Pilbara will be material:

*"...based on the experience to date in the NWIS, and in Australian energy markets more broadly, Alinta believes that the acquisition by new entrants of a 30% market share in Horizon's 'large use' L4, P2 and the Horizon large-use customers who were previously supplied under the M2 tariff (**Horizon Large Use Tariff Categories**) over a 15 year period is a reasonable estimate."*

*"Based on this estimate of market share, new entrants (including Alinta) could be expected to acquire a market share of close to 80 GWh per annum in the first ten years of competition... After 15 years competition, the new entrants' combined market share would be close to 110GWh per annum."<sup>14</sup>*

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<sup>12</sup> In 2014 Alinta's in-house Customer Service Centre won the Gold Medal for Australia's best customer service excellence for a Medium Enterprise or Division of Business, at the national Customer Service Council's 12th annual awards. Refer to: <https://alintaenergy.com.au/about-us/news/australia-s-best-customer-service>

<sup>13</sup> Alinta's Home Capped Gas Plan was a finalist in the recent CME/AIE Western Australian Energy Awards 2017, in the Energy Innovation of the Year category.

<sup>14</sup> Alinta Energy (2017), Coverage Application under the Electricity Networks Access Code 2004 (WA), pp. 10.

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Note that Alinta's estimate is based on a number of examples from other Australian jurisdictions where energy markets have been opened to competition.<sup>15</sup> Including:

- in Victoria and South Australia, over 80% of customers have signed market contracts since FRC was introduced in early-mid 2000;
- The New South Wales gas market, where the incumbent retailer's share was reduced to 71% following 7 years of competition; and
- The West Australian gas retail market, where Kleenheat has progressively increased its market share since its entry in 2012-13 to 12.5% of residential and 15.4% of business customers<sup>16</sup>.

Alinta considers the acquisition of an estimated 80-110 GWh per annum by new entrants represents a significant portion of the electricity customers supplied using the Horizon NWIS Network.<sup>17</sup> This clearly substantiates a *material increase* in competition, as compared to the counterfactual where there is no access to the Horizon NWIS Network, and Horizon remains the monopoly retailer of electricity to such customers.

#### 4.1.4 Issues raised by the Issues Paper

The Issues Paper makes two observations in relation to matters not explicitly addressed in Alinta's coverage application. These are that Alinta's application does not address the:

1. Extent to which alternative sources of energy supplies (including self-supply) may affect the level of competition for network services; and
2. Implications for competition in the electricity generation market if the Horizon NWIS Network is covered.

Alinta's responses to both these questions are presented below.

##### *Applicability of Self-Supply Options*

Alinta recognises that 'alternative sources of energy supplies' – such as large customers building their own conventional, substitute generation and transmission networks, or small customers adopting off-grid technologies, such as solar PV and batteries – are an increasing feature of the electricity sector. These developments may affect the level of demand at delivery points on the Horizon NWIS Network and thus competition for the 'network services' provided by Horizon, which are the subject of Alinta's coverage application.

Notwithstanding, unless it could be shown that electricity generation, network and retail services in the NWIS are provided in the same, single market – a conclusion that Alinta submits is strongly at odds with the facts – then the potential role of such alternative sources of energy supplies are not determinative considerations for the purpose of assessing Alinta's coverage application. This is because the effect on competition to be assessed under

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<sup>15</sup> Alinta Energy (2017), Coverage Application under the Electricity Networks Access Code 2004 (WA), section 4.2.1.

<sup>16</sup> ERA 2016 Annual Performance Report, Energy Retailers

<sup>17</sup> Alinta estimates a total load for Horizon of 550 GWh per annum. Of this amount, Alinta estimates that two thirds would fall into Horizon's large use NWIS tariff categories. Mathematically 110 GWh divided by 363 GWh is approximately 30%.



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Criterion (a) is in relation to one or more identified *dependent* markets, rather than the degree of competition (through substitution) in the market for ‘network services’ (as provided by Horizon) itself.

In particular, customers who have or may build their own generators and associated transmission networks that are not connected to the Horizon NWIS Network are not relevant to the Criterion (a) assessment of Alinta’s coverage application. Coverage of Horizon’s network will not affect the level of competition to supply those customers with retail electricity services.

Alternatively, some customers may build or adopt their own generation facilities, but nevertheless remain connected to the Horizon NWIS Network – such as smaller customers taking up emerging solar PV or battery technology. Such customers do form part of the dependent market identified in Alinta’s coverage application, and Alinta acknowledges that the demand for retail electricity will be affected by the extent to which such alternative energy forms are taken up. However, these developments fall well short of the degree of substitution required to conclude that competition in the market for retail electricity is already sufficiently effective that access to the Horizon NWIS Network will not promote a material increase in competition in the market for retail electricity supplied from the Horizon NWIS Network.

#### *Reticulation of Natural Gas*

The Issues Paper also mentions alternative energy sources, such as natural or compressed gas. Alinta notes that there is no reticulation of natural gas via gas distribution networks in the vicinity of the NWIS. The delivery of compressed natural gas to gas-fired electricity generation is possible, but for many reasons this is an unrealistic option for most electricity users in the NWIS. For instance, the ownership and operation of gas fired generation is cost prohibitive for almost all customers. Therefore, effective competition brought about by the supply of natural gas is not considered realistic.

#### *Implications for competition*

Alinta’s view is that there will be a material increase in competition in relation to both the retail and generation market<sup>18</sup>, as the effects on competition are likely to be the mirror image of one another. In particular, the value of competition is strongly evidenced by the examples of retail markets in other locations around Australia that have opened to competition.

However we note that for the purposes of assessing the application the Minister only needs to conclude that there has been a material increase in competition in relation to one dependent market. Alinta submits that, for the purposes of assessing the coverage application, this should be the market for the retail supply of electricity to customers connected to the Horizon NWIS Network.

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<sup>18</sup> With this increased competition, the potential for innovative development, including provision of behind the meter solutions will also increase.



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#### 4.1.5 PUO questions for stakeholders relating to Criterion (a)

Having described the context for defining the relevant dependent market, the following section directly addresses the PUO's questions for stakeholders relating to Criterion (a).

*Question 4: Will access to the Horizon Power electricity network within the NWIS promote competition in another market or markets? What is the nature of those markets?*

The preceding section clarified that the definition of the relevant dependent market and described the nature of that market as being the market for the retail supply of electricity to customers supplied using the Horizon NWIS Network.

Details of how access would promote competition in the dependent market were provided in Alinta's application for coverage and are also set out in section 4.1.1. Alinta submits this should be accounted for in assessing the application against Criterion (a).

*Question 5: Is there already significant competition in those markets?*

There is no competition for distribution connected customers currently. The market is currently served solely by Horizon – a single, vertically integrated monopoly business. Alinta possess a retail licence and has access to generation capacity to supply electricity to customers connected to the Horizon NWIS Network. However, Alinta is unable to supply these customers without the right to access the Horizon NWIS Network. In the absence of competition from Alinta, or other retailers, it follows that there is presently no significant form of competition in the dependent market.

*Question 6: Are there different related markets for transmission as compared to distribution services, and what is the nature of these different markets?*

Alinta has identified the relevant dependent market as the market for retail electricity customers supplied by means of the Horizon NWIS Network – whether the customers are connected to the distribution or the transmission network, or the size of the customer, is not relevant and therefore should not be treated as a different related market<sup>19</sup>.

*Question 7: Do other sources of energy, such as natural gas or self-supply options, provide effective competition in supply of electricity in the NWIS?*

For the reasons explained above, other sources of energy do not provide effective competition in the supply of electricity in the NWIS. *Question 8: If you are a generator or electricity retailer, would you be interested in seeking access to the services of the Horizon Power NWIS network now or in the foreseeable future?*

This question is generally not applicable to Alinta given it's the party that initiated the coverage process.

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<sup>19</sup> Noting this, Alinta does recognise that customers connected to the transmission network would have different loss factors applied than customers connected to the distribution network.

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*Question 9: Would the service quality and/or prices in another market be improved as a result of access the Horizon Power electricity network within the NWIS? How would this occur?*

Electricity customers supplied using the Horizon NWIS Network have indicated to Alinta a strong interest in the opportunities that competition delivers: price differentiation, innovative and focussed product offers and enhanced customer service.

Access to the Horizon NWIS Network would afford Alinta, and potentially other retailers, the opportunity to compete to supply retail electricity customers within the Horizon NWIS Network. Alinta would do so through more customer-focused, innovative product offerings that are priced in order to win market share.

Alinta is confident that it can improve outcomes for customers on the Horizon NWIS network if access was provided. This is the outcome that has been achieved in every other retail electricity market in Australia where competition has been introduced as a consequence of network access being open to retailers. There is no reason that the NWIS would have any different outcome.

The benefits of greater retail competition in the Pilbara will include:

- Enabling choice for customers;
- Increased scale of the contestable market, promoting participation and competition;
- Incentive for efficiency improvements;
- Improved customer service and more innovative and responsive retail products as retailers compete to acquire and retain customers;
- Tariffs that more accurately reflect the cost to supply customers, reducing the reliance on State Government subsidies; and
- Greater consumer understanding and active participation in the energy sector.

In its coverage application, Alinta provided examples of the effect of energy market competition in other jurisdictions, such as Victoria and New South Wales.

## 5 Uneconomic to Duplicate (Criterion (b))

Criterion (b) of section 3.5 of the Code asks:

*“Would it be uneconomic for anyone to develop another network to provide the covered services provided by means of the network?”*

The Issues Paper makes reference to the relevance of the findings of the High Court in *The Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* case in relation to the applications for declaration of services provided by the Pilbara iron ore railways (the **Pilbara Rail Decision**) in assessing the application for coverage against this Criterion.

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Specifically, the Issues Paper states that the application of the Criterion hinges on whether it would be privately profitable for anyone to develop another distribution and/or transmission network to provide the same covered services on a stand-alone basis, or as part of a larger project. The PUO notes that to consider this Criterion effectively it will need to obtain information regarding the costs of duplicating all or parts of the Horizon NWIS Network.

Additionally, the Issues Paper also makes reference to the National Competition Council's view:

- That the assessment of profitability should relate at least to the period for which coverage is sought but may be referable to another time period, for example the timeframe an investor or financier utilises in making their investment decision or the likely operating life of a new facility; and
- That where development of a new facility is unprofitable on a stand-alone basis, but thought to be profitable as an integrated part of a larger project, the assessment of profitability should include consideration of the impact of the cost of developing the new facility on overall project profitability.

## 5.1 Alinta's views



**Key Consideration: It is both uneconomic and infeasible for another party to duplicate the network services provided by the Horizon NWIS Network**

Alinta considers that designing and building a competing network would be expensive, complex and time consuming, and there would likely be significant difficulty in obtaining necessary regulatory approvals and land tenure (particularly in respect of the distribution network servicing urban areas). It would call for the duplication of the Horizon NWIS Network. The considerable cost, combined with Horizon's position as an incumbent that would be highly motivated to maintain its market share in the market for covered services, means that it would be uneconomic for any person to develop a competing facility.

The enormity of the costs required to duplicate a transmission and distribution network, to enable access to compete against an incumbent provider in order to supply only a portion of the existing market with lower (competitively priced) energy charges, would render duplication unprofitable, and therefore uneconomic. The calculation to demonstrate this point is contained in section 4.3.2 of Alinta's coverage application<sup>20</sup>.

### 5.1.1 Relevant legal considerations relating to Criterion (b)

As set out in further detail in Alinta's coverage application, on the basis of the High Court's decision in the Pilbara Rail Decision, Criterion (b) requires the Minister to be satisfied that it would not be "privately profitable" for anyone (including Horizon) to develop a second competing facility to the Horizon NWIS Network.<sup>21</sup> The High Court described this as "*the*

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<sup>20</sup> Alinta Energy (2017), Coverage Application under the Electricity Networks Access Code 2004 (WA), section 4.3.2.

<sup>21</sup> *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 at [107].

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question that lies at the heart of every decision to invest in infrastructure, whether that decision is to be made by the entrepreneur or a financier of the venture".<sup>22</sup>

The High Court explained the private profitability test in the following terms:

*"It would not be economical, in the sense of profitable, for someone to develop another facility to provide the service ... unless that person could reasonably expect to obtain a sufficient return on capital that would be employed in developing that facility. Deciding the level of that expected return will require close consideration of the market under examination. What is a sufficient rate of return will necessarily vary according to the nature of the facility and industry concerned. And if there is a person who could develop the alternative facility as part of a larger project it would be necessary to consider the whole project in deciding whether the development of the alternative facility, as part of that larger project, would provide a sufficient rate of return."*<sup>23</sup>

The critical issue is identifying a person that could earn a sufficient "return on capital" to build the competing facility. The "return on capital" is necessarily calculated on the basis of a "rate of return" on the capital investment, earned over a period of time.

The appropriate "period of time" will fundamentally depend on the period in which it is likely the developer can continue to operate the facility and charge for services.

The longest potential time period would be the economic life of the relevant assets, as that represents the longest period in which assets can be usefully operated to earn a return on capital. However, a shorter period is appropriate if the facility can only be profitably operated for a shorter time period (e.g. because there will be no paying customers in the future, a licence to operate the facility will expire, or land tenure will terminate).

In line with the High Court's test, Criterion (b) should be primarily assessed on the basis of the private profitability of operating a "stand-alone" facility. However, if there is evidence that a person could develop the facility as part of a larger project, then (and only then) would it...

*"...be necessary to consider the whole project in deciding whether the development of the alternative facility, as part of that larger project, would provide a sufficient rate of return."*<sup>24</sup>

### **5.1.2 Assumptions relating to the cost and profitability of network duplication**

Alinta demonstrated in its application the cost to duplicate the Horizon NWIS Network is clearly unprofitable and therefore prohibitive. Alinta provided a detailed calculation to demonstrate this fact which remains relevant and should be taken into account for the purposes of assessing the coverage application against Criterion (b). The network costs incorporated in Alinta's modelled example are a simple summation of the estimated costs in the table provided in Alinta's coverage application.<sup>25</sup> In light of the Issue Paper, Alinta

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<sup>22</sup> *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 at [106].

<sup>23</sup> *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 at [104].

<sup>24</sup> *Pilbara Infrastructure Pty Ltd v Australian Competition Tribunal* [2012] HCA 36 at [104].

<sup>25</sup> Alinta Energy (2017), Coverage Application under the Electricity Networks Access Code 2004 (WA), Figure 4.

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wishes once again to highlight the important point that the output of the calculation is not sensitive in any way to the underlying inputs and assumptions used.

Alinta is able to provide an excel document containing the original example to the PUO, which can be used to test this statement. For example, the PUO queried Alinta's use of a 6% cost of capital. To demonstrate how the uneconomic outcome is not influenced by the cost of capital used, Alinta offers the following:

- The NPV estimate (based on a 6% cost of capital) put forward in Alinta's coverage application was - \$1.062 billion. Continuing with the simple example used by Alinta within its coverage application, adopting a 0% cost of capital gives a NPV of - \$1.021 billion and a 20% cost of capital gives a NPV of - \$1.059 billion;
- Alinta's simple example ignored debt gearing, however the sensitivities presented above aim to demonstrate that the 'expected market returns' remain substantially negative regardless of the actual cost of capital applied. To explain, the investment required to duplicate the network for a network business with a cost of capital of 0% produces a negative NPV in excess of \$1 billion. Equally, incorporating a cost of capital of 20% (which is clearly well above any allowable rate for an efficient network business) also shows that the expected NPV remains substantially negative (again in excess of negative \$1 billion). Therefore, regardless of the actual cost of capital applied, the 'natural monopoly' attributes of network duplication clearly render such an exercise to be unprofitable and uneconomic.

It is therefore clear that the assumption around the cost of capital applied does not alter the resultant significant negative NPV or change the uneconomic nature of duplicating the network. This is also true for other assumptions made in Alinta's analysis, including the number of switch yards and substations, and the distribution/transmission split of total line length.

Even if the cost were not prohibitive, which Alinta has clearly established would be the case, it would be infeasible for any person to develop a competing facility during the proposed period of coverage (e.g. because there is no land available, because of regulatory constraints or because it would simply take too long). This point is discussed further in section 5.1.3.

In the Issues Paper, the PUO specifically queries the assumption made by Alinta with respect to no load growth. Alinta considers that this is a realistic estimate that reflects the current economic environment where growth is slowing as many large projects transition from capital expenditure phase and into full scale production. Additionally, low iron ore prices mean it's unlikely that there will be a significant growth in energy requirements for the region in the medium term. However, as outlined above, even if a significant increase in load growth was incorporated into the modelling, this would not alter the substantially negative NPV or the uneconomic nature of duplicating the network. Alinta has applied a cumulative, annual load growth rate of 6% over a ten year period to demonstrate this point. This would see the size of the market almost double (i.e. an increase of ~70%). Under this scenario, the NPV estimate changes from - \$1.062 billion to - \$1.008 billion, this is clearly still unprofitable and uneconomic.

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Alinta would be pleased to work with the PUO if required to test any other plausible scenarios, each of which can be expected to reinforce that it is uneconomic to duplicate the Horizon NWIS Network.

Finally, the PUO highlighted that Alinta's analysis appears to assume that the dependent retail market will include customers from both the transmission and distribution network. That is, its modelling exercise does not treat the transmission and distribution networks on a stand-alone basis. In its issues paper, the PUO notes that the distinction between the transmission and distribution network assets may have consequences for determining the profitability of duplicating the network to provide services for different types of customers that are connected, or may connect, to either of the networks.

In response, Alinta considers that the private profitability test should not separate the duplication of the transmission and distribution assets. Alinta's coverage application makes it clear that it seeks access to the network that comprises the electricity transmission and distribution assets currently owned and operated by Horizon that form part of the NWIS<sup>26</sup>.

Other than a few larger mining loads, Alinta is not aware of any customers connected directly to the transmission section of the Horizon NWIS Network. Alinta seeks network access to supply customers that are distribution connected. However, the supply of these distribution connected customers is not possible without also being able to also transmit electricity through the transmission network.

Separation of the transmission and distribution sections that form the Horizon NWIS Network for the purposes of the private profitability test therefore applies a logic that is not relevant to Alinta's, or very likely any other retailer's, access requirements for the Horizon NWIS Network. Put simply, Alinta would be unable to supply additional customers without access to the distribution network, so the costs of distribution should be considered in conjunction with costs of transmission assets associated with the Horizon NWIS Network.

### **5.1.3 Feasibility of building another network**

The above analysis assumes that it would, in fact, be legally and physically possible for another party to develop another network to provide the same network services as those currently provided by the Horizon NWIS Network (both transmission and distribution). If it is, in fact, not feasible, then it follows that it is uneconomic for a person to build a competing network.

Alinta has substantial doubts about whether it would even be feasible to build a competing network. This is because it may be infeasible for anyone to get the necessary access rights and tenure in a congested urban area. For example the relevant regulatory and local government agencies would not grant approval for duplication of poles and wires, as there is simply no land available (inside congested urban areas with pre-existing roads, footpaths and houses). If that is the case, then it follows that, given the main intention of Alinta's coverage application is to be able to supply a number of distribution-connected loads, this

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<sup>26</sup> Alinta Energy (2015), Coverage Application under the Electricity Networks Access Code 2004 (WA), p.5.



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would not be possible without access to Horizon's poles and wires that form a part of the Horizon NWIS Network.

#### 5.1.4 PUO Questions for Stakeholders on Criterion (b)

The following section directly addresses the PUO's questions for stakeholders relating to Criterion (b).

*Question 10: What evidence is there that it would, or would not, be privately profitable for any party to develop another network to provide the same network services as provided by Horizon Power through the electricity network within the NWIS, on a stand-alone basis?*

For the reasons set out in section 5.1.2, Alinta considers that it would not be privately profitable (nor economically efficient) for any person to develop another network to provide the same network services provided by Horizon. Further, Alinta has doubts about whether it would be feasible to build a competing network to provide the same services as those currently provided by the Horizon NWIS Network (both transmission and distribution). This is because it may be infeasible for anyone to get the necessary access rights and tenure in a congested urban area. This has been demonstrated in the sections above.

*Question 11: Is it appropriate to consider the duplication of the transmission and distribution networks separately for the purpose of the private profitability test?*

As outlined in section 5.1.2, the private profitability test should not separate the duplication of the transmission and distribution assets. No retailer would be able to supply additional customers without access to the distribution network, so the costs of distribution should be considered in conjunction with transmission assets of the Horizon NWIS Network.

*Question 12: Are the assumptions Alinta Energy has used to support its conclusion that duplication of the network is [un]profitable, reasonable?*

This question is generally not applicable to Alinta given it's the party that made the assumptions to support our conclusion that duplication of the network is unprofitable. However, Alinta notes that in completing its original analysis of the profitability of duplicating the Horizon NWIS Network, Alinta adopted a number of network cost assumptions based on the work previously coordinated by the Australian Energy Market Operator (**AEMO**).<sup>27</sup> Where it was not possible to base the assumptions on the work of AEMO, other independent sources were identified, including the Economic Regulation Authority's (**ERA**) inquiry into the funding arrangements of Horizon and the work undertaken by Sinclair Knight Merz (**SKM**) to assist the WA Independent Market Operator (**IMO**) in undertaking its review of the Margin Peak and Off-Peak values in 2013/14.

Where it was not possible to source information from external, third party sources, Alinta adopted conservative assumptions based on its own power and infrastructure development experience and expertise. However, crucially, as indicated in Alinta's original application, regardless of the assumptions adopted, it remains uneconomic to duplicate the Horizon

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<sup>27</sup> Refer to specific references provided in Alinta Energy (2017), Coverage Application under the Electricity Networks Access Code 2004 (WA), p.13.

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NWIS Network. This is demonstrated in the sensitivity analysis undertaken by Alinta, presented above. The sensitivity analysis clearly indicates that it will never be privately profitable or economic (i.e. not NPV positive) to duplicate the Horizon NWIS Network.

*Question 13: Would it be privately profitable to duplicate transmission assets used to service large customers in the Karratha and Port Hedland regions?*

As outlined in section 5.1.2, and in response to question 11, the private profitability test should not separate the duplication of the transmission and distribution assets.

No retailer would be able to supply additional customers without access to the distribution network, so the costs of distribution should be considered in conjunction with transmission assets associated with the Horizon NWIS Network.

*Question 14: Are there any factors likely to emerge in the foreseeable future that will affect the cost and profitability of duplicating the network?*

Alinta does not consider that there are any factors that may emerge and significantly change the economic proposition of duplicating the Horizon NWIS Network.

## 6 Not contrary to the public interest (Criterion (c))

Criterion (c) of section 3.5 of the Code asks:

*“Would access (or increased access) to the covered services provided by means of the network not be contrary to the public interest?”*

The introduction of competition in the market for the retail supply of electricity to customers supplied using the Horizon NWIS Network through the entry of Alinta (and other retailers) will enable greater choice for those customers. This will ultimately deliver lower prices, a wider range of service options and flow-on multiplier benefits to the wider economy. However, the PUO identifies that the introduction of retail competition may have implications for Horizon’s overall operating costs and questions whether this would be in the public interest given the State Government’s uniform tariff policy<sup>28</sup>.

The Issues Paper identifies a number of particular matters that are potentially relevant for the purposes of assessing whether coverage is in the public interest. The paper also makes specific reference to those matters outlined in both the National Competition Council’s *Declaration of Services* guide and the *Competition Principles Agreement*, which established the framework for access regimes applying at both the State and Commonwealth level. These include:

- *Declaration of Services:*
  - Economic Efficiency arising from promotion of competition;

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<sup>28</sup> The uniform tariff policy requires that all small use customers, regardless of where they are connected, pay the same price for electricity.



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- Regulatory costs of an access arrangement, including the cost of negotiating access and arbitrating access disputes;
  - Disruption costs where access may involve some disruption to the operations of the network service provider and potentially other parties; and
  - Investment effects to ensure that the risks of investments in infrastructure are not distorted with or without access rights.
  - *Competition Principles Agreement:*
    - Ecologically sustainable development;
    - Social welfare and equity considerations, including community service obligations;
    - Government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
    - Economic and regional development, including employment and investment growth;
    - The interests of consumers generally or a class of consumers;
    - The competitiveness of Australian businesses; and
    - Efficient allocation of resources.

The Issues Paper suggests that, of the matters outlined above, those relating to social welfare and government policies are particularly relevant for the purposes of assessing whether Alinta's coverage application is in the public interest.

## 6.1 Alinta's views



**Key Consideration: Enabling access to the Horizon NWIS Network would not be contrary to the public interest. In fact it would promote the public interest by enabling the introduction of retail market competition.**

Alinta considers that access to the Horizon NWIS Network would not be contrary to the public interest. In fact, enabling access to the Horizon NWIS Network would promote the public interest by aiding the introduction of competition in the market for the retail supply of electricity to customers, giving rise to substantial benefits to those customers. These benefits will not be outweighed by the potential for any increase in costs to Horizon (or any other party), the likelihood and magnitude of which Alinta disputes.

Enabling Alinta (and other participants) to retail electricity in the Horizon NWIS Network will promote competition and customer choice. Competition in retail energy markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that better meet consumer needs and find lower cost solutions, resulting in savings

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that are ultimately passed on to consumers. Enabling access to the Horizon NWIS Network will deliver these substantial public benefits (satisfying Criterion (a) and (b)).

The PUO has identified that the introduction of retail competition may have potential implications for Horizon's overall operating costs and raises the related question as to whether this would be in the public interest given the State Government's uniform tariff policy.<sup>29</sup>

Alinta notes that Criterion (c) is defined in the negative. The consequence of it being specified in this manner is that, in order to make a decision not to cover the Horizon NWIS Network, the costs of regulated access must outweigh the benefits of regulating natural monopoly services.<sup>30</sup> It follows that the Minister would need to identify considerable public detriments or costs which it could be concluded with a high degree of confidence would outweigh the competition benefits (as well as the other public benefits Alinta identifies in the following sections) before concluding that the Horizon NWIS Network should not be covered under this criterion.

Taking as the point of reference for the assessment of Criterion (c) the PUO's suggestion that the introduction of competition may cause Horizon's overall operating costs to increase; Alinta submits that there are two distinct considerations with respect to the public interest consequences. These are:

1. Is it likely that the total cost of serving customers in the Horizon NWIS Network (whether supplied by Horizon or any competing retailer) will increase or reduce over the long term, as a result of coverage being granted and retail competition being introduced for customers supplied using the Horizon NWIS Network?
2. If the Horizon NWIS Network was to be covered and retail competition introduced, are there any implications for the operation of the Tariff Equalisation Contribution (**TEC**) and Tariff Adjustment Payment (**TAP**), being the mechanisms presently in place to deliver on two particular government policy objectives, being:
  - the equalisation of electricity tariffs across the state, by reference to the cost of supply in the SWIS (the TEC); and
  - the delivery of a state-wide subsidy to household and small business customers (the TAP)?

The remainder of this section addresses the particular considerations that are relevant for examining these questions, as well as a range of wider public interest considerations not identified in the Issues Paper. Alinta submits that none of these considerations suggest that coverage of the Horizon NWIS Network would be contrary to the public interest; rather, they all point to coverage substantially promoting the public interest.

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<sup>29</sup> The uniform tariff policy requires that all small use customers, regardless of where they are connected, pay the same price for electricity.

<sup>30</sup> This is the approach the courts have taken in relation to the equivalent criterion in Part IIIA of the CCA: for example, see *Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [590]

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### 6.1.1 Effect of Coverage on Total Cost of Serving Customers in the NWIS

The PUO has identified that the introduction of retail competition may have potential implications for Horizon's overall operating costs and raises the related question as to whether this would be in the public interest given the State Government's uniform tariff policy.<sup>31</sup> Taking up this theme, Horizon's Discussion Paper from 2014 claims that the introduction of retail competition, as facilitated by coverage of its network being granted, will result in increased costs in the order of \$10.4 million per annum.<sup>32</sup> Alinta's views on this matter follow:

1. Alinta completely refutes Horizon's estimate of the effect on its costs – most of which occur in relation to its generation activities – as a consequence of the introduction of competition. The cost estimates developed by Horizon are addressed in detail in Appendix 1, where Alinta establishes that approximately \$9.4 million of these costs will not be incurred.

Notwithstanding, in Alinta's view the principal relevant consideration from a public interest perspective is not any potential change in Horizon's cost, but rather the change in the overall cost efficiency with which customers in the Horizon NWIS Network are supplied (under a competitive environment as a result of coverage being granted), as opposed to under a monopoly (which reflects the status quo). To the extent that costs of supply may change following coverage being granted, the relevant public interest consideration is in the total costs of all suppliers, rather than the average or total cost of any one individual supplier.

It follows that the consideration identified by the Issues Paper and the related material put forward in the Horizon Discussion Paper from 2014 in relation to its own costs is not of itself sufficient to draw any conclusion in relation to the public interest. Rather, in addition to the effect of coverage on Horizon's operating costs, account must also be taken of the fact that the lost supply of generation from Horizon's generation portfolio must be met by other generators whose efficiency would improve and unit operating costs would reduce, resulting in no meaningful (if any) net increase in the costs, as a result of coverage being granted. For example, if there was to be any reduction in the thermal efficiency of Horizon's generation portfolio as a result of a loss of market share, this can be expected to be offset by a corresponding increase in the thermal efficiency of Alinta's generation plant, as a result of its increased market share.

Further, it is important to distinguish any effect on costs as a result of coverage from those arising anyway. For example, in relation to Horizon's generation portfolio, the likelihood that the cost of plant coordination may increase seems low, since a degree

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<sup>31</sup> The uniform tariff policy requires that all small use customers, regardless of where they are connected, pay the same price for electricity.

<sup>32</sup> The TEC is the subsidy between the SWIS and the NWIS to ensure all electricity customers in WA pay the same tariffs. Alinta understands that the TEC equates to an approximate \$167 million a year subsidy as outlined in the 2017-18 WA State Budget Papers.

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of coordination between generators is already necessary, because at least two independent generators presently supply different customers over Horizon's network.

2. Even if the total cost of *operating* the existing generation plant, metering, and retail billing arrangements were to increase, a public interest assessment would also require consideration of the potential benefits of a reduction in future generation and retailing *investment* costs, on account of the increased efficiency of investment decisions under competition, as distinct from under a monopoly. The experience of virtually all competitive electricity markets is that the potential for reductions in the cost of future generation investment (by incentivising investment in the right plant, of the right scale, and at the right time) are likely substantially to outweigh any increase in generation operating costs.
3. Alinta accepts that the potential for increased regulatory costs is a relevant public interest consideration - however, these must be put against the likely increased efficiency arising from competition (as above).

To summarise, it is simply incorrect for an assessment of the public interest to focus on the operating cost implications for Horizon alone, as is implied by the material in its 2014 Discussion Paper. Rather, a public interest-based assessment of the effects of the introduction of competition arising from the granting of coverage to the Horizon NWIS Network requires a complete assessment of the full range of costs and benefits that would arise.

### 6.1.2 Implications for the Operation of the TEC/TAP

Even if Horizon's claims were to be taken at face value, its 2014 Discussion Paper suggests that consideration needs to be given to how to address the associated cost burden on the TEC<sup>33</sup>. The Issues Paper notes that the potential impact on the State Government's uniform tariff policy is a factor relatively unique to the circumstances of the present application that may be of relevance in considering the public interest.

Alinta submits that the effect on the operation of both the TEC and the TAP give rise to two distinct considerations as regards the public interest. These are that:

1. For customers connected to the Horizon NWIS Network, the TEC and TAP operate on the assumption that there is just one retail supplier, yet competitive neutrality considerations mean that these will inevitably need to be modified once retail competition is enabled; and
2. The potential implications of the TEC and TAP – after appropriate modification – is a function of the efficiency of overall service delivery to customers connected to the Horizon NWIS Network, rather than just through Horizon, as the incumbent supplier.

Taking these considerations in turn, it is important to recognise that the operation of the TEC and TAP pre-suppose that there is only one supplier in the NWIS (being Horizon). However,

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<sup>33</sup> The TEC is the subsidy between the SWIS and the NWIS to ensure all electricity customers in WA pay the same tariffs. Alinta understands that the TEC equates to an approximate \$500 million a year subsidy.

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if Alinta (or, indeed, any other party) is to become a potential supplier of household and small business customers connected to the Horizon NWIS Network, then competitive neutrality, and therefore the public interest, requires that operation of the TEC and TAP be modified so as to provide for customers eligible for subsidy under both the TEC and TAP mechanisms still to receive those payments, through their new retail supplier. This principle aligns with the question for stakeholders raised in the PUO's Issues Paper. Irrespective of whether the government was to modify the TEC and the TAP so that subsidies to relevant customers connected to the Horizon NWIS Network were delivered in a competitive neutral manner, it is important to bear in mind that the anticipated drain on the public finances of such future TEC and TAP payments should be dictated by the overall supply cost efficiency, rather than by the particular costs incurred by Horizon (and any other party).

In the long term, the best outcome for customers in the SWIS and for Western Australia will result from increased competitive pressure being applied to Horizon, forcing it to be leaner and more efficient. Alinta suggests that this outcome is undoubtedly in the public interest, and that insulating Horizon from competitive forces is undoubtedly not.

The remainder of this section discusses a range of wider public interest considerations not identified in the Issues Paper. These include:

- Achieving competitive neutrality (section 6.1.3);
- Addressing the current asymmetry in bargaining power between Horizon and other parties (section 6.1.4);
- Ensuring Horizon operates an “open and fair” access regime (section 6.1.5);
- Ensuring the efficient allocation of resources (section 6.1.6);
- Promoting the competitiveness of Australian business (section 6.1.7); and
- Regulatory costs (section 6.1.8).

### 6.1.3 Achieving competitive neutrality

When considering Criterion (c), it is important to recognise the purpose and objective of the Code. The Code is made under Part 8 of the *Electricity Industry Act 2004* (WA). The purposes of Part 8 are to provide access to services and to give effect to the relevant principles of the Competition Principles Agreement in respect of the provision of access to services.

The objective of this Code (**Code objective**) is to promote the economically efficient:

- (a) investment in; and
- (b) operation and use of,

networks and services of networks in Western Australia in order to promote competition in markets upstream and downstream of the networks.

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The Minister **must** have regard to the Code objective when making a coverage determination.<sup>34</sup>

Importantly, the Code applies equally to services provided by facilities operated by statutory/public and private bodies (and automatically applies to one statutory body: Western Power in respect of the Western Power Network). The same rules apply to both kinds of bodies.

One of the key objectives of the Competition Principles Agreement is for the parties to implement competitive neutrality, that is, Government businesses should not enjoy any net competitive advantage simply as a result of their public sector ownership.<sup>35</sup>

This policy applies to the *business* activities of publicly owned entities. Subject to very limited (and non-relevant) exceptions, Horizon, in performing its functions, must act in accordance with prudent commercial principles and endeavour to make a profit, consistently with maximising its long term value.<sup>36</sup> It is clear that, while Horizon is a statutory body, it is to be operated as a business (just as Western Power is in respect of the Western Power Network).

This means that the Minister should not find that increased access is contrary to the public interest on the basis of Horizon's public ownership, or because any additional regulatory costs might partly be funded by public money (including through the TEC), given the overriding Code objective and net public benefits described in these submissions (including the public benefits that arise from satisfying Criterion (a) and (b)).

Alinta considers that in assessing the coverage application it will be particularly important to distinguish between the public's interests and Horizon's interests as a publicly owned entity. To the extent that competition can deliver better outcomes for distribution connected electricity customers then this is a relevant consideration in assessing the public benefit of coverage. The fact that enabling greater competition would potentially result in Horizon losing a number of customers and so having to recover costs over a smaller customer base or seeking to reduce its cost structures is simply an outworking of a competitive market.

To deny access to Horizon's NWIS Network simply because it would further expose the inefficiencies of Horizon's operations would be detrimental and not in the public interest.

#### 6.1.4 Removing asymmetry in bargaining power

The Australian Competition Tribunal has recognised that, when considering whether access or increased access to the service would not be contrary to the public interest,<sup>37</sup> it is relevant to consider the net public benefit that may result from redressing the bargaining power asymmetry between the monopoly provider of services and access seekers.

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<sup>34</sup> *Electricity Networks Access Code* (2004), section 2.2.

<sup>35</sup> *Competition Principles Agreement*, clause 3. This has been recently reaffirmed in the Intergovernmental Agreement on Competition and Productivity-Enhancing Reforms dated 9 December 2016 (see clause 9(f) in relation to compliance with competitive neutrality principles).

<sup>36</sup> *Electricity Corporations Act 2005* (WA), section 61.

<sup>37</sup> The Tribunal assessed these matters in relation to section 44H(4)(f) of the CCA, which is in near identical terms to criterion (c) of the Code.

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By way of illustration, in *Virgin Blue Airlines Pty Limited*,<sup>38</sup> the Tribunal found that a binding dispute resolution process would address the bargaining asymmetry between Sydney Airports Corporation Limited and the airlines using Sydney Airport, and provide a better framework for commercial negotiation.<sup>39</sup> These were significant factors in its finding that increased access to the relevant services would not be contrary to the public interest.

Consequently, when assessing Criterion (c), it is also relevant to consider the net public benefit that would result from redressing the bargaining power asymmetry between Horizon, as the monopoly provider of covered services, and potential customers of those covered services (including Alinta). This is because the prospect of a binding dispute resolution process, as well as regulation of price and other terms of access, provides an incentive for parties to reach a fair negotiated position, and constrains Horizon's monopoly power.

### 6.1.5 Ensuring Horizon operates a "open and fair access" regime

Horizon has stated that:

*"Horizon Power already provides access to its [transmission assets in the Horizon NWIS Network] on an open access basis, consistent with the access regime established by the Code".*<sup>40</sup>

This suggests that Horizon may argue that there is no public interest to be served by imposing obligations under the Code that are substantially the same as obligations Horizon has voluntarily accepted in respect of the transmission (but not distribution).

Alinta notes that Criterion (c) is not a broad ranging test for whether or not coverage would be in the public interest, but rather is intended to ensure that coverage would not be contrary to the public interest (i.e. a negative test). While Alinta maintains there is considerable net public benefit to the Horizon NWIS Network being covered, Criterion (c) does not require the Minister to be satisfied there is a public interest in coverage – it only requires the Minister to be satisfied that it is not contrary to the public interest. Criterion (c) cannot be used to call into question the results obtained by examining other criteria – rather, it calls for identifying any other matters that have not been considered under the other criteria that render or might render access contrary to the public interest. This important distinction is well-recognised by cases on substantially identical requirements in Part IIIA of the CCA and the National Gas Law: e.g. *Re Duke Eastern Gas Pipeline* [2001] ACompT 2 at paragraph 145.<sup>41</sup>

In particular, case law indicates that the fact that access to the relevant network is already available will not, of itself, mean that coverage is contrary to the public interest. For example, in *Virgin Blue Airlines Pty Limited*,<sup>42</sup> Virgin Blue successfully applied for declaration of the airside service at Sydney Airport even though access was already available. Similarly, in the more recent decision of *Port of Newcastle Operations Pty Ltd v Australian Competition*

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<sup>38</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5.

<sup>39</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5 at [606] and [609]. Sydney Airport Corporation Limited unsuccessfully appealed the Tribunal's decision to the Full Federal Court, but not in relation to the Tribunal's findings on this criterion.

<sup>40</sup> *2014 Application for Coverage of Alinta's East Pilbara Network* at [6]. See also similar comments in *Horizon's 2014 discussion paper* at page 11.

<sup>41</sup> This has been recently re-affirmed in the cases of *Application by Glencore Coal Pty Ltd* [2016] ACompT 6 (at [170]), and *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 (at [151]).

<sup>42</sup> *Virgin Blue Airlines Pty Limited* [2005] ACompT 5.



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*Tribunal* [2017] FCAFC 124, the Full Federal Court confirmed the decision of the Australian Competition Tribunal to declare services provided by the Port of Newcastle under Part IIIA of the CCA. This was despite the fact that access was, at that time, already available to users of the Port, and the Port of Newcastle had statutory powers to levy charges on the vessels which used the services. The Full Federal Court expressly rejected an argument that the existing usage of participants is a relevant consideration under the public interest criterion.<sup>43</sup>

Alinta's view is therefore that it is not relevant to consider, under criterion (c), the extent to which Horizon Power claims that it already provides access to the Horizon NWIS Network, or the terms on which it claims that it is prepared to provide access.

However, in the case that the Minister does consider such matters, Alinta wishes to explore Horizon's claims of providing "open" access. In particular, Horizon has indicated that the ETAC it proposed that Alinta enter into (**Proposed ETAC**) has been developed to be consistent with the Code to the fullest extent possible given the physical and geographic limits of the network. Similarly, Alinta notes that Horizon indicates that the current pricing model is consistent with the Code and is appropriate to use for access pricing purposes.

Alinta disagrees with these two propositions. Key provisions of the Proposed ETAC are substantially more adverse to the customer when compared to the terms of the Model Standard Access Contract in the Code. These differences cannot be explained by any physical or geographical limits of the network. Alinta considers the terms of the Proposed ETAC to be onerous and unreasonable, and the fact Horizon insists on including them in its Proposed ETAC demonstrates its superior bargaining power compared to its customers.

Similarly, the way that Horizon has used the Depreciated Optimised Replacement Cost (**DORC**) method to calculate the value of their Initial Capital Base (**ICB**) to determine an asset base for access price modelling purposes, is not in keeping with the high-level Code objectives around efficiency, the efficient use of network services and the promotion of competition.

Alinta also takes issue with the Horizon's pricing methods. Citing clause 7.3(b)(ii) of the Code, as Horizon do, and stating its pricing at the stand-alone cost of service provision is consistent with the Code is a critically flawed interpretation. The stand-alone cost of service provision is used to set an upper bound / maximum limit and is in most cases not the forward-looking efficient cost. The Code's guiding principle is clearly and absolutely one of economic efficiency (clause 2.1 and clause 7.3(a) are just some examples) and regulators from all Australian jurisdictions have for some time used the 'Building Block' approach to determine prices in line with forward-looking efficient costs.

To this effect, Alinta notes that during independent review by the ERA (2011) concerns around the appropriateness of Horizon's pricing model and methods were raised which to date have not been addressed. In Alinta's opinion, the ERA's reasoning and rationale is

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<sup>43</sup> *Port of Newcastle Operations Pty Ltd v Australian Competition Tribunal* [2017] FCAFC 124 at [151]. This was because considering such matters under criterion (c) would cause tension with the competitive analysis already undertaken under criterion (a). As discussed above, criterion (a) does not direct attention to the extent to which access is already available, or the terms on which it is already available.



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clear. To take and maintain a different view, as Horizon has, to that determined by the independent economic regulator is not realistic nor in keeping with the Code.

These issues are explored further in Appendix 4.

Alinta submits that by ensuring “fair and open” access to the Horizon NWIS Network the public interest will be promoted.

### **6.1.6 Efficient allocation of resources**

Allowing competitive market pressures will improve the efficiency of resource use associated with and connected to the Horizon NWIS Network. This will be achieved through:

- The least cost generation assets being used to supply load within the Horizon NWIS Network as a result of competitive prices that reflect the underlying wholesale cost of electricity being offered to attract customers.
- Generation assets connected to the Horizon NWIS Network being most appropriately used as any with spare generation capacity will be sold through to customers (either directly or through contracting with a retailer).
- The removal of Horizon’s current monopoly position as a retailer to small/medium sized businesses and non-mining commercial and industrial customers<sup>44</sup>.

Alinta submits that coverage will not be contrary to the public interest as it will in fact promote the public interest by ensuring efficiency of resource use in the Horizon NWIS Network.

### **6.1.7 Competitiveness of Australian Businesses**

Enabling access to more competitively priced electricity will create a competitive advantage for those businesses operating in the Pilbara. Given that the majority of larger distribution connected customers in the Pilbara area support the mining industry, a decrease in their electricity costs will translate to an improvement in the viability of continuing to operate in the Pilbara. It will also enable them to:

- Compete more actively with businesses in both the east coast and international markets; and
- Ensure greater consistency with electricity customers in the SWIS that consume more than 50MWh in a year, who have the benefit of being able to choose their retailer and potentially negotiate a better electricity offer than that provided by the incumbent retailer.

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<sup>44</sup> Alinta notes that while larger mining loads may have countervailing market power to the extent that they can build their own generation, the cost of self-supply makes it largely untenable for small/medium sized and C&I customers currently and under the current arrangements a significant disparity between the bargaining power of customers and Horizon persists. While Horizon is a regulated business there is limited ability currently for small/medium sized and C&I customers to negotiate better rates than the standing tariffs. There is also no incentive for Horizon to offer any discount to these customers.

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This will ultimately be to the benefit of the broader Pilbara economy through enhancing its attractiveness as a location for business customers and therefore creating a market environment which will drive lower costs for the mining sector, thereby enhancing the international competitiveness of the iron ore industry. Alinta does not consider these outcomes will not be contrary to the public interest but rather will promote the public interest.

### 6.1.8 Regulatory Costs

Alinta's application acknowledged that the introduction of competition is likely to impose some regulatory costs on Horizon and the State. Alinta contends that these costs should be weighed against the significant and long term economic benefits associated with the introduction of competition in the Horizon NWIS Network.

While Alinta is not in a position to be able to identify the exact regulatory costs that will be incurred by Horizon, given the relatively small and less complex nature of Horizon's network in the broader NWIS, we would expect a less onerous access arrangement in comparison to other network arrangements within Australia, including Western Power and ATCO. Subsequently, we consider that the estimation of costs associated with regulation outlined within Horizon's 2014 Discussion Paper is significantly higher than would likely be incurred. Alinta notes that, if covered, the quantum of regulatory costs will be scrutinised to ensure they are prudently incurred, and this external, independent, scrutiny may in fact lead to cost reductions.

Alinta notes that Horizon has indicated that it voluntarily operates a fair and open access regime, including having engaged external consultants to develop a "Pricing Model" that is based on the principles set out in the Code. As outlined above, Alinta's view is that it is not relevant to consider, under either criteria (a) or (c) of the coverage criteria, the extent to which Horizon claims that it already provides access, or the terms on which it claims it is prepared to provide access. However, in the case that these matters are considered, Alinta's view is that a number of Horizon's claims in this regard do not withstand scrutiny. However, Horizon cannot point to "additional" regulatory costs to the extent that Horizon has already voluntarily incurred costs where it claims it has aligned aspects of its operation with the Code. Any public detriment arising from Horizon incurring some additional regulatory costs is wholly offset by the benefit in bringing independent regulatory scrutiny to the Horizon NWIS Network, and the public benefits from increased competition in retail electricity markets.

In assessing whether access is not contrary to the public interest, we recommend that the PUO independently determines an estimate of the likely costs of regulation which ensures that:

- The identified costs are proportionate to the extent and size of the network and associated regulation; and
- The costs represent those that would be incurred by a reasonable and efficient network operator.

Alinta considers any additional costs of regulation arising from coverage, while likely to be relatively small in comparison to the total operating costs of Horizon, will be appropriate to

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incur given the broader public interest associated with greater electricity retail competition in the Pilbara. In other words, the regulatory costs associated with coverage would not be contrary to the public interest.

Further details of Alinta's specific views on Horizon's estimated costs from its 2014 discussion paper are provided in Appendix 1.

### 6.1.9 PUO Questions for Stakeholders on Criterion (c)

The following section directly addresses the PUO's questions for stakeholders relating to Criterion (c).

*Question 15 - What factors are relevant to the public interest assessment of determining coverage of the Horizon Power NWIS network?*

*Question 16 - What weight should be given to the equity considerations and government policies relating to the uniform tariff policy that impact on electricity customers located within the SWIS?*

*Question 17 - Are the assumptions made by Alinta in assessing the likely effects from competitive entry reasonable?*

*Question 18 - What are the likely effects of competitive entry in the Horizon Power NWIS retail market for residential, commercial and industrial customers?*

These questions have been addressed in section 5 above.

## 7 Geographical location of the network and extent of interconnectedness

Section 3.6 of the Code states that:

*"The Minister must when exercising the Minister's functions under this Chapter 3 have regard to the geographical location of the network and the extent (if any) to which the network is interconnected with other networks."*

In terms of the geographical location of the Horizon NWIS Network, Port Hedland and Karratha are located within the broader Pilbara region. The Horizon NWIS Network is predominantly coastal and extends to the townships of Port Hedland, South Hedland, Goldsworthy, Karratha and Dampier, among others. The port infrastructure in this vicinity is used for exports by the major iron ore miners BHP Billiton, Rio Tinto and Fortescue Metals Group. It is also understood that it will be used to supply power to the Roy Hill Iron Ore project by Horizon utilising electricity purchased by Horizon from the South Hedland Power Station.

The area generally is a resources and energy hub, with the Pilbara Development Commission reporting<sup>45</sup> that:

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<sup>45</sup> Pilbara Development Commission, "The New Pilbara," 2016.

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- Over a third of the world's iron ore comes from the Pilbara;
  - in 2015 the North West Shelf accounted for 70% of Australia's LNG exports; and
  - In 2015-16 the Pilbara contributed 13% to Western Australia's total revenue.

In terms of interconnectedness the Horizon NWIS Network is part of the broader NWIS, and is interconnected within the meaning of the Code with network infrastructure owned by the following parties and/or their related bodies corporate:

- BHP Billiton Iron Ore Pty Ltd;
- Rio Tinto Limited;
- The Pilbara Infrastructure Pty Limited; and
- Alinta.

The balance of the NWIS (non-Horizon owned) spans a significant part of the Pilbara and much of the power infrastructure extends inland to provide power for the iron ore mining operations of Rio Tinto and BHP Billiton.

### **7.1.1 PUO Questions for Stakeholders on geographical location and the extent of interconnectedness**

The following section directly addresses the PUO's questions for stakeholders relating to geographical location and the extent of interconnectedness.

*Question 19- Are any factors associated with the geographical location of the Horizon Power NWIS network relevant to the Minister's decision as to whether that network should be covered under the Code?*

Competition through the provision of lower costs to customers operating in a high cost regional environment should be paramount. As stated previously, competition in the retail market will arguably decrease costs and, therefore, increase productivity, contributing to higher output and growth for the region. Given the substantial output and economic significance of the geographical region, increased productivity through lower energy costs will deliver an economic multiplier, providing material benefits to the West Australian economy.

*Question 20- Are any factors associated with the extent of interconnection of the Horizon Power NWIS Network with other networks relevant to the Minister's decision as to whether that network should be covered under the Code?*

As stated above, Alinta seeks coverage only of that portion of the NWIS which is comprised by Horizon's network infrastructure. Alinta does not consider that any factors associated with the extent of interconnection of the Horizon NWIS Network with the other networks within the NWIS is relevant to the Minister's decision as to whether that network should be covered under the Code.

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## 8 Conclusion

Alinta's Coverage Application, and this response to the PUO's issues paper, has demonstrated that the granting of coverage will promote competition in the retail electricity market that exists in the form of those customers supplied with electricity using the Horizon NWIS Network. This will occur through Alinta's economically efficient use of the network and its services, and so aligns with the Code objective.

Further, the benefits provided through lower energy costs and enhanced productivity will support and grow the contribution made by the NWIS geographical region, to benefit those in the region and the State more broadly. Given this and in circumstances where all three coverage criteria are satisfied, Alinta submits that the Minister should decide to cover the Horizon NWIS Network in accordance with the Code.

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## Appendix 1 – Alinta’s response to Horizon’s claimed costs of access

Horizon’s 2014 Discussion Paper outlines a number of costs associated with coverage<sup>46</sup>:

- Costs that it deems will be incurred by it alone – regulatory costs of \$1 million per annum to comply with coverage and \$0.2 million per annum to implement / maintain new metering and billing systems; and
- Costs associated with inefficiencies that it considers will be incurred by both Horizon and Alinta (and potentially other parties supplying the distribution base if the system is covered) – costs of \$9.2 million due to decreased thermal efficiency and reserve capacity costs.

Alinta recognises that these costs may have changed since the 2014 Discussion paper, however an updated Discussion Paper has not been provided.

Alinta disagrees with Horizon’s assessment of costs and individually addresses each claim made by Horizon below.

### **Portfolio dispatch**

Horizon claim:

*“Dispatching to multiple smaller portfolios (as opposed to dispatching to one larger portfolio) results in incremental inefficiency in generation conversion efficiency of 10% resulting in an increased fuel cost of approximately \$5 million per annum.”<sup>47</sup>*

Alinta does not agree with Horizon’s claim of a \$5 million per annum efficiency loss relating to the argument it makes around dispatching to multiple smaller portfolios. In fact, to the contrary, Alinta believes that there will quite possibly be positive benefit from a result of efficiency gains and portfolio optimisation.

Fundamentally, there are flaws with Horizon’s argument:

- There is nothing preventing generators contracting bilaterally with each other to buy / sell generated load to optimise their individual dispatch.
- Horizon’s line of argument implies the exclusive operation of a ‘gentailer’ model, however this may not be the case. Quite possibly, multiple retailers could enter and compete using electricity purchased from generators such as Alinta, TransAlta, Horizon (ATCO) or other potential entrants.

Like Horizon, Alinta operates multiple gas turbines at its power station sites. These individual units are often only partially dispatched to supply its current contracted load.

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<sup>46</sup> Alinta recognises that these costs may have changed since the 2014 Discussion Paper, however an updated Discussion Paper has not been provided.

<sup>47</sup> Horizon Power, Discussion Paper, December 2014, p.5

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Therefore, any gain in load would bring about improved heat rates.<sup>48</sup> Equally however, any loss of load may provide an opportunity to turn off a unit and increase the load of remaining units running (and therefore dispatch with higher heat rate efficiency).

In an environment where generators and retailers can access the network, participants will be incentivised to contract and trade bilaterally with upstream and downstream counterparties where opportunities to more efficiently operate are present. Network access will provide opportunities to optimise and further improve Horizon's current dispatch operations.

Alinta considers it is important that traditional monopoly businesses such as Horizon adjust their operations to participate in market style arrangements as it will improve their own efficiency and ultimately benefit consumers. It should be a focus of government to ensure that existing arrangements which continue to enable monopoly type behaviours do not continue to be enshrined.

### **Reserve Capacity**

Horizon claim:

*"Reserve capacity of 35MW is required for 2 separate portfolios (as opposed to for 1 portfolio) resulting in an increase in annual cost of \$4.2 million."<sup>49</sup>*

Horizon is incorrect in claiming there is a need to duplicate the reserve capacity of 35MW for two separate portfolios. Duplication is not required and no additional cost need be incurred.

The key point here is that the current total reserve capacity requirement for the NWIS<sup>50</sup> will not change, regardless of the number of participants. It simply sees multiple parties being responsible for a proportion of the total reserve capacity that relates to the peak requirements of their own portfolio. Similar to the arguments made around 'dispatching to multiple smaller portfolios', there is nothing preventing participants contracting bilaterally with each other to buy and sell capacity to more efficiently service the peak loads of individual portfolios. Once again, organisations should be willing to adjust and open their own operations to participate in market style arrangements for the improvement of their own efficiency.

Putting aside the fact that the overall capacity requirement for the Horizon NWIS Network would not change as a result of competition and that the reliability criterion would continue to be met (simply, instead, by multiple parties), it is inappropriate to construct any cost using the AEMO's benchmark reserve capacity price. The AEMO's price is uniquely developed for the WEM to attempt to reflect the costs of building a 160 MW OCGT in the SWIS.

Of relevance here, there is no liquid capacity in the WEM, there is simply an administered price paid for capacity that it is traded through a centralised agency, AEMO. However, the

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<sup>48</sup> The heat rate of a generator unit refers to the rate at which fuel (eg. gas) is converted to one megawatt hour of electricity. The lower the heat rate, the higher the generator's efficiency, as less gigajoules (GJ) of gas is required to produce a megawatt hour (MWh). Heat rates are generally measured in terms of GJ/MWh.

<sup>49</sup> Horizon Power, Discussion Paper, December 2014, p.5.

<sup>50</sup> The total reserve capacity requirement for the NWIS is a market-determined amount rather an official volume set by the IMO, as occurs in the WEM.



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significant majority of capacity is traded bilaterally through contracts in the WEM. Indirectly this occurs in the NWIS, where retailers charge and contract on the basis of meeting their peak capacity requirements.

### ***Ancillary Services and N+1 Security***

Horizon claim:

*“Further, in the absence of wholesale and ancillary service mechanisms, either the network operator would have to arrange ancillary services, at a cost, or each supplier must have their own ancillary services and reserve capacity, resulting in a duplication of the 35MW of reserve capacity required for each party to achieve N+1 security.”<sup>51</sup>*

Alinta does not agree with Horizon’s claims that competition, brought about by network access, will create the need to duplicate reserve capacity and ancillary services to achieve N+1 security on the network.

Similar to the arguments around reserve capacity requirements, the total requirement for ancillary services are not influenced by whether single or multiple parties supply load on the network. Regarding spinning reserve and N+1 security, it can be either a shared or single supplier service. Duplication does not currently occur despite the fact that multiple parties (Horizon and Alinta) supply load on the network. Were Alinta to acquire load, then proportionately it would bear a greater spinning reserve requirement and the party who lost the load would bear.

This said, participants have a choice as to whether they elect to supply spinning reserve for their own portfolios or, alternatively, seek to contract bilaterally to optimise the provision of spinning reserve across the networks / multiple portfolios. How this takes places should be a market led outcome driven by participants who are incentivised to achieve lower costs and optimise their own operations.

Alinta acknowledges the importance of ancillary services such as spinning reserve; however Alinta notes that Horizon’s current technical rules make little mention of spinning reserve requirements. Instead, in the technical rules, network objectives such as frequency control cite the requirement to shed load to restore network frequency. For example, section 2.3.1(a) states:

*“Network Service Providers must design and install an automatic under-frequency load shedding system on the transmission and distribution systems to ensure that the frequency performance of the power system following a contingency event.”*

Further, section 2.3.1(b) states:

*“Network Service Providers must ensure that up to 75% of the power system load at any time is available for disconnection.”*

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<sup>51</sup> Horizon Power, Discussion Paper, December 2014, p.4.



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## **Additional Regulatory Costs**

Horizon claim:

*“Coverage under the Code results in additional cost to Horizon Power in the order of \$1 million per annum.”<sup>52</sup>*

These estimated costs to Horizon of preparing an access arrangement for approval by the ERA are not realistic. Alinta considers that any access arrangements for the Horizon NWIS Network be significantly different to those other arrangements currently in place in WA, including ATCO and DBP which require more sophisticated arrangements. In particular, Alinta considers that it is unlikely that there will be many access disputes that arise in response to the declared service and that when (and if) these arise they will be unlikely to have the associated complexity of disputes seen in other markets.

Alinta considers that a more realistic estimate of the regulatory costs of coverage is as follows:

- One additional FTE (approx.); and
- A budget for consultants of approximately \$1 million for determining each new access arrangement (i.e. every four years).

## **Metering and Billing Systems**

Horizon claim:

*“The capital and operating costs of new metering and billing systems is in the order of \$0.2 million per annum.”<sup>53</sup>*

*“In addition to the cost burden of lower generation conversion efficiency there is also material upfront investment and ongoing operating costs required in metering and billing systems to implement and manage a large number of open access connections, particularly on the distribution network.”<sup>54</sup>*

Alinta considers that Horizon Power’s estimated costs of implementing new metering and billing systems appears reasonable overall. This is because Alinta understands that upgrades have been made to Horizon’s billing system which will enable it to separately charge retailers for network costs at limited cost.

Additionally, Alinta acknowledges Horizon’s advanced metering infrastructure project, which was completed in October 2016, where 47,000 customers in remote and regional WA have had the latest metering technology installed. This technology will appropriately allow for the churn of customers easily between retailers, through the ability to complete remote meter reads.

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<sup>52</sup> Horizon Power, Discussion Paper, December 2014, p.5.

<sup>53</sup> Horizon Power, Discussion Paper, December 2014, p.5.

<sup>54</sup> Horizon Power, Discussion Paper, December 2014, p.5.

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## Formal Electricity Market Structures

Horizon claim:

*“In markets such as the Wholesale Energy Market (WEM) and the National Electricity Market (NEM) the inefficiencies of splitting portfolios are addressed through highly liquid spot trading markets, centralised ancillary service mechanisms and, in the case of the WEM, a centralised reserve capacity mechanism. The Pilbara does not have any of these market mechanisms and, as a result, the cost inefficiencies of multiple independent parties supplying a small market are passed through to the public stakeholders.”<sup>55</sup>*

No legal requirement exists for ‘formal’ electricity market structures to be in place in order for network coverage to be granted. Despite this, Alinta notes that the market for electricity in the Horizon NWIS Network is well established.

The bilateral arrangements currently in place have served this market well. Alinta sees no need for the development of ‘formal’ wholesale trading structures, such as structured bidding platforms for spot, day ahead or forward electricity markets. The lack of ‘formal’ market structures will in no way inhibit the development of competition and competitive market outcomes in the Horizon NWIS Network. Further, the development of such structures would impose an inappropriate cost on the electricity industry, iron ore industry and community.

As outlined in Alinta's coverage application, Alinta estimates a total contestable load for Horizon of 550 GWh per annum, of which it is reasonable to assume a load acquisition by new entrants of 80-110 GWh per annum over a 10-15 year period. Given the relatively small size of estimated load acquisition, the development of formal wholesale trading structures would appear unnecessary. Instead the bilateral arrangements currently in place should remain and continue.

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<sup>55</sup> Horizon Power, Discussion Paper, December 2014, p.4.

## Appendix 2 – Implications of coverage to Horizon’s average costs

Alinta recognises that a reduced retail load may increase Horizon’s average total cost, but submits that the quantum of this increase is relatively small. The relevant question is the proportion of Horizon’s costs that:

- Do not vary with output (i.e. are fixed) and so would not reduce in line with any loss of volume to competition; and
- Are not associated with its distribution and transmission network, and so could not be recovered through an access charge.

Table 1 sets out Horizon’s retail electricity supply costs into generation, network and retail, and fixed and variable components over the period from 2010 to 2014.

**Table 1 – Breakdown of Horizon’s costs into variable and fixed components**

	2009-10	2010-11	2011-12	2012-13	2013-14
Costs that vary with output	208.0	220.3	224.2	236.3	232.0
Fixed costs recovered via access charges	21.7	27.2	43.0	53.5	60.2
Fixed costs not recovered from access charges	95.6	124.5	141.1	142.6	155.3
<b>Total</b>	<b>325.3</b>	<b>371.9</b>	<b>408.4</b>	<b>432.3</b>	<b>447.4</b>
Proportion of fixed costs not recovered via access charges	29%	33%	35%	33%	35%

Source: Alinta analysis; ERA, 'Inquiry into the Funding Arrangements for Horizon Power – Final Report', 18 March 2011.

There is limited information available about Horizon’s costs and so it has been necessary to make the following assumptions, i.e.:

- all operating costs vary with output, except for the overheads which are treated as fixed;
- Horizon sets access charges so that it recovers a proportion of its fixed costs from Alinta that is equal to the proportion of total volume supplied by Alinta; and
- the proportion of costs in Horizon’s RAB that is related to distribution and transmission is not known, but is conservatively assumed to be 50 per cent.

These assumptions suggest that based on the costs for every 100 dollars of retail revenue that Horizon loses to a competitor, it will:

- see a reduction in costs of around 52 dollars;
- receive around 12 dollars in revenue from access charges; and

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- continue to incur 35 dollars of fixed costs despite the reduction in volume.

This demonstrates that a lost dollar of Horizon's sales does not translate into a dollar of costs borne via the TEC/government.

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## Appendix 3 – Treatment of Government Policy

Alinta appreciates that in making a decision as to whether coverage of the Horizon NWIS Network would be in the public interest it is important that the broader market context is taken into account, including existing government policies and equity issues.

However, Alinta considers it is equally important that any assessment is not simply made based on current market conditions but that the likely future implications of coverage are also taken into account. This is particularly important given the long-life of network assets and is consistent with the general principles embodied within the broader range of relevant matters for the purposes of the public interest assessment that are outlined in the Issues Paper.

Alinta considers that the impacts of coverage on the broader government policy should not be taken into account when making an assessment of Alinta's application (or should only be given a small weight). This is because:

- There is uncertainty as to whether the uniform tariff policy will continue to be implemented in its current form going forward;
- There are a number of inefficiencies created by the current TEC; and
- It is not sustainable for the State Government to continue to provide significant subsidies to Horizon.

These points are explored further in the sections below.

### **Government Policy Uncertainty**

Alinta submits that it is unclear whether the current approach adopted for implementing the State Government's uniform tariff policy (which ensures equity for customers across Western Australia) is sustainable going forward.

- In April 2013, the then Minister for Energy raised concerns that the tariff equalisation scheme is very large and an impost to customers in the SWIS, specifically noting that *"It [the tariff equalisation policy] will need to be looked at. Those people are not poor, and are employed by very wealthy multinationals"*.<sup>56</sup>
- The Labor Party pledged during the last election to maintain the uniform tariff policy but remove the TEC, rather paying the subsidy directly from Government funds<sup>57</sup>. Alinta is not aware of any policy announcement on the TEC since the change in government.
- The Economic Regulation Authority's inquiry into the funding of arrangements of Horizon Power (2011) recommended that the TEC be funded by a customer service obligation payment direct to Horizon. This has the benefits of:

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<sup>56</sup> <https://au.news.yahoo.com/thewest/a/16693192/cloud-over-horizon-power/>

<sup>57</sup> <http://www.markmcgowan.com.au/news/household-power-bills-to-be-7-per-cent-lower-under-wa-labor-96>

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- Lower distribution network tariffs in the SWIS;
  - Removing price distortion in the competitive markets that existing within the SWIS;
  - An earlier timeframe to achieve full retail contestability in the SWIS;
  - Greater transparency around the overall level of subsidy for Horizon; and
  - Being consistent with how other utilities are subsidised.<sup>58</sup>
- Since the electricity market in WA is continually subject to regulatory and policy change, this creates an ongoing level of uncertainty as to the future design of the NWIS and applicable government policies. As a consequence Alinta considers that the impacts of coverage on the broader government policy should not be taken into account when making an assessment of Alinta's application (or should only be given a small weight).

### ***Inefficiencies in the Tariff Equalisation Contribution***

There are a number of inefficiencies associated with the current approach of applying the TEC and TAP to implement the State Government's uniform tariff policy. These include:

- The design of the TEC gives no incentive for Horizon to operate efficiently, because payments made to Horizon (or its customers) are based on its actual costs rather than its efficient costs;
- The current subsidies institutionalise inefficiency on the part of Horizon (the importance of costs being efficient is recognised by the fact that the TEC is derived by reference to efficient costs in the SWIS);
- The TEC should be based on Horizon's efficient costs. Post-coverage, this should be amended to reflect the average efficient cost of both Horizon and any other suppliers to customers in the NWIS. It is not in the public interest that inefficient costs continue to be enshrined by the current application of the uniform tariff policy; and
- Enabling a more competitive market to evolve will be the most effective way to ensure that these inefficiencies are removed. The increase in efficiency brought about by competition should be accounted for by the PUO in any consideration of increases in Horizon's costs as a result of regulatory overlay, reduced thermal efficiency of generation and so on.

### ***Sustainability of operating subsidies for Horizon Power***

The continual increases in the operating subsidies provided to Horizon by the State Government have been identified as being unsustainable in the long term. A strategic review of the operation of Horizon occurred in 2013 with a view to reducing the level of subsidy from the state over time. Since it is anticipated that a similar focus will remain on the efficiency of

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<sup>58</sup> Refer to: <http://www.erawa.com.au/cproot/9503/2/20110418%20Publication%20-%20Inquiry%20into%20the%20Funding%20Arrangements%20of%20Horizon%20Power%20-%20Final%20Report%20Tabled%20in%20Parliament.pdf>

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Horizon's business, a more competitive market will be the most effective manner for ensuring the efficiency of Horizon's operations.

Given these considerations, Alinta recommends that:

- The broader implications for the TEC that are associated with enabling competitive market outcomes should not be taken into account when making an assessment of Alinta's coverage application (or only have a minor weight applied); and
- A review should be initiated with respect to the continued appropriateness of the uniform tariff policy, with a particular focus on identifying any alternative mechanisms for administering the policy which would:
  - Ensure that the true price of delivered electricity is charged to customers; and
  - Remove behavioural distortions associated with indirect subsidies, including exploring the options for paying any necessary subsidies through the Government's consolidated fund.



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## Appendix 4 – Issues with Horizon’s Proposed ETAC & Pricing Model

Alinta takes issue with comments made by Horizon that it offers open and ‘Code-consistent’ access to the transmission component of the Horizon NWIS Network.

Horizon has made the following statements about the transmission components of the Horizon NWIS Network:

*“Horizon Power already provides access to its [transmission assets in the Horizon NWIS Network] on an open access basis, consistent with the access regime established by the Code.”<sup>59</sup>*

*“Horizon Power currently provides open access to customers seeking network services to its networks at 66kV and above in the Pilbara.”<sup>60</sup>*

*“In these circumstances, coverage of the Horizon Power transmission network will not result in a material practical increase in competition as all of the transmission-connected customers currently have open access, Code-consistent ETACs in place and Horizon Power is prepared to commit to offering access on this basis to any potential future customers.”<sup>61</sup>*

Further, Horizon claims that:

*“Mechanisms have been developed by appropriately qualified people, independent legal, economic and engineering consultants [such mechanisms including] ... a pricing policy that requires Horizon Power to negotiate pricing that is equal to, or is less than, the stand-alone cost of service provision if an applicant for network services can demonstrate that the Network Pricing Model is not achieving this outcome.”<sup>62</sup>*

and

*“Horizon Power is willing to have these mechanisms reviewed by independent third parties and has demonstrated a willingness to adjust these mechanisms if stakeholders identify any material inconsistency with the Code.”<sup>63</sup>*

As outlined above, Alinta’s view is that it is not relevant, under either criteria (a) or (c) of the coverage criteria, to consider the extent to which Horizon claims that it already provides access, or will voluntarily provide access, or the terms on which it claims to do so. In particular, this is not relevant to an assessment of whether coverage will promote a material increase in competition. Please see the main body of this paper for further detail on the reasons for this view.

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<sup>59</sup> Application for Coverage of Alinta’s East Pilbara Network at [6]. See also similar comments in Horizon’s discussion paper at page 11.

<sup>60</sup> Horizon Power, Discussion Paper, December 2014, p.1.

<sup>61</sup> Horizon Power, Discussion Paper, December 2014, p.1-2.

<sup>62</sup> Horizon Power, Discussion Paper, December 2014, p.1.

<sup>63</sup> Horizon Power, Discussion Paper, December 2014, p.1.

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However, in the case that the Minister does consider Horizon's claims in relation to the existing access that it is prepared to provide, Alinta wishes to outline its views on those claims. The sections that follow focus on Horizon's ETAC, its pricing methods and access pricing model to highlight the core areas of inconsistency with the Code's principles.

### *Issues with the Proposed ETAC*

Alinta notes that under the Proposed ETAC:

- Horizon is not liable for any loss suffered by the Customer<sup>64</sup> arising from any act or omission of Horizon, even where Horizon has acted negligently or in breach of the Proposed ETAC or a statutory duty. Horizon is also not liable to the Customer for any loss arising out of or in connection with any third party claim however caused. Horizon provides no indemnities in favour of the Customer.
- On the other hand, there is no exclusion of the Customer's liability to Horizon in any circumstances, other than a mutual exclusion of liability for "excluded loss". The Customer must also indemnify Horizon against:
  - Losses suffered by the Customer arising from an act or omission of Horizon (except in the case of wilful misconduct);
  - Losses suffered by Horizon arising from damage to Metering Equipment due to the Customer's acts or omissions;
  - Losses suffered by Horizon arising out of a user's breach of the Technical Rules;
  - Additional costs incurred by Horizon to ensure Horizon complies with the Technical Rules as a result of any act or omission by the Customer or its contractor;
  - Losses suffered by Horizon or Horizon's workers in connection with any third party claims arising in connection with the Proposed ETAC, any act or omission of Horizon or its workers and the performance or non-performance of the Services under the ETAC, irrespective of negligence or default on the part of Horizon or its workers.

This is in contrast to the considerably more balanced approach in the Model Standard Access Contract, under which each party who is negligent or commits a default under the contract indemnifies the other party against any direct damaged caused by such negligence or default.

- Horizon's maximum aggregate liability to the Customer in any Contract Year is capped at 6 months of Charges (except in the case of liability arising out of fraud, wilful misconduct, death or personal injury to the extent caused by an act or omission of Horizon, however the exclusions of Horizon's liability noted above mean that

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<sup>64</sup> For the purposes of this appendix "Customer" refers to the party to which access to the Horizon NWIS Network is being granted by Horizon.

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Horizon would not be liable for many of these losses in any event). The Customer's liability to Horizon, however, is completely uncapped.

By contrast, the Model Standard Access Contract contemplates caps on the liability of both parties.

- Charges for the services under the Proposed ETAC are set by reference to Horizon's "Price List" and are subject to review by Horizon from time to time. Although Horizon referred to its pricing policy and Proposed ETAC that require Horizon to abide by any such pricing policy or model in setting the Price List from time to time (or to provide any details of how any amended prices have been determined). Accordingly, Horizon has the unfettered ability to change the prices under the Proposed ETAC at any time to whatever amounts it sees fit. The Customer has no right to terminate the Proposed ETAC following any amendment to the Price List, and so would be locked into the prices set at Horizon's discretion for the remainder of the term.
- Under the Proposed ETAC both parties must comply with the Technical Rules published by Horizon and amended by Horizon from time to time, in its absolute discretion. By way of contrast, the applicable technical rules under the Model Standard Access Contract are those applying from time to time to the Network under Chapter 12 of the Access Code. Accordingly, there is regulatory oversight of the Technical Rules applied under the Model Standard Access Contract.
- The definitions of the Exit Service and an Entry Service under the Proposed ETAC only require Horizon to use "reasonable endeavours" to provide the service and only when the "Horizon Power System is in a satisfactory operating state (in its sole discretion)". The Model Standard Access Contract contains no such qualifications.

### ***Issues with Horizon's Pricing Method***

Horizon has consistently stated to Alinta that its access prices are set at the 'stand-alone cost of service provision' and that this is a listed method under the Code at clause 7.3(b)(ii), so therefore is consistent with the Code.

Alinta takes issue with this interpretation and statements made by Horizon that such pricing methods comply with the Code. Alinta notes that:

- Clause 7.3(a) states that reference tariffs should recover the "*forward-looking efficient costs of service provision*";
- This is further supported by the overriding Code objective at clause 2.1, which states:  
*"The objective of the Code is to promote economically efficient investment in and operation of and use of networks and services of networks in Western Australia...";*
- The 'stand-alone cost of service provision' establishes a maximum or upper bound when setting tariff prices, at clause 7.3(b)(ii); and
- Equally, the Code states that the 'incremental cost of service provision' sets the lower bound at clause 7.3(b)(i).

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Therefore, the guiding principle is clearly and absolutely one of economic efficiency. Citing clause 7.3(b)(ii), as Horizon does, and claiming pricing at the stand-alone cost of service provision is consistent with the Code, is a critically flawed interpretation. The stand-alone cost of service provision is used illustratively to set an upper bound for individual tariffs and is in most cases not the forward-looking efficient cost for the entire set of network services.

Regulators from all Australian jurisdictions have for some time used the 'Building Block' approach to aggregate the efficient costs of service provision. In summary, the Building Block approach allows for the recovery of a return on capital, a return of capital (depreciation) and operating expenditure. This sees tariffs sit at a point between the lower and upper bound pricing methods discussed in the Code's clauses 7.3(b)(i) and (ii) and, importantly, aligns with the Code objective at clause 2.1, '*to promote economically efficient investment in and operation of and use of networks and services of networks*'.

Of relevance here, the ERA has already indicated its preferred approach in its Final Report (2011) into the costs of Horizon, where it adopted the use of the Building Block approach to assess the efficient costs of Horizon.

### ***Issues with Horizon's Access Pricing Model***

Alinta in its dealings with Horizon has had the opportunity to review elements of Horizon's Access Pricing Model. Alinta makes the following comments below to respond to claims made by Horizon that it, "*provide[s] open access on terms and pricing consistent with the Code*" and is "*willing to have these mechanisms [e.g. its pricing model] reviewed by independent third parties and has demonstrated a willingness to adjust these mechanisms if stakeholders identify any material inconsistency with the Code*".

Central to the operation of Horizon's access pricing model, Horizon has used the Depreciated Optimised Replacement Cost (**DORC**) method to calculate the value of its Initial Capital Base (**ICB**).

Horizon claims that DORC is a listed method of asset valuation in the Code, so therefore must be accepted. Alinta notes that the Code lists the DORC method as a method of valuing an asset base. The Optimised Deprival Value (**ODV**) method is another method listed by Code. Alinta's view is that the use of DORC, in the way that Horizon has, is not in keeping with the overriding Code objective around efficiency, the efficient use of network services and the promotion of competition.

A key point to note is that the ERA – the independent third party who has a mandate to determine these matters – has clearly and publicly taken a different view to that of Horizon's approach on such matters. The ERA (2011) was very clear in its final report when they stated:

*"Whilst appreciating Horizon Power's concerns, the Authority has decided not to accept Horizon Power's depreciated replacement cost valuation of its ICB.*

*Firstly, it is not generally considered appropriate to provide regulated companies with a return on and of their assets that is greater in present value terms than the amount the regulated companies would have initially paid for the assets. To do otherwise would be to give the regulated companies a windfall gain.*

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*Secondly, the Authority is aware that Horizon Power's depreciated replacement valuation includes assets that were originally funded by third parties. To include these assets in Horizon Power's asset base would result in Horizon Power earning a return on, and so benefiting from, assets that it did not pay for.*

*Thirdly, Horizon Power argued that a higher valuation would provide them with income to pay for asset replacements in the future. The Authority does not accept that it is appropriate to have current customers fund expenditure that occurs well into the future. Instead, the rate of return provided to Horizon Power allows it to fund those replacement assets at the time the expenditure is incurred.<sup>65</sup>*

In Alinta's opinion, the ERA's reasoning and rationale is clear. To take and maintain a different view, as Horizon has, to that determined by the independent economic regulator is not realistic nor in keeping with the Code.

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<sup>65</sup> Economic Regulation Authority (2011), Inquiry into the Funding Arrangements of Horizon Power – Final Report, p.39.